

Senator PROXMIRE. Oh, yes. I would like to interrupt right there.

For example, what it showed in New York was that there was a decline in the number of managers and so forth in New York, from 618,000 to 569,000. And that included retail trade. That was a decline of 49,000; where the decline of individual retail proprietors was 87,000.

This means that other businesses increased. But I am talking about the retail area. Here is the area where we have had devastating impact of the supermarkets.

Mr. LOEVINGER. So far as I am aware, the argument of most of the supporters of resale price maintenance is that it is necessary to insure the survival of small business, particularly retail business.

However, nobody has attempted to analyze and examine the figures to determine whether or not in fact this is what such laws do.

Now, we have had as many as 45 out of the 48 States having fair trade or resale price maintenance laws in the past, as you know. The number now has declined to about 25. But over a long period of time we have had a very good laboratory-type experiment with these laws.

The Department of Justice has undertaken an analysis of the figures, and we have found that without variation, year by year, over a more than 10-year period, the business rate failures for business generally, and apparently for retail businesses, are higher in those States with resale price maintenance than they are in those States without resale price maintenance. And the difference is a very marked statistical difference.

Now, the analysis suggests why this may be true. The complaint is that small business is having a difficult time competing with large business and holding its own with chainstores and manufacturers.

However, the resale price maintenance approach puts it entirely within the power of the large manufacturer to control the price, and to establish the conditions which are supposed to help small business.

In fact, these manufacturers are mostly interested in the large retailers, and the chainstores, and in many cases are affiliated with chainstores.

Under the pending bill, in fact, there is a specific provision that permits manufacturers with their own retail outlets, their own factory stores, their own chainstore affiliations, to engage in resale price maintenance.

To say that this is a bill that will protect small business seems to me to be like saying we will deputize all of the robbers that we catch and make them part-time policemen in order to protect citizens against robbery. This just makes no sense at all.

On the other hand, the argument that is made most frequently by the very sincere, very articulate, and very well informed advocates of such legislation, is that the things that they must really guard against are so-called loss leader pricing.

It is said, and quite properly, that we cannot make the pricing system too inflexible, but that we must prevent the long purse of big business from being used to drive small business out by loss leader pricing.

I think it is significant, however, that Senator Humphrey has had a bill in the Senate, if I recollect correctly, S. 2120, specifically directed against loss leader pricing, in which all of these very vocal advocates of resale price maintenance have shown almost no interest.

Such a bill as that by Senator Humphrey, without commenting briefly on—

Senator PROXMIRE. He is the author of both bills.

Mr. LOEVINGER. I understand he is a coauthor.

Senator PROXMIRE. He is the principal sponsor of the stabilization bill.

Mr. LOEVINGER. But I have talked with Senator Humphrey, and I believe Senator Humphrey is behind both bills.

The significant thing is that the lobbies, the people who are advocating laws of this sort, are pushing the resale price maintenance, exhibiting not the slightest interest, as far as I can determine, in the loss leader bill.

Now, the loss leader bill is a bill that would cut clear across the field, that would attack directly the evil sought to be remedied. It would establish a uniform rule of law. It would not leave the protection of small business to the tender mercy of large business. It would not establish any of these very questionable situations in which it is not at all clear what the rule is going to be, because it depends upon the private action of particular businesses.

It is a relatively clear-cut and a relatively clean approach to the problem, which does establish a uniform legal rule that has some chance, at least, of achieving the objective sought.

I think that the quality stabilization bill or resale price maintenance bills have no chance of achieving the objectives to be sought, and in fact would work in reverse, as our statistics indicate they have to date.

Senator PROXMIRE. First let me say that I support both bills enthusiastically, and let me say also that the statistics I have seen—and I would be very anxious to see your statistics—the statistics that I have seen have given exactly the opposite picture.

For example—and there are many, many examples—the maintenance of prices for gasoline in New Jersey was a clear demonstration, it seems to me, of the possibility of eliminating price wars which are destructive of the small businesses and do very little or nothing for the consumer.

As a matter of documented fact, when the small dealer was wiped out, prices had gone up in the past very sharply before retail price maintenance came in, and after it the situation of stability at a moderate price had prevailed pretty consistently, so that consumers and small business both gained greatly.

I would like to ask you about something else.

Has the Department of Justice expressed an interest in the identical bid situation, which concerns us very deeply, concerns this Senator, at least, and, I know, other members of this committee?

The fact that we have had over a past year or so one example after another of firms, as many as four or five firms, bidding—and these are all the firms that do bid—and every bid being exactly identical on a pretty big contract, down to the fourth or fifth decimal point?

This has been a matter of real concern, and I know that Senator Lausche has offered several examples to the Senate, and I have had several in my State, and I am wondering if the Department of Justice has gotten into the situation at all.

Mr. LOEVINGER. Yes, sir. We have been very interested and very active. As you are undoubtedly aware, following the suggestion of this committee and of Congressman Patman and Senator Douglas, the President issued an Executive order calling for the reporting and collating of identical bids.

Senator PROXMIRE. What has happened on that? What is the situation now?

Mr. LOEVINGER. This has been implemented and undertaken.

Following the Executive order, in order to do this properly, we had extensive conferences with representatives of the Defense Department and GSA. What was sought was to get a form of report and standard regulations that will provide for the report, so that they would come in in useful form, that could be manipulated, and that would permit the data to be worked with. If we simply had miscellaneous reports coming in, without any uniformity, of course, it would be impossible to work with such a mass of data.

These regulations were promulgated, and if I recollect correctly, reports started to come in around September 1 of 1961, from the Federal agencies. Subsequently, extensive conferences were held with representatives of State governments, and analogous forms were promulgated for the States.

The States, of course, could not be required to report, but the States, the larger municipalities, school districts, and similar governmental units, were invited to report.

Senator PROXMIRE. The larger municipalities? I know that several of the complaints I received were from small municipalities in Wisconsin.

Mr. LOEVINGER. There are a total of 102,000 governmental units engaged in purchasing in the United States. We concluded it would be physically impossible to handle reports from this many.

Therefore, invitations were sent to larger municipalities, school districts, counties, and purchasing groups, and in addition we have plans for a random selection of the others in order to give a cross section that is representative of the entire local and State governmental purchasing operation.

We think that the reports that are being secured will cover 75 to 80 percent of the purchasing and of the population.

In addition, anyone else who wishes to report, of course, is invited to do so. But we have simply felt that the circulation of over 100,000 governmental units for this purpose was a burden that was just a little too great to handle.

Reports have been received since this program was initiated, and the initial report of the Attorney General has been prepared by the staff and is now being examined by the Attorney General. I believe this committee will have it within a relatively few days.

(Discussion off the record.)

Senator PROXMIRE. I just have one other question, Judge. That relates to what I think is an unfortunate lack of advertised competitive bidding in procurement in our Government.

I am particularly concerned with the space budget, where as I understand it, only \$1 out of less than \$10—actually it is, I think, \$9 out of \$100—represents procurement based on advertised competitive bidding.

Congress has established advertised competitive bidding as the preferred method of procurement. We all recognize the enormous benefits from advertised competitive bidding, not only to the taxpayer, which are obvious—costs are bound to be lower, it would seem to me—but particularly for the opportunities for all business people to compete on an equal and fair basis without special privilege. And small business does a lot better, as you know, on advertised competitive bidding.

I know that this is something that may be a little delicate, because it has to be within the purview to a considerable extent of the particular agency involved. But I wonder if the Department of Justice expresses an interest and a concern to the Defense Department, the Space Agency, and so forth, with regard to advertised competitive bidding.

Mr. LOEVINGER. Well, we do where we have a legitimate opportunity to do so. It is not the function of the Department of Justice or of the Antitrust Division to supervise the activities of NASA or the Department of Defense, and we do not undertake to do so.

Occasionally, we do have some function to perform which gives us an opportunity to comment on a particular practice. We have gone over certain contracts and have commented on various provisions in them, and suggested on occasion modifications that we thought would encourage competition.

The Department of Justice has the duty of commenting on surplus property disposal. You may have seen a little story in the papers recently about the disposition of a plant on Long Island where the Department of Justice said that it could not approve the proposed disposition as being consonant with the statutory standards, because it was disposed of under conditions that did not permit competitive bidding.

In general, however, Government procurement is an activity that does not come within the jurisdiction of the Department of Justice, and which the Department of Justice does not importantly influence.

It is, as I have suggested earlier, one of those other policies that does have to do with the competitive character of the economy in addition to antitrust.

Senator PROXMIRE. In view of your expertise in competition, and your tremendous experience in this area—I am speaking both of you and the Department of Justice—and its responsibility for competition and antitrust action with regard to competition, I think that any observations, any study, any recommendations, which you might have, either to Congress or to the agencies, would be enormously helpful, because this is something that we feel pretty helpless about in Congress.

Our Government has been losing out on competitive bidding, and we are told by the top Government officials that they cannot do it,



that it is easier to negotiate, or more in the national interest to negotiate. But it is hard for us to challenge that.

And we have instances where we are just positive that this is not the proper procedure. So that any opportunity which the Department of Justice might find in the future to urge competitive bidding would be, I think, very helpful.

Mr. LOEVINGER. Yes, sir.

Chairman PATMAN. Thank you.

Judge Loevinger, we will resume with you, then, Wednesday morning, at 10 o'clock, if it is all right with you.

Thank you kindly, sir, for your appearance, and your answers to the questions, your comments, and your statement.

Mr. LOEVINGER. Thank you, Congressman.

Chairman PATMAN. Tomorrow morning at 10 o'clock, here in this room, we will have as witnesses Edwin J. Nourse, former Chairman, Council of Economic Advisers, 1946-49, Alfred E. Kahn, professor of economics, Cornell University, Walter Adams, professor of economics, Michigan State University, and Richard J. Barber, professor of law, Southern Methodist University.

The committee will stand in recess until 10 o'clock tomorrow morning.

(Whereupon, at 11:15 a.m., the committee was recessed, to reconvene at 10 a.m., Tuesday, August 21, 1962.)



# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

TUESDAY, AUGUST 21, 1962

CONGRESS OF THE UNITED STATES,  
JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representative Patman; Senators Proxmire and Bush.

Present also: William Summers Johnson, executive director; John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will please come to order.

Dr. Nourse, will you come around, please?

The committee continues hearings on the state of the economy and policies for full employment.

This morning we are concentrating on competition and monopoly problems and the question of how to strengthen and maintain competition, which is our historic national policy for trying to achieve full employment and growth and progress in our economy.

Our first witness this morning is Dr. Edwin G. Nourse, the first Chairman of the Council of Economic Advisers and a distinguished educator and economist.

Dr. Nourse, I see you have a prepared statement. You may proceed in your own way. If you would like to, you can file a statement, and it will go in the record at this point, and then you can summarize it and comment on the parts that you think are necessary.

I mention that in view of the fact that we have a panel coming on after you, and it looks as if we will just have this morning to do the whole thing. And then we would like to have you, if you desire to do so or are willing to do so, join the panel. Then we will ask all of your questions.

Whichever you prefer, sir. We are indeed glad to have you.

## STATEMENT OF DR. EDWIN G. NOURSE, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, 1946-49

Dr. NOURSE. Mr. Chairman, it is a pleasure to be back here testifying before this committee, which I have done several times over the years.

My paper is only five pages, and I think, I probably would not be able to pick out its highlights very well.

Chairman PATMAN. You may proceed in your own way.

Dr. NOURSE. It seems a good augury for the continuing intellectual leadership rendered by the Joint Economic Committee that the chair-

man and his fellow members were not satisfied to conclude this series of hearings on the state of the economy and policies for full employment with attention focused so exclusively as it has been thus far on fiscal and monetary processes and policies. I deplore the exaggerated emphasis that professional economists have in recent years been giving to this "macroeconomic" part of the total economic process, important as it undeniably is per se.

I would suggest that the situation is broadly comparable to that in the field of medical thinking and practice. There, the relatively recent emergence of radical surgery as a corrective and preventive technique has often led to overweening reliance on these procedures, to the partial eclipse of medication, diet, and other traditional methods in the whole regiment of health maintenance and restoration. Fortunately, the "internist" has now appeared as a medical specialist, devoted to treatment of "the whole man" by coordinating medication, surgery, physical therapy, and even psychosomatic techniques into a comprehensive and well-balanced pattern of health care.

The internist of economic health is commonly referred to—sometimes with condescension—as a generalist. But I submit that such generalists or economic internists should be included along with fiscal, monetary, and private-sector specialists on whatever panels this or other committees of the Congress consult and likewise on such advisory staffs as are used by the executive branch.

Obviously, with the flow of funds through the Public Treasury, with Federal spending and taxing now covering operations which amount to about one-sixth of the gross national product, the fiscal policy area is one of very great importance. Likewise, the administration of a national currency that is to be flexibly responsive to business needs and be suitably geared to the investment process through interest rates is of vital consequence. But in the last analysis, the problems emerging with reference to both these functions and the burdens that devolve on both these organs of the national body economic are kept manageable or are rendered insuperable by the way in which the private sector of the economy is functioning. Even fiscal and monetary policy cannot be adequately analyzed and formulated in isolation from the processes of the private business world—collective wage bargaining, administrative price setting, capital formation, and investment.

To make our basically private enterprise system operate so well in the use of national resources and the satisfaction of human wants that its shortcomings will not have to be "compensated" by frequent and massive fiscal and monetary manipulation (with their threat of advancing statism), our business structures—primarily of the corporation and the union—and the policies and practices of their executive officers and their lesser participants must maintain a dynamic balance between saving investment and labor inputs (including technical and managerial skills) on the one hand and such disbursements of purchasing power as will result in promptly clearing the market of the varied and voluminous product of comfortably full capacity operation.

This is a sweeping, highly generalized, even pompous statement of ideal operation of our everyday bread-and-butter, free enterprise, producer-meets-consumer business world. In proportion as actual performance falls below that ideal or a reasonable approximation of it, our ambitious and impatient populace will demand that their demo-

cratic Government fill the gap or attempt to fill it through fiscal and monetary devices, however drastic and hazardous as to their foreseeable side effects. Of these harmful consequences, inflation, impairment of private enterprise, and loss of operational flexibility are outstanding.

There is much in evidence today (and strong in influence at policy-making centers) a cult of economic magicians, who claim that fiscal and monetary action alone can, in any time of business sluggishness, so stimulate the private economy that a desired rate of acceleration will be induced. They regard this response as bankably certain. Tax abatement or enlarged Government spending, they argue, can be undertaken in magnitudes great enough to insure effectiveness, with confidence that prompt growth in the volume of national production, multiplication of jobs, fattening of profits, and easing of credit will preclude a budget deficit and indeed create a Treasury surplus as well as a rise in the level of general consumption.

This consummation, so devoutly to be wished, entails also, in that philosophy, an upward spiral of continuing national economic progress, but seems to me to rest on oversimplified assumptions about the fundamental nature of free enterprise, business motivation, consumer behavior, and collective wage bargaining. In an article several years ago, I attempted to portray the difference in two major schools of economic thought among businessmen as well as economists in these terms:<sup>1</sup>

The divergence of views concerning goals espoused in the Employment Act (and means of reaching them) grows out of two basic concepts of the nature of our enterprise economy. One may be called the filling station philosophy; it is concerned primarily with a fuel supply poured in from the outside. The other may be called the service shop approach; it is concerned primarily with optimum adjustment of the working parts internal to the machine.

The filling station approach is external to the policy and action of individuals, of firms and organized groups, and even of Government except in its fiscal role. It is concerned with aggregate magnitudes on both the supply and demand side of the labor market—total labor force and total job offerings. It conceives our economy as an integrated mechanism having a rated productive capacity expressed in numerical manpower comparable to the horsepower of a machine. If output falls below theoretical capacity, the sovereign remedy is to "turn on more juice" in the form of total monetary demand \* \* \*.

In contrast to the filling station approach, that puts all or most of its policy eggs in one statistical basket, the service shop approach does not start from a unique theory of cause and cure (or even an attribution of categorical dominance to any one line of causation). The policymaker proceeds to make comprehensive diagnostic studies of the economy to discover any possible source of low performance or a combination of many small maladjustments or functional derangements. His objective is to see what small or local lapses from maximum or optimum use of labor power add up to enough unemployment to become a cause of general concern and the initiation of public action. This approach centers its diagnostic techniques and remedial prescriptions on matters internal to the business process such as income incentives and purchasing power of households, firms, and communities—the modernized refinement of Say's law. Like medical therapy, its prime concern is to locate organic flaws or functional derangements (physical, chemical, biological, or psychosomatic) which are responsible for disability, pain, or malfunctioning. For these the physician seeks specific remedy though he finds the temporary stimulation of alcohol, adrenalin, or benzedrine pills useful on occasion. \* \* \* It is obvious that the two philosophies are not mutually exclusive, but the difference in emphasis is so great as to amount to a difference in kind when it comes to sharp issues of employment policy, or, more broadly, economic stabilization policies.

<sup>1</sup> "Defining Our Employment Goal Under the 1946 Act," Review of Economics and Statistics, May 1956, p. 195.

Developments in technology in business structures and practices, in the culture patterns of our people, and in the international complex of which we are a part have made terrific demands for revamping of our free enterprise system since World War II—the life span of this committee. Your committee's record of recognizing the challenges within the private sector as well as the public sector of the national economy is admirable. I need cite only your special studies of automation and of small business and your comprehensive examinations of employment, growth, and price levels, and of the relationship of prices to economic stability and growth.

I read the present signs as portending failures in the reciprocal adjustments among wages, prices, profits, and capital formation in the years just ahead that threaten to show a performance of the private economy far below the goals set in the Employment Act of 1946 under which this joint committee was set up. Such shortfalls in the private sector would throw burdens on fiscal and monetary policy so far outside their normal scope as to upset a sound division of labor between the two branches of the national economy—private and public.

It would appear to me in this connection that the economic statesmanship of the President has shown a better balance than the policy line of his professional economic advisers. In the early months of his administration, he established a continuing Advisory Committee on Labor-Management Relations as a sort of summit conference between the Departments of Commerce and of Labor and the prime ministers from organized labor and big business. The Executive order of February 16, 1961, setting up this Advisory Committee stated that its purpose—

is to help our free institutions work better and to encourage sound economic growth and healthy industrial relations. \* \* \* It will bring to the great problems of collective bargaining, industrial relations, wage and price policies, and productivity the experience and wisdom of labor, management, and public experts in these fields (and) help restore that sense of common purpose which has strengthened our Nation in times of emergency, and generate a climate conducive to cooperation and resolution of differences.

Obviously, what this Advisory Commission can accomplish will be in no small part the mutual education of these leaders in strategic posts and in effecting some rapprochement among them. It should serve as a seminar in which the issues that divide our two great business classes and that retard the progress of the economy may be formulated in realistic terms by the men most intimately aware of and most deeply involved in the results of their solution or their impasse. This very fact of deep personal involvement, however, is a difficulty of the summit conference as well as a condition necessary to effective treaty-making.

And so, in May 1962, the President convened a White House conference of larger membership, embracing more executives of individual companies, lesser labor officials, lawyers expert in economic affairs, and academicians of the real world, not the ivory tower.

In response to a question at his next press conference about results of this meeting, President Kennedy said:

The meeting, of course, had two phases, one with public speeches [and one with private round-table meetings]. I wished in the public meetings that we could have discussed what I feel are some of the newer problems that the

economy faces and which labor-management faces. I understand that in the private meetings there was much more willingness to forget some of the old basic arguments between labor and management and to consider some of the new challenges.

As I said in my opening, what I would like to hear them talk about is how the Government, labor, and management can function so as to provide for a steadily increasing economy, how we can prevent periodic recessions every 2 or 3 years, how we can maintain full employment, what is the proper relationship between Government and business and labor. These are all matters which concern us today and about which we must do something. I would like to have their views on it, not so much their views on questions which have been debated, about which we are fully informed of the points of interest of each of the parties, but rather these new and rather sophisticated technical problems. I hope we will have another conference quite soon, so that we can continue to talk about these things.

I understand that not only another single conference but a continuation of conferences of somewhat different pattern is being planned for.

It seems to me evident that a succession of such conferences on a topically specialized seminar basis, that is, taking up separate problems intensively, might really do something toward consensus as to causes and develop competent and searching criticism of proposals to effect a breakthrough from what threatens to become a stalemate in our economy.

The nature of this challenge suggests to me an opportunity of unique service for this Joint Economic Committee. It was set up under an almost revolutionary statute declaring "a continuing policy and responsibility" of the Federal Government to promote maximum employment, production, and purchasing power.

While the role of this Committee was first defined as review of the Economic Report of the President, it has fortunately developed on much broader lines. It has become, in effect, a continuing research center for the Congress. Much comparable work is done by older committees, such as Ways and Means, the Judiciary, with its Subcommittee on Antitrust and Monopoly, Money and Banking (or Currency), Agriculture, and the like. But their investigations have a relatively narrow frame of reference, generally on an ad hoc time span.

It is this Committee, with its continuing and comprehensive mandate, that might collate the work of the various congressional committees in the economic area, as well as that done by the executive branch through its Labor-Management Committee and White House conference and special study committees of other departments and the President's Council of Economic Advisers.

Particular attention should be given to scrutinizing all promising but novel proposals for dealing with the private economy in ways as imaginative and forward-thrusting as those which our "opposite numbers" in the field of natural sciences and technology are bringing to practical fruition in the very years when our economic performance yields to the drag of hard-bitten prejudices and dogmas and of unyielding group interests.

Chairman PATMAN. Thank you, sir.

Dr. Nourse, I know you are a wise man, and you have had a lot of practical experience. Are you really very optimistic about what may come out of the President's Labor-Management Conference?

In other words, what do you think it is possible for them to agree on?

Dr. NOURSE. Well, it is pretty hard for them to agree in the Labor-Management Committee, there, on anything. As I said in the paper, they can educate each other somewhat. They can clarify their separate positions with reference to the total economy to some extent.

Now, I think what is latent in your mind is a feeling that they cannot budge very much. They are locked into their particular interest groups. And that is why I stressed the possibility of these conferences of broader character defining particular issues in more objective terms.

In answer to your question, I would say that I think in the use of the White House conference, or something else of that sort, there is some real possibility of progress.

Chairman PATMAN. Senator Bush, would you like to ask some questions?

Senator BUSH. Dr. Nourse, did you see the editorial in the Washington Post this morning, by chance?

Dr. NOURSE. No, I did not. I was hurrying down to this meeting.

Senator BUSH. It is entitled "Federal Reserve Policies." I wondered whether you had had a chance to look at that.

Dr. NOURSE. No, I have not.

Senator BUSH. The general question raised in the editorial is: If private business can be financed through the banking system, why cannot the Federal Government be just as effectively and properly financed through the banking system?

Dr. NOURSE. Well, of course, that is a very long controversy, and I have consistently taken the opposite position, that the Federal Reserve System is a unique system of a national federation of still private banks, and that they have a function there in dealing with the business community, being elastic, meeting the needs of the community, and they cannot dictate conditions from their side. As Mr. Martin's expression runs, they have to roll with the punch or "lean with the breeze."

Now, there is a very strongly held view among some economists and political scientists that this separation between the functioning of the public Treasury and the functioning of the commercial banking system, as headed up in the Federal Reserve, should be merged. And of course that goes back to "the accord" and the independence of the Federal Reserve System.

I simply can state my position categorically, that I believe that the separation is most compatible with our traditions and is most compatible with sound economic reasoning, as I understand it.

Senator BUSH. You had left Washington when the accord came into being?

Dr. NOURSE. I have never left Washington, Senator. My roots are too deep, here. I had left the Executive Office of the President.

Senator BUSH. That is what I mean.

Dr. NOURSE. But I was very happy at that accord, because as Chairman of the Council of Economic Advisers, I felt locked in by the policies that had to be incorporated in the President's Economic Report, before that unpegging of the interest rate took place.



Senator BUSH. It says in this editorial, in the next to last paragraph:

According to Dr. Martin, it is perfectly proper for the banks to finance private indebtedness by creating money, but when one suggests that public debt be handled in the same manner, he alludes to the dark dangers of printing press money. Is he suggesting that the banking system should discriminate against the Federal debt? It is of course true that reckless use of bank-financed public debt would lead to inflation, but the very same stricture may be placed against bank-financed private debt.

Dr. NOURSE. Well, that is perfectly true.

Senator BUSH. I want to ask you a question about that. My impression is that these two cannot be compared, for one principal reason. In the first place, when a private borrower goes to the bank, his credit is carefully scrutinized, his profit and loss statement is scrutinized. Presumably he has to have a record of earnings which shows that he is in the black and able to stay there and get there. His balance sheet is examined.

And his whole credit position is examined and then established; whereas when the Federal Government goes—

And also, he is borrowing on a short-term basis, because the banks do not lend on a long-term basis.

Dr. NOURSE. Yes.

Senator BUSH. Now, while he is doing that to establish his credit and make a loan, somebody else is paying one back. In other words, you have a constant pay-back going on, which deflates the inflationary force of bank borrowing.

In other words, as new money is created, it is also being retired by those who are paying back.

Is that not so, so far?

Dr. NOURSE. Yes.

Senator BUSH. The difference, then, with the Federal Government, is that when it goes in, the record does not show that it pays back. The money is created by the establishment of a deposit for the credit of the Secretary of the Treasury, but it stays there, and when the time comes, it is renewed. New notes are sold; new loans are made; and the increase in the money supply remains. This has been going on over the years.

Dr. NOURSE. Yes, sir, though Federal bonds can be paid off and the national debt reduced.

Senator BUSH. So that the effect of the Government borrowing through the banks in that way is to increase the money supply and keep it increased. Is that not so?

Dr. NOURSE. Yes. I think that there is a basic difference and that is why I believe that two unlike things should not be mixed in the same system.

Now, on the other hand, they are not water-tight compartments. As the Fed says—I remember Randolph Burgess particularly saying this: "While we are free of subservience to the Treasury, we have to be aware of their problems and responsive to them."

But the distinction that you make, that they are two very different ways of handling financial matters, is the basis of my feelings that we should not merge.

Senator BUSH. Therefore I take it that you would endorse Mr. Martin's stand when he spoke of the deficit which is impending for the 1963 fiscal year, and which was then in prospect of being considerably enlarged by a tax cut.

Dr. NOURSE. Yes.

Senator BUSH. Now, we do not intend to have that, apparently.

But he said that he could not be counted on, that the Fed could not be counted on, to finance the deficit. You would approve of that position?

Dr. NOURSE. I would, decidedly.

Senator BUSH. Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Dr. Nourse, I would like to join the chairman in saying you reflect your wisdom in this paper. I am delighted to see that you feel that there has been much too much emphasis on fiscal and monetary policy to the disregard of other policies which can be very helpful and significant in improving our economy and enabling us to move ahead. This is a very strong statement of that position.

I would just like to say, though, carrying on for a minute longer, on this point that Senator Bush so ably raised: Dr. Hansen, of Harvard University, has pointed out that over time we have had almost identical relationship between total debt and the gross national product; that is, the proportion has been about the same.

There have been times when the national debt has been very low, but when private and local debt under those circumstances, State debt and so forth, has been high in relationship to gross national product. It is a very steady relationship.

Therefore, if you follow a dogmatic position of saying that under no circumstances will the Federal—and, incidentally, Mr. Martin has never taken that position; he was very clear here the other day in saying that he would not take it—if you take the position, however, that seems to be advanced, that you will never finance the Federal deficit to any extent through the banking system, then it would seem to me you are saying: At times, when the Federal Government is expanding its deficit and private debt seems to be declining, regardless of what economic conditions seem to call for, you will contract the money supply.

Now, the President of the United States has indicated, and his economic advisers have indicated, that they think we need to expand our economy.

I am inclined to disagree with some of their methods. I do not think that we should have the kind of a super deficit which we seem to be about to have in 1963.

But if they do intend to do that, and Chairman Martin tightens money as he says he might, it would seem to me that we have the two instruments of economic policy clashing; with fiscal policy trying to expand, and move the economy ahead and provide more employment, and monetary policy putting on the brakes and slowing down the economy.

Now, I would feel that it might be wise, under some circumstances, although certainly not under all, for the money managers to expand the money supply by financing part of the deficit through the banking system.

And I would like to give you just one example of this. Supposing that we have no tax cut, we have no increase in Government expenditures. Suppose under these circumstances that the economy begins to turn down. We still have a deficit. The deficit, because the economy is turned down, begins to grow.

Now, under these circumstances, why would it not be wise for the Chairman of the Federal Reserve Board to finance that deficit through the banking system, thereby having less contracting influence on the economic system than if bonds were sold to the public?

Dr. NOURSE. Well, I would say it would be wise, and they manifest that kind of wisdom. The remark was made that they cannot be unaware of Treasury needs. As stated, in this instance I cited, they had seven refunding operations coming up within the remainder of the year. It was then about midsummer, I think.

Now, they must make so tight a money market as to defeat the funding operations of the debt management of the Treasury. That is what I think "leaning with the breeze" means in that connection.

On the other hand, to simply say, "We go along with whatever there may be," if we follow a loose-money policy in the time when the financing is jeopardizing the health of the economy—I think that is another position more extreme than they have been willing to take, and they are right at the present time following a somewhat tighter money policy than certain factors in the economy think is desirable.

In other words, that simply is using the brake in the system wisely, not freezing the brake and, as they charged one time, throwing the passengers through the windshield. But it is keeping the system under control with a deference of one branch for the other, I think that is the essence of wisdom, there.

You have used the expression "dogmatic policy." I think that dogmatic policy would be fatal. And yet, the absence of any policy would be just as fatal.

Senator PROXMIRE. Well, I would just like to conclude by asking you if it is not right that when we have a situation of substantial unemployment, and unemployment is serious now, and we have a situation of a lack of full utilization or nearly full utilization or even optimum utilization of our industrial facilities, and when we have a stable price level—we have a very stable wholesale price level and a nearly stable retail price level—and when the international payment situation is improving, as it has been, and when the experts come up and tell us that interest rate differentials are not a significant factor in the international payment situation, anyway, under these circumstances it would seem unwise, at least, to follow a policy of monetary tightness.

Is that not correct? Or is it correct?

Are these not the criteria that should be considered, primarily?

Dr. NOURSE. Well, you say "tightness." But tightness is not one categorical concept. It is a question of degrees of tightness. And that is the point I was trying to make. That to throw all control away is just as bad as to have a rigid control.

Senator PROXMIRE. I am not talking about pegging the Government bonds, or returning to anything of that kind. I am not talking about very low interest rates. I am just saying that in the future—

the past is finished—in the future it would seem to me most unfortunate, if the conditions remain about as they are, if we are going to follow a policy of not increasing the money supply with the gross national product.

We would have rising interest rates and some restraint on the economy moving ahead, at a time when we need to do so. And we suffer this restraint because of monetary policy. If we get into an inflationary system, that is quite different. We are not in that now.

Dr. NOURSE. Yes. We are not in a crisis situation. I agree on that.

Senator PROXMIRE. I want to apologize for having done just exactly what you say we have mistakenly done, that is, put so much emphasis on monetary policy, or fiscal policy, because I do think that your contribution this morning has been extraordinarily helpful, and I agree with it quite fully.

Chairman PATMAN. Dr. Nourse, you made one statement, that the Federal Reserve should not defeat the debt management policy of the Federal Treasury. I would like to invite your attention to the fact that when the last issues were put out recently, one issue was 4¼ percent, due in 30 years, I think, and the Treasury expected to sell about \$750 million worth. Well, they actually sold about \$316 million worth.

That is an instance that occurs to me. When the Federal Reserve was sitting idly by and permitting the Treasury to lose, the Federal Reserve could have purchased those bonds one way or another, without any inconvenience or trouble or cost, without any possibility of loss, and finally have fed them back into the market when the market was better and when the climate was more suitable.

But the Federal Reserve did not help the Treasury at all on any of those issues, so far as I know. And I think that is a dangerous trend.

Of course, the Federal Reserve, if they want to carry out a hard-money policy, and leave the impression and have the psychological weight behind it that it would have, that interest rates are going up, and therefore convince the people that a 4¼-percent Government bond issue will not sell, they have made a point, there. But the point I think is against the public interest.

What do you think about it?

Dr. NOURSE. Well, I do not claim to be privy to all the issues that were involved in that situation. In a general way, however, it would seem to me that the Treasury, in its debt management, was trying to lengthen the maturities and feel out the market for longer maturities; and the Fed could follow two policies:

(1) We let you perform this experiment in the existing state of the commercial market. We let the market tell you what this debt management possibility is.

(2) They could have, on the other hand, followed the course which you suggest, of making an artificially favorable situation for the sake of making that offering fully successful.

Now, I may be an old-fashioned conservative, but it seems to me——

Senator BUSH. They would have to buy the bonds. They could not create a situation. Banks do not buy 30-year bonds.

Chairman PATMAN. Well, if they want to, they buy them; they have been buying tax-exempt bonds lately.

Senator BUSH. No; they buy shorts. You do not advocate buying long-term bonds with short-term deposits, do you?

Chairman PATMAN. No; I do not. I do not think the banks belong in the long-term Government bond market, and certainly not in the tax-exempt market. But, the Fed can always carry them. All they have to do is create more money. They could buy up the entire national debt, if they wanted to. There is no restriction on it.

That is correct, is it not?

Dr. NOURSE. That is a rather dangerous power.

Chairman PATMAN. I am not advocating it, and no one else is advocating it. But it could be done?

Dr. NOURSE. Yes. That is why discretion is so important.

Chairman PATMAN. The fact of the matter is that I have been keeping up with the payments of the Federal Reserve into the Treasury. Every month they are paying in about \$68 to \$70 million into the Treasury. That money, of course, is there because they bought Government bonds without paying anything for the bonds, on the Government's credit, and they collect the interest from the taxpayers through the Treasury, and then the surplus goes back into the Treasury. That is part of the surplus every month, \$70 million, approximately \$840 million a year.

Now, it is my contention that when the bond sales and the price of the bonds justify it, the Federal Reserve should be allowed the privilege, and encouraged through the open market operations, to buy bonds, so long as it does not upset the market, and accumulate them; in that way the Government would save the interest expense on them.

I would not do it to the extent of causing inflation or destroying our monetary system. Certainly not. But it is possible for the Federal Reserve to acquire a portion of the national debt that way. Not quickly, not suddenly, but over a period of years, when the climate is right, to acquire those bonds and let the interest flow back into the Treasury—reduce the interest burden on the budget.

Now, of course, some people will throw up their hands and say, "That would cause inflation." But there are ways to put the brakes on inflation.

Take the reserve requirements of banks, for instance. You could change them, if you wanted to. There is nothing sacred about them. I know one time when they were doubled, to keep people from getting adequate purchasing power. So certainly they could increase the reserve requirements of banks and prevent any type of inflation.

So do you not think it would be in the public interest if we had a policy like that, where the Fed could more and more accumulate Government obligations, when it would not upset the economy, and it would not be inflationary?

Dr. NOURSE. Mr. Chairman, if I may make a respectful comment, I would say that the intricacies of this matter are almost endless, and unfortunately it seems to me that we have lapsed back into a discussion of fiscal policy, here, whereas I thought the purpose of this hearing and the testimony to be given by the members of the panel is to explore forces of the private market.

Chairman PATMAN. Well, of course, we have broad jurisdiction, you know.

Dr. NOURSE. But again, it is a question of balance.

Chairman PATMAN. I doubt that a point of order would be good on almost anything asked for before this committee. But, in any event, I will not pursue that further, except to ask what you consider to be the paramount subject today; monetary policy, or monopoly?

Dr. NOURSE. Well, monopoly; except more broadly stated. That is to say, I think that we have canvassed more fully the situation on fiscal policy, and we have not gone adequately into the question of market relationships, not merely monopoly, unless you interpret monopoly very broadly in terms of the concentration of labor power, as well as the concentration of managerial power.

Chairman PATMAN. Well, thank you very kindly, Dr. Nourse. We appreciate your testimony. It will be helpful to us.

I understand that Dr. Nourse is unable to be with us this afternoon. He has asked, however, that we include in the record a reprint of an article that he published in 1960 on "Some Questions Emerging Under the Employment Act." It contains his views on the issues with which we are concerned in this phase of the hearings.

(The matter referred to follows:)

[The American Economic Review, May 1960—The Journal of the American Economic Association]

#### SOME QUESTIONS EMERGING UNDER THE EMPLOYMENT ACT

By Edwin G. Nourse, Joint Council on Economic Education

##### I

There is a striking disparity between the grand national purposes declared in the Employment Act of 1946 and the paralyzing squabbles that have erupted in the steel industry and that impend for the automobile and railway industries in 1960. As setting for an analysis of causes of this disappointing development and for promising means of combating or, if possible, reversing it, I submit several all-too-categorical propositions.

The Keynesian dialectic for a high-production economy sustained by the grace of compensating fiscal policy and stabilizing monetary policy has proved inadequate for dealing successfully with the postwar problems of our economy. We have been confronted with many operational dilemmas in trying to adapt particular pricing and income-determining institutions and practices to the higher price level which had been, in a very irregular pattern, induced by the tumultuous wartime developments and improvisations. Alvin Hansen admirably previewed the complex nature of the Employment Act problem in his *Economic Policy and Full Employment* (1947). Referring to inflation as "the immediate danger," he said: "In our modern, highly complicated economic order we are continually in danger. It is not easy to keep the system in balance. That involves not only fiscal and monetary controls, but also, among other things, a balanced *wage-and-price policy, control of monopoly, promotion of high productivity, technical progress and, above all, social unity and cohesiveness.* [Italics added.] Stability, maximum production, and full employment are not easily achieved goals. We are perhaps out of the kindergarten, but we still have a long way to go." (Page vii.)

Unfortunately, neither Hansen nor any great number of our fad-following profession felt moved to explore the private market prerequisites for full employment symmetrically with their explorations of the public control aspects. But thirteen years of experience, during which conditions have been very favorable and performance of the economy on the whole quite gratifying, have shown that, under the institutions and the mores of our enterprise economy, "opening the money spigot" wide enough to get full employment results in dangerous

inflation and "reversing the money pump" drastically enough to prevent inflation produces intolerable unemployment. The continued rise in industrial prices and service rates during the 1957-58 recession while unemployment persisted or even mounted has now caused attention to shift to this field. This has given us the catch phrase "cost-push" inflation. I myself have been moved to label the phenomenon "institutionalized" inflation; that is, an inflationary trend built into the market process through the institutions of the large corporation, the big union, and big government sensitive to the political pressures of special-interest groups. This institutionalized inflation embraces not only the conditioning structures of business, labor, and government but also personal attitudes and group practices—the mores or ideologies of the elite groups which, as corporation executives, union leaders, Administration and Congressional officials, constitute our effective cadre of policymakers.

To grasp the complex realities of institutionalized inflation and gauge the possibilities of achieving sustained high production without periodic disruption of price-and-income alignments, our American "mixed" economic system may be visualized as a global process comprising a hemisphere of private business administration and a complementary hemisphere of public economic administration. This public hemisphere is divided into quarter-spheres of credit administration and spending-taxing administration. The private hemisphere is similarly divided into quarter-spheres of capital administration or price-investment policy and labor resource administration and wage negotiation. These four quarter-spheres of the economy, though separable for many purposes of analysis, are intricately intermeshed in actual operation. Thus, there cannot be an effective demand-pull that is independent of the cost-pushes of speculative business enterprise and resource-owners' opportunism. Nor can there be an effective cost-push that gets very far in defiance of the power of appropriation committees and credit agencies to "advise and consent." Fiscal policy is a powerful initiating and guiding force as it injects funds here and drains them off there. But also it is strongly conditioned by the price or cost situations brought about by the speculative and innovating activities of management and by the offensive and defensive strategies of organized labor.<sup>1</sup> For example, cost of government payroll and procurement and the yield of any tax structure are markedly affected by the level and structure of prices and of incomes brought about by the administrative policies of management and of organized labor and their articulations through collective bargaining.

To a very important extent, therefore, both fiscal policy and monetary policy are the captives of market policy or, stated more precisely, captive to market behavior, with its decisive administrative component. To recognize this fact of our economic life today is to realize the sterility of the aggregate demand formula in the unique causative, explanatory, and correctional sense in which it has been so freely used in recent years. The tough questions ultimately raised by the Employment Act are not primarily or dominantly those of public action to compensate for failure of the private economy to effect sustained high production. They are basically questions of how to forestall such failure by improving the institutions of the market—for goods, for services, and for funds—and how to raise the mores of individual and administrative responsibility<sup>2</sup> to a level compatible with the character of modern industry and trade. While permitting and indeed facilitating such concentrations of private economic power as are needed for efficiency in handling our fast-advancing technology, we need also to effect disciplines (i.e., group behaviors) in a domain that we have debauched into but by no means mastered. Our objective should be to preserve that "free competitive enterprise" premised in the Employment Act, not as a mere abstract ideal, but to make that freedom and the competition among larger operating units that results therefrom achieve the high economic goal of maximum consumer real purchasing power better than atomistic competition ever served the much less ambitious objectives of Smith's, Ricardo's, and Malthus' time. Big-

<sup>1</sup> While recognizing the withering of the Invisible Hand and moving to repeal Say's Law, we should take some care not to throw out realism's baby with the theoretical bath water. Labor's wage advances and management's markups are income generating, and pro tanto demand creating or fortifying—so long as the Fed and/or the fisc continue to put up the chips—and productive capacity is not allowed to breach the dam of price maintenance.

<sup>2</sup> I do not say social responsibility because I believe that the economist qua economist should keep his analysis on the operative or technological rather than the moralistic plane.

unit competition must find an optimum blend of internal constraint, that achieves discipline in its own ranks, and such cooperation among special interests as will promote a constellation of private prosperities as integrated parts of maximum national prosperity.

## II

Concentrations of private economic power are a perfectly normal manifestation of the economics of enterprise. Under our traditional principle of free private enterprise we have permitted the ambition, the ingenuity, and the daring of business leaders to develop the industrial and the commercial corporation to the point where a single firm may hold assets, develop money flows, and control personnel to an extent that exceeds the economic power of any one of perhaps a quarter of our sovereign states or of many a foreign country. The right of both horizontal and vertical integration permitted under the law (despite occasional curbs) has contributed powerfully to the stimulating of production, the enlargement of employment opportunities, and marked rise in the real purchasing power of consumers. Its impact on national stability has been more equivocal.

Paralleling the development of the giant corporation, we have, under our traditional principle of free private enterprise, permitted the ambitions, the ingenuity, and the daring of labor leaders to build up unions of size and power in many regards approaching and in some regards surpassing those of the largest corporations. Much as the "infant industry" argument in the manufacturing area in time became an absurdity, so the "underdog" justification for public policy further enlarging the rights allowed to, and the benefits conferred upon, organized labor has become obsolete.

The workability of a system of free competitive private enterprise under modern conditions pivots on the institution of collective bargaining, and it had seemed an almost axiomatic proposition that all that was necessary to give bargaining between units of unlimited size the same beneficence as that traditionally ascribed to atomistic bargaining was for private action to promote and public authority to permit structures that would achieve "equality of bargaining power." It would be hard, however, to concoct a phrase more elusive in interpretation and more untoward in its application than this one—unless it be "bargaining in good faith." Instead of promoting market equilibrium through rational juxtaposition of supply realities against demand realities, each side sought to maximize its fire power to force a decision which would be to its financial advantage. The consequences of this line of development seem now to have brought us to the distressing alternatives of inflation or return to the cold war of the class struggle.

Rather than countervailing against each other to achieve high production and price stability, great concentrations of economic power become a prime initiating and aggravating force of inflation. Instead of an apparatus of wholesome adjustment, we get a continuing race for more power on both sides and impasse when the summit is reached. Neither party is willing to admit that collective bargaining fulfills its role as balance wheel through "equality of bargaining power" if it has to accept contract terms below the level of its demands. Paraphrasing George Orwell's brilliantly satirical phrase in *Animal Farm*: Both pigs must be equal, but each pig must be more equal than the other.

Success of the industrial union tactic of striking that oligopolistic employer who appeared at the moment to be in the most vulnerable position or to have a recognized position of policy leadership moved the steel companies this year to confront the solidarity of the United Steel Workers union with the matching solidarity of the twelve major steel producing companies. But this strong riposte in the game of bargaining power promptly engendered a countermove toward a still larger solidarity among unions as a whole. Several of them passed resolutions to support the United Steel Workers in their strike, and the AFL-CIO and several individual unions not only gave unequivocal moral support but also voted substantial cash subsidies to increase the defensive power of the United Steel Workers.

Do we not here see the race for countervailing power generating a trend toward cartelization of industry by the back door that we have persistently turned back at the front door under our antitrust principle? Whether or not the Department of Justice will challenge this development remains to be seen. Thus far the monolithic labor suzerainty has been able to maintain substantial immunity from the antitrust laws. Something radical or at least showing sparks of inventiveness now needs to be done to check the erosion of that competitive



flexibility that is essential for an enterprise economy to deal with real operative situations.

Our traditional theories of competition were developed long before these modern complexities had emerged. Edward Chamberlin's pioneer study of monopolistic competition took a long stride forward into the realities of today's commercial and industrial life. But the focus was on maximization of the profits of the business firm. There needs to be—and to some extent there has been—an enlargement or elevation of this type of theory to encompass maximization of the productivity and distributive dynamism of the whole economy. Public inquiries and private studies are now vigorously underway (notably those sponsored by the Joint Economic Committee and the Senate Subcommittee on Antitrust and Monopoly) to see if we can arrive at some actionable consensus as to what concentrations of economic power now permitted by law and administrative rulings are inimical to the intentions expressed in the Employment Act, and what steps we should take to validate those intentions. Never before has the practicing economist been vouchsafed so adequate and competent a body of analytical and empirical material for his professional synthesis. We should now be near a break-through on both the juristic and the educational front.

### III

Both the analyses of economists and the attitudes of the business world and general public divide rather clearly into two broad schools of thought as to the market phase of our current national economic problem. On the one hand are the radicals or pessimists, who despair of getting really full employment and avoiding inflation without superseding the free market or substantially limiting the present scope of freedom in the product, labor, and money markets. They would resort to extensive price, wage, and interest rate controls. This defeatist position seems to me premature, though it follows not unnaturally on the heels of disenchantment with the oversimplified belief that the purposes of the Employment Act were to be achieved through the wonder drugs of fiscal and monetary policy alone. It reflects an impatience with the slow and difficult process of progressively improving our market institutions in the light of larger experience and changing conditions and of progressively improving the performance of private administrative agencies in those markets in the light of research and a broadening viewpoint. The proponents of price and wage controls look for quick and decisive results from resort to centralized decision making.

But such shortcuts lead seductively to a fully authoritarian system. Experience with OPA, OPS, AAA, and indeed even much of public utility regulation seems to me to furnish ample evidence of both the theoretical shortcomings and the administrative difficulties of government control in the market process. No comprehensive rule book of price setting can be devised in advance by even the most competent team of market experts and economic professionals. However well conceived are the prices initially set at strategic spots, they impose unforeseen disturbances on major and minor commercial relationships. These immediately clamor for compensating adjustments. Control of the price structure creates demand for control of the processes of production and distribution. (See the "rake's progress" of agricultural "adjustment" acts.) Hope that market controls can be rationalized under a few broad principles or limited to a few strategic points proves illusory, and the system rapidly bogs down in a morass of detailed regulations, exceptions, grievances, and evasions. As for a standby apparatus, it is sure to grow costly during periods of inaction and be found obsolete when need for action arises.

The milder proposal that intended new prices or rates be posted and then held in abeyance while the public scrutinizes their justification and impact nominally substitutes the intellectual approach for the power approach to economic adjustment. But those whose critical judgment would be competent in the appraisal of proposed action cannot in any real and important instances become adequately informed as to the complex factors involved. The mere form of the price or wage proposal and the conditions of compliance present insuperable practical difficulties. If the steel companies were to make such an advance declaration of intention, it would not be sufficient for them to state a single price on basic steel because there are many grades and types of steel and specifications as to "extras," fabrications, terms of sale and delivery, and the like. These could not all be set out in the price proposal, and whatever base price was finally set by the company in the light of public reaction could be

materially modified in application through skillful manipulation of these escape possibilities. Similarly in the case of automobiles, is it conceivable that the companies could, months in advance of the introduction of a new model, inform the amateur public and enlighten their professional rivals as to the precise character of vehicle to which any specific price was to apply? The companies themselves are, up to the last moment of announcing the new models, uncertain as to what prices they can, must, or will name.

The labor aspect of the notice-and-waiting proposal is in some ways simpler than the price aspect. But with all the skill differentials, seniority rights, fringe benefits, and grievance procedures by which the basic hourly rate is intertwined, the practical use of this approach to wages (and work rules) seems slight. Nor does recent experience in the steel impasse encourage the hope that either management or labor would be responsive to public opinion even if it could be captured, measured, and weighed as to its internal variations.

But there is a more fundamental theoretical reason for eschewing the idea of a change of venue from the market to the government regulatory agency. The underlying premise on which the proponents of government intervention must rely is that the official pricemaker possesses a magic touchstone for the performance of this task, whereas such prescience is not available to private price setters or price negotiators. The first of these premises, in my judgment, constitutes an overestimate, the latter an underestimate.

The plea for radical government regulation was presented vigorously before this Association a year ago by Ben Lewis. Burlaquing the economic sophistication required, and in considerable measure attained, by some executives of big business units, as "corporate conscience \* \* \* marinated in goodness \* \* \* as benevolent individuals construe goodness," he laid down the dictum that such managerial policymaking "has nothing to do with economizing"; i.e., getting good allocation of productive resources:

"It is neither the privilege nor the responsibility of any individual, however conscientious or statesmanlike, voluntarily to render economizing decisions in the name of society. \* \* \* Economizing is society's job. \* \* \* Economic decisions must be right as society measures right. \* \* \* An economy is a mechanism designed to pick up and discharge the wishes of society in the management of its resources. Sometimes we seek through government to make the market itself operate more effectively as an economizing instrument; sometimes we move positively into the market with our sleeves rolled up and force the economic verdicts which, collectively, we want. \* \* \* Through government we supplement the market; we also supplant the market. \* \* \* The years ahead will see a great increase in conscious, collective, governmental controls and of governmental enterprise. \* \* \* The conviction that great power over the economy must reside only in a government of the people will be acted on relentlessly, bluntly, and with force."

Passing over Lewis' fast semantic shuffle between "society," "the economy," and "government" and the socialist implication of his prediction, I find myself in considerable disagreement with his dichotomy between big business purblind to what the public wants by way of allocation of resources and big government suffused with full understanding of these wants, full wisdom in resolving conflicts among them, and an adequate apparatus for implementing its "right" answers. The anthropomorphic idea that either society or government can know, discover, or formulate "the public interest" is a figment of the imagination since "society" does not and cannot have an official spokesman, and the officials of government bring their own limited empirical knowledge and very considerable personal biases and special-interest affiliations into their vocation as policy makers. Congressional action is not based merely on honest debate among informed statesmen; it also reflects ruthless pressures of interest groups and sordid trades among "practical" politicians. This voice of the people is in only the most Pickwickian sense the voice of God. Though it is the only workable alternative to authoritarianism that democracy has found for the shaping of fiscal policy and the institutional framework of the market, it is thoroughly unacceptable as a substitute for profit-seeking, responsible, ad hoc decision making of and within business firms and labor unions.

#### IV

If, then, we reject the deceptively simple device of cutting the Gordian knot of our full employment versus inflation dilemma by the use of direct government price and wage controls, what positive program can we adopt? My answer

to this challenge begins with a caveat. Zeal in attacking the problem of linking maximum production with dollar stability should be tempered with careful discrimination. "As prudent men we should not take hasty steps to alter an institutional system so deeply grounded in our traditions and so successful in meeting immediate postwar demands and opportunities. At the same time we should not be tardy in taking well considered steps toward correcting such deeplying or slowly developed shortcomings as time has revealed in our modern system of free but highly organized industrialism."<sup>3</sup>

Within such an interpretation of the needful role of the Federal Government in the private market, our positive program should be a vigorous implementation of the policy explicitly stated in the Employment Act; namely, "to foster and promote free competitive enterprise." This clause was not a mere political gesture toward threadbare tradition, but rather was a correct reflection of a basic principle of American and Western European economic science—that free competition among the complex thrusts of supply forces and the diverse pulls of demand forces furnishes the optimum condition for attaining maximum productive use of the economy's resources and maximum consumer satisfactions. Four ingredients of a free enterprise program seem to me to be indicated: (1) integration of our sprawling and confused antitrust statutes under a basic policy law or Joint Resolution that declares a comprehensive principle of free competitive enterprise; (2) pressure for vigorous and consistent enforcement of this principle both through the Department of Justice and also the ancillary agencies of the Federal Trade Commission, the National Labor Relations Board, the Secretary of Agriculture (Capper-Volstead and Marketing Agreements Acts), and several independent commissions; (3) realistic studies by the economics profession of the fundamental theory of large-scale competition, and the use of this enlarged understanding for the guidance of courts in applying general statutes to particular situations; of Congress and of administrative agencies in perfecting our competitive institutions and current practice under them; and (4) systematic but nonpropaganda campaigns of general education of the various functionaries and the general public in the operative requirement of a free competitive economic system.

The integration of a consistent and comprehensive procompetition legal structure should begin with a clear-cut declaration that all parties and interest groups shall stand equal before the law of the land, that no segment of the economy—industrial, commercial, agricultural, labor, or financial—shall be immune from safeguards set up to prevent the abuse of concentrated economic power. This unification of our institutions of big-unit competition would then require careful re-examination of our many special regulatory laws to see that their provisions are in strict conformity with the general declaration of policy as well as recognizing the operative needs and peculiarities of the several business areas. Even so, the definitions and rules embodied in these special statutes can hardly be more than a skeleton of generalized statements of principle and intent which must have flesh put on its bones by enforcement authorities—who must exercise a considerable margin of discretion in interpreting a given state of facts in a complex and changing economy and in aligning regulatory action with declared policy.

To say this emphasizes the close interrelationship among all four of the ingredients I have proposed. For the selection of cases to be examined and acted upon by the Department of Justice or the independent commissions and the findings made by them must be guided by economic analysis as much as by legal technicalities or by ease of handling or prospect of a successful outcome. It is cause for congratulation that there are today a considerable number of professionally competent economists in the staffs of these several agencies, that they draw upon the skills of brother economists in academic and business connections, and that the variegated wisdom of all three groups is made available to our lawmakers and amenders through the intellectualized apparatus that has been introduced into our Congressional system—and that is still growing. This is all the more important because so many vital questions of both corporation and labor practice are still in so ambiguous and indeterminate a state.

We do not have any economic pope who is in a position to give us any infallible answer, for instance, as to the competitive or noncompetitive impact of conglomerate mergers or the lush proliferation of big companies into lines re-

<sup>3</sup> Excerpted from the writer's testimony before the Senate Subcommittee on Antitrust and Monopoly Hearings on Administered Prices, pt. I, p. 13, July 9, 1957.

lated only remotely if at all to the company's original business. Similarly on the labor side, it appears that outlawing the national wage contract would be found highly disadvantageous by some employers and a statutory "right to work" inequitable by many workers. Until we have something more closely approaching scientific demonstration in numerous cloudy areas, we will do well to limit the law to statements of principle and purpose and rely on judicial or quasi-judicial procedures to articulate declared policy with ad hoc puzzlement. In discharging this vital role, some courts now avail themselves of economic counsel in balance with their use of legal counsel; others prefer, in the bright blue yonder of the economic stratosphere, to "fly by the seat of their juridical pants."

While my emphasis on the usefulness of the economists as expert witness in litigation and as staff member or consultant in the legislative area may seem to be in the nature of a commercial for our craft, in fact it is a sober challenge to us to foreswear a good deal of academic boon-doggling in the name of research and come up with some illuminating answers or at least well-grounded and stimulating hypotheses as to the nature and potentialities for both good and harm of price and non-price competition between large economic units and some inventive proposals for capturing the benefits and avoiding the abuses of such massing of private power.<sup>4</sup>

v

In thus seeking to devise a model of privately administered price-making and wage negotiation compatible with the purposes of the Employment Act, can we discover any hard core of theory as to the basic nature of our problem which might furnish theoretical keys to its situation? I venture to suggest two hypotheses.

First, I am persuaded that a basic reason why an irresistible force of union cravings meets an immovable body of managerial prerogative is that the scope of decision making on wages and work rules has become too wide and its situs too far removed from the core issues that need to be resolved. This proposition, however, must not be mistaken as the premise for a sweeping proposal for corporation-busting or union-busting; it simply points to a discriminating realignment of functions. The issue as to centralization versus decentralization in the private hemisphere of our economy runs closely in parallel with the same issue in the public hemisphere. While certain functions such as defense, international relations, and fiscal policy must be and remain the functions of government, in the great body of operational matters, both civil and criminal, we find it better to let local autonomy decide upon patterns of life which free citizens find best adapted to their peculiar circumstances and values. They may invent, experiment, learn by doing, and profit by the experience of other autonomous groups. Similarly, certain financial and related investment and technological policies of the modern corporation can most efficiently be centrally determined. Wage bargains and detailed work rules seem to me to fall in a distinguishably different category and to call for serious effort by all parties to discover principles and shape practices of local autonomy that would promote serviceable reconciliation of conflicting alternatives on both sides rather than creating a widespread, even national, impasse by trying to extend a single formula to quite unlike situations. Instead of the sort of centralization marked by the intrusion of AFL-CIO and its Industrial Union Department and by the industry-wide coalescence of major companies in the national wage bargaining which tied up the steel industry and the economy, we need more flexible differentiation of local situations and variety of accommodation through initiative, experimentation, and natural selection.

Of course any such suggestion will be greeted by the union hierarchy as a proposal to "weaken the unions" and evoke the real, and in its time, legitimate

<sup>4</sup> But even under the institutions we now have and with the understandings we have already gained, we should be able to recognize and act upon a few extreme situations where concentrations of economic power are so massive—and still growing—that government should proceed actively, not merely to check, but to reverse them. On the corporate side, I would nominate the General Motors Corporation; on the labor side, the Teamsters Union (quite outside the issues of shady practices now under attack). Exemplary action in each of these extreme cases would serve as a warning to others who have not yet stretched so far the tolerances of our free enterprise doctrine. And, even more significantly, the size and importance of these cases would assure such thorough discovery proceedings and such appeal to economic analysis by outstanding experts by both prosecution and defense as would define national policy over the whole area and for a considerable time into the future. The logic of action in the two cases is not identical, but it is equally compelling—though it is not possible to elaborate it here.

dread of the "company union." But note that I am not proposing the abolition of the national union or the multi-union federation—simply a restoration of powers of choice lost to the operational groups through the growth of union hierarchies. The national union will still have a centralized role of general policy making, promotion, and enterprise leadership—including legitimate lobbying. It may formulate general policies as to work rules (as it now does) and propose wage levels and differentials, but with these tailored by the local to its own peculiar (environmental) conditions, and state of the employing company (as textile workers have done). The main point is that any strike vote shall be taken independently for itself by each union without constraint by others. This would not be a departure from practices which now obtain sporadically within the union movement, but would regularize and generalize the principle and would allow "the show to go on," recognize difference in operational requirements, assure self-determined values, and raise the dignity of local leadership. It would not have to rubber stamp central policy or seek promotion to the national hierarchy via such subservience. Union members who have felt they had to support the national leaders even in an "unpopular" strike might ponder whether their own interests would not be served better by contributing to the making of differentiated adjustments than by accepting authoritarian decisions.

Note, too, that my proposal includes a similar restitution of powers of decision making by the centralized corporation to its component operating units.

This diagnosis is not based on the negative proposition that bigness must always suffer from bureaucratization, but on the positive concept of economic statesmanship and promotion of the common good, about which there is such ambiguity. Much as officials of the national government should and, to a not always recognized extent, do have a national or statesmanlike outlook even amidst the practical necessities of reflecting local and interest-group pressures, so top executives of national corporations and top officers of national unions have a similar opportunity (and duty) to learn of the national process within which their management must function and of practicing two-way statesmanship: backward for the enlightenment of their constituent parts and forward to the enlightenment of government agencies as to the needs and response of their "factor" group and its underlying parts.

A second impediment in the path of fundamentally workable adjustments is the refusal of management almost universally to admit that the price of product (in its relation to volume of sales, number of jobs, and rate of profits) should be considered as an integral part of the wage problem. If management were to admit the functional inseparability of these issues, it should expect labor similarly to treat wages in their relation to volume of employment, productivity, and actual rather than formulated living costs. This issue goes to the very heart of the proposals currently being made in various forms for dealing with labor-management deadlocks by means of "fact-finding" committees, compulsory arbitration, Presidential pressure for some "recommended" terms of settlement, or legislation providing for "a third chair [the public's] at the bargaining table." The simple fact is that corporation orthodoxy clings to the huckstering philosophy of early proprietary capitalism even in our new day of trustee capitalism. The progress of science and engineering has, in the area of technology, eroded the province of "trade secrets" almost to the vanishing point, and industrial executives have found that patent licensing is a practicable way of competitive life. We now need a counterpart development under which rational determination of critical cases within the price-income process could be approached by arraying the pertinent factual material and applying to it the best of professional expertise (with such fruitful variants of interpretation as economists would offer—even as scientists and engineers do). In a word, our society is now laboring under a serious cultural lag, and will continue to do so until we can bring ourselves to substitute scientific method for "muscle" in the conduct of big-unit industrialism.

In the fourteen years since the war we have demonstrated only a very precarious kind of control over the built-in or institutionalized inflation that has evolved and only dubious and adventitious capability for full and sustained use of our national resources for production. We are now, very properly, probing into a variety of local and more or less discrete manifestations of this unsatisfactory performance, in the hope of improving economic structures and elevating economic practice. Along with these activities, and as a guide to them, we should also ponder deeply what are the over-all impli-

cations of the maximum production policy or doctrine to which we give lip service. Both Sir William Beveridge as the British prophet Isaiah of the full employment gospel and Alvin Hansen as its American John the Baptist stated the postulates in quite explicit terms.<sup>5</sup> These prerequisites were: widespread economic sophistication and a pervasive spirit of social cohesiveness or national unity.

Reverting to Hansen's comment that, in terms of economic sophistication and social unity, we were, in 1947, "out of the kindergarten but still have a long way to go," what can be said of progress made since then? The record seems to me to be seriously disquieting. The most charitable estimate is that we have moved on to the stage of teenage turmoil, with its undisciplined aggressiveness, adolescent frustrations, and intellectual confusions. There was a flash of economic insight in the steel companies' statement of the need to get the cost-price mechanism under control if we are to attain a competitive stance in world markets and competitive dynamism among domestic industries. But there was egregious economic stupidity (and even business stupidity) in their bland assumption that price and profit factors should be immune from any part in the readjustment process, while wages and volume of employment took the full brunt. There was a flash of economic perspicacity—even precociousness—in the argument of the vice-president of AFL-CIO that our basic problem is that of "learning how to distribute abundance" and in his reasoning that wages cannot be adequately analyzed—and adjusted—in isolation from price and profit information and analysis. But I do not find equal or even minimal grasp of the global economic process in his supposition that money wages can be advanced by larger and larger amounts on each contract renewal date, that those with the highest rates should get the largest new gains, and that each of the leaders get more than any of the other front runners.

I have already stressed the responsibility of our profession to provide clearer analyses of the complex problems of this real world and more cogent and practical proposals for positive devices for meeting them. But a means of selling as well as producing such intellectual merchandise is needed. This over-all factor or condition necessary to the successful practice of economic democracy is referred to by its proponents as the educational approach or "intellectualism on the economic front." It is tagged by its detractors as the hortatory approach, admonition, or the "jawbone attack." Only at our peril do we sneer at "creeping admonitionism" and declare that "statesmanship is for the statesmen" and thus that private statesmanship is "for the birds"—even in the day of multi-billion-dollar corporations and multi-million-member unions and the still more powerful solidarities of both.

It should be remembered that admonition is an art widely practiced by many who ridicule it when practiced by the professor or by the President. Business organizations carry on an elaborate campaign of admonition to their workers, their shareholders, and the public against the economic fallacies of labor, or government, and of "liberals" generally. The unions conduct a parallel crusade to educate the public as to the errors of capitalist practice and theory. They are now embarking on even more ambitious plans to admonish voters against endorsing measures or electing men who fail to understand the role and needs of labor in a full-production economy. And, of course, the political campaign, the legislative process, and the executive branch of government reek with admonition. As I told a meeting of business executives while I was on the firing lines from the colonial town meeting to the modern business convention and the Congressional hearing, the endlessly wagging jawbone has been one of our best devices for making progress both in common understanding and in the mutual tolerance essential to a self-regulating society.

This is the distinctive economic weapon of a free society in its battle against authoritarian imperialism. If we allow it to rust or use it but feebly, we shall not have validated the inherent potentialities of a self-disciplined enterprise system and of economics in the public service.

<sup>5</sup> Beveridge stipulated "a coordinated attempt, not a blind groping and pressing by numerous groups each of which sees only its own sectional interest and tries to exploit its particular strategic advantage": voluntary arbitration of wage disputes; and both prices and wages "determined by reason, in the light of all the facts [employers opening their books to public scrutiny] and with some regard to general equities." Hansen gave us the admirable generalizations already quoted: "a balanced wage-and-price policy and, above all, social unity and cohesiveness."

Chairman PATMAN. Now, for our next witnesses this morning, we have a distinguished panel of economists, one of whom is a professor of law and a former staff member of the Joint Economic Committee.

Our panelists are Dr. Walter Adams, professor of economics, Michigan State University; Dr. Alfred E. Kahn, chairman of the Department of Economics, Cornell University; Dr. Robert F. Lanzillotti, head of the Department of Economics, Michigan State University; and Dr. Richard J. Barber, professor of law, Southern Methodist University.

Gentlemen, we are glad that you have come. Our procedure is to have each member of the panel make a brief opening statement, then members of the committee may wish to put some questions to the panel.

We usually take you alphabetically, Dr. Adams, so we will start with you.

#### STATEMENT OF DR. WALTER ADAMS, PROFESSOR OF ECONOMICS, MICHIGAN STATE UNIVERSITY

Dr. ADAMS. Thank you, Mr. Chairman.

May I ask that my statement be inserted in the record at this point?

Chairman PATMAN. Yes, sir. Without objection, your statement will be inserted at this point.

(Statement referred to follows:)

#### STATEMENT OF DR. WALTER ADAMS, PROFESSOR OF ECONOMICS, MICHIGAN STATE UNIVERSITY

It is reported that when Galileo made his telescope and discovered the satellites of Jupiter, his findings were disputed by the head professor of philosophy at the University of Padua. "We know," he said, "that there are seven planets, and only seven, because there are seven openings in the human head to let in the light and air: two eyes, two ears, two nostrils, and a mouth. And the seven metals and various other examples also show that there have to be seven. Besides, the stars are invisible to the naked eye; therefore they do not influence human events; therefore they are useless; therefore they do not exist. (*Quod erat demonstrandum!*)" (Quoted in Frank H. Knight, *Intelligence and Democratic Action*, p. 57.) The event occurred in 1610, long after man had supposedly emerged from the darkness of the Middle Ages to the light of the Renaissance.

That type of reasoning has not yet disappeared. It has survived in fields other than astronomy, in lands other than Italy, and times even more enlightened than the 17th century. Today, for example, one can still find economists who argue as follows: (1) Monopoly power exists in theory but is rare in practice; (2) it cannot be measured with elegant precision; (3) being unmeasurable, it cannot possibly be widespread; (4) even if it were widespread, it would be held in check by interindustry competition, the corporate soul, the gales of creative destruction, countervailing power, congressional investigations, and presidential admonition; (5) in any event, there is no urgency for public action until further research has unearthed the final answers.

I do not happen to share this Pangloss view of things. Conceding the fact that monopoly power is never absolute—that no system of price administration is ever foolproof—I submit that concentrated economic power is a fact of American life. It exists; it is pervasive; it is dangerous. It poses what I consider the No. 1 domestic problem of our time—the prevalence of private socialism in what we like to think of as a free enterprise economy.

Let me explain the different types of market power—conglomerate, vertical, and horizontal—by using the General Motors Corp. and the auto industry as an example. (1) Conglomerate power: This means that a firm's operations are so widely diversified that its survival no longer depends on success in any given product market or any given geographical area. Its absolute size, its sheer bigness, is so impressive that it can discipline or destroy its more specialized competitors.

General Motors, of course, possesses conglomerate power. Until recently part of the giant Du Pont empire, this corporation is not only the largest automobile company in the world, but also a significant factor in diesel locomotives, buses, trucks, refrigerators, electric ranges, auto financing, batteries, earth-moving machinery, etc. This corporation could decide to enter the ice cream industry—intent on capturing 20 or 40 or 100 percent of the sales—and succeed in this endeavor. It would matter little whether GM was indeed an efficient ice cream manufacturer or whether its ice cream was indeed tastier than more established brands. By discreet price concessions, saturation advertising and attractive promotional deals, it could commit its gargantuan financial power to the battle until only so much competition as GM was prepared to tolerate would be left in the industry. Remember that, in good years, the annual profits of General Motors are roughly as big as the combined assets of Borden and National Dairy.

Put differently, in a poker game with unlimited stakes, the player who commands disproportionately large funds is likely to emerge victorious—regardless of ability, virtue, or luck. He has the one asset the others lack, viz., the power to bankrupt his rivals. Given the laws of probability, his power alone tends to be decisive.

(2) Vertical power: This means that a firm engaged in successive stages of production and distribution can squeeze its suppliers by denial of access, or its distributors by denial of supplies, or both by manipulation of price. In the case of General Motors, congressional committees have received ample evidence of the corporation's power over automobile parts manufacturers and automobile dealers. The record on this score requires no elaboration here.

(3) Horizontal power: This is market control in its pristine, classical form. It consists of dominance over an industry (in relative, percentage terms), and is manifested in entry controls, price leadership and followership, and other assorted forms of oligopolistic cooperation.

General Motors, with its more than 50 percent control over the automobile industry, is a prize example of horizontal power. Its decisions what to produce, where to produce, how to produce—what price to charge, what target profit to aim at, what means of raising capital to employ—these and similar decisions have a profound impact not only on its fellow oligopolists, but the whole automobile industry, the American businessman, the American consumer, the American worker, and the American economy. These are decisions which affect the general public, but they are made by a private government—subject to only the loosest public control and involving only the remotest participation of our democratic citizenry.

(a) Pricing.—General Motors sets its prices so that—over the long run and assuming "standard volume" (operations at roughly 80 percent of capacity)—they will yield an average profit (after Reuther and after taxes) of 15 to 20 percent on invested capital. This is called target-rate-of-return pricing. It is the same cost-plus system of pricing used in the regulated industries—with this difference: the rate of return allowed a public utility is determined by a government regulatory commission, whereas the General Motors rate is determined by the company itself. It is not imposed by the autonomous forces of the market place as in a competitive industry; it is not imposed by a public regulatory commission; it is the private exercise of discretionary power by a corporation with dominant control of the market. Not only does General Motors possess this market control, but as the Kefauver committee hearings showed, it has been amazingly successful since World War II in exercising such control and achieving its self-determined and predetermined target rate of profit.

That it was able to do so is partly due to the slavish pliability of its major rivals. The latter have simply not chosen to challenge General Motors' price leadership and contented themselves to follow, within rather narrow limits, the lead of the industry's giant. One dramatic illustration revealed by the Kefauver hearings involved the pricing of the 1957 models: Ford had announced an average 2.9 percent price increase—"no more than our actual costs for materials and labor have gone up;" General Motors 2 weeks later announced an average 6.1 percent increase on comparable models; whereupon Ford quickly revised its price list upward—no doubt to meet the higher price of a competitor. When Chrysler later fell in line, the traditional pattern in the low price field was maintained. The deleterious effects of such conduct, I trust, will become apparent later in my presentation.



(b) *Product design.*—While the automobile industry in the days of Henry Ford I was an arena of price competition—with companies reaching out for “the other 95 percent of the market” by competitive price reductions, the rise of General Motors ushered in a diversion of the industry’s competitive energies into nonprice rivalry. Whereas Henry Ford told his customers that they could choose any color automobile as long as it was black, the industry by 1960 was offering more than 300 different passenger models and the manager of General Motors’ Chevrolet Division boasted that his factories were turning out a custom-made car for almost every buyer. Chevrolet, he said, offers the buyers so many combinations and permutations of body styles, color, trim, and equipment options that (without counting accessories) Chevrolet could have produced its entire 1960 output of 1,850,000 passenger cars without making any two of them exactly alike. Price cutting to tap new layers of domestic or foreign demand had become an anachronism, only to be replaced by advertising outlays, annual model changes, and the horsepower race. The automobile, no longer a mere vehicle for transportation, was made a complex and luxurious amalgam of superengines, taillfins, quadruple headlights, and a cornucopia of chrome. Inevitably, its cost of production and price increased steadily and alarmingly.

For the Big Three, according to the Kefauver committee, depreciation and obsolescence costs rose from \$183.2 million in 1950 to \$679.8 million in 1957; selling and administrative expenses from roughly \$450 million to \$1,200 million; and the annual cost of special tools from \$182.3 million to \$762.0 million. (It should be noted that production volume in 1950 and 1957 was 7 million cars which makes these comparisons especially relevant.) At Ford, the dollar cost of major model changeovers increased more than 6½ times between 1948 and 1957, and at an increasing rate: in 1957 these costs were more than 3 times as high as in 1953. Since sales increased at a much slower rate, the ratio of styling costs to sales (and production costs) increased significantly—doubling between 1948 and 1957. In economic terms, the effect of this nonprice rivalry was to raise overhead costs and exert an upward pressure on price; this in turn, given the elastic demand for automobiles, tended to depress volume and raise unit fixed costs even further. The consequences, as we shall see presently, were far from gratifying.

(c) *Export policy.*—How should American automobile companies supply their oversea markets? Should they utilize and expand their domestic facilities or rely on their foreign subsidiaries? Should General Motors supply its oversea markets from Detroit, Flint, and Lansing, or from the Opel factory in Germany, the Vauxhall factory in Great Britain, or the Holden factory in Australia? Should Ford turn to River Rouge or to Dagenham, England, and Cologne, Germany? The choice that is made has an obvious impact on the volume of private investment at home, on employment, on purchasing power, on economic growth—and even on Government tax receipts.

Shortly after World War II, according to press reports, General Motors was contemplating the marketing of a new small car to be produced at a new plant built somewhere in the United States. This was the Holden, and its production facility was eventually located in Australia. This decision apparently became a policy trend in the industry. In 1958, J. Wilner Sundelson, manager of facilities and operations planning, Ford International Division, openly said: “\* \* \* in our planning, we have taken the view that vehicle exports from the United States, which are playing a declining role in Europe, will virtually vanish \* \* \*. Given the geographic penalty of the U.S. exporters in the European market \* \* \* it will readily be understood why we do not anticipate selling many U.S.-made cars in 1970 in the Common Market. Not only vehicles and vehicle components but parts and accessories will be exported from the United States in limited quantities.” In 1961, Frederic G. Donner, chairman of the board of General Motors, echoed these sentiments: “\* \* \* we will build cars and trucks in the United States for the home market and for those markets that want American-type cars, and we will continue our longtime policy of building cars abroad for sale in our oversea markets.” No wonder that American automobile exports between 1950 and 1959 declined from 120,000 to 104,000 while General Motors’ Opel exports from Germany increased from 25,000 to 169,000, the German Ford exports rose from 8,000 to 65,000, and Chrysler’s Simca exports from France rose from 7,000 to 121,000. No wonder that the percentage share of American automobile exports declined radically not only in Europe and the world at large but also (and significantly) in the Latin American market at our back door.

Again I say that the effect of these decisions by American companies had an obvious effect on domestic production, employment, payrolls, growth, tax receipts, and the U.S. balance of payments.

(d) *Market results.*—What then are the effects of these corporate decisions with respect to pricing, product design, and exports on the economic performance of the automobile industry—and, indirectly, the levels of production and employment in the American economy? To approach an answer, let us first examine the domestic automobile market, and then the world market.

In the domestic market, European imports became a significant factor between 1955 and 1959. Their number increased from 57,000 to 668,000, and their relative share of the American market rose from less than 1 percent in 1955 to more than 10 percent in 1959. The reasons, according to a survey of the National Automobile Dealers Association, was that the imports were cheaper to operate and gave better gas mileage; that the original purchase price was lower; that they were easier to park; and that they were easier to handle in traffic. In other words, the American consumer was in open revolt against the Big Three's price policy and product design. While the price of the standard six-cylinder two-door Ford increased from \$1,707 in 1955 to \$2,261 in 1961, the comparable Plymouth from \$1,738 to \$2,260, and the comparable Chevrolet from \$1,685 to \$2,230, the European makes effectively held the line. The Volkswagen went up from \$1,495 in 1955 to \$1,565 in 1961; the Fiat 600 from \$1,298 in 1957 to \$1,398 in 1961; and the Renault Dauphine actually reduced its price from \$1,645 in 1957 to \$1,385 in 1961. (These are all delivered prices in the United States, after payment of transport costs and import duties.)

The reason for the success of the European imports obviously was not that American producers were incapable of turning out a competitive model, but rather that they had chosen not to do so. They had become sufficiently insensitive to consumer desires—persuaded by their own propaganda that they could foist ever larger gas-guzzling monsters at ever higher prices on the hapless American public. Once the oligopolists were brought back to reality by the marginal competition of the European imports, they proceeded to bring out the compact cars which quickly terminated the import threat. Since 1959, both the number of imported cars and their percentage share of the American market has decreased steadily. A different price and product policy by the Big Three—forced on them by "outside" competition—had obviously turned the trick.

In the international arena, too, there is dramatic evidence that the Big Three's price, product, and export policies have caused the United States to lose out in world markets. In motor vehicle exports to the world at large (excluding the United States), according to the Department of Commerce, the U.S. share has declined from 41 percent in 1954 to 26 percent in 1960. At the same time, Germany's share rose from 16 to 24 percent, and that of the other OEEC countries from 15 to 25 percent. Even in Latin America, an area in which we enjoy massive advantages and which by geography and tradition is so closely tied to the United States, the U.S. market share declined from 81 percent in 1954 to 65 percent in 1960, while the United Kingdom's share increased from 5 to 7 percent, Germany's share from 8 to 15 percent, and the other OEEC countries' share from 7 to 12 percent. Put differently, the shortfall in U.S. automobile exports between 1954 and 1960 amounted to some \$656 million; that is, if American exporters had been able to command the same share of world markets in 1960 as they held in 1954, the United States would have earned an additional \$656 million through automobile sales abroad. (This, incidentally, is the largest shortfall of any manufactured commodity group—followed by a \$395 million shortfall in iron and steel, a \$335 million shortfall in industrial machinery, and a \$108 million shortfall in agricultural machinery and tractors.)

Clearly, the Big Three have priced and designed themselves out of world markets, on the one hand, and have made a conscious decision to supply overseas markets from their foreign subsidiaries, on the other. The impact of these private corporate decisions on domestic production, employment, and growth require no elaboration.

By using General Motors and the Big Three in the auto industry as an example—and no more than an example—I have tried to illustrate the existence of the vast discretionary power in the hands of some large corporations. "That power," as Justice Douglas once said, "can be used with lightning speed. It can be benign or it can be dangerous." In a democracy, dedicated to free competitive enterprise, such power should not exist. It should be decentralized. "It

should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men." The fact that they are not rapacious robber barons, but respectable and social minded, is irrelevant. The fact that they are imbued with the "corporate soul"—a sense of social responsibility—may qualify them to decide what is good for General Motors; it does not entitle them to determine what is good for Detroit or for the United States. Such decisions, in a democratic economy, are the function of the competitive marketplace. And when a corporation or group of corporations become so big that they are immune from the regulation of competition—so big that they constitute what amounts to a private government—then those corporations are too big for their own good and certainly too big for society's good. They then become an instrument of private socialism which is incompatible with both free enterprise economics and political democracy.

Dr. ADAMS. Thank you.

It is reported that when Galileo made his telescope and discovered the satellites of Jupiter, his findings were disputed by the head professor of philosophy at the University of Padua, who said:

We know that there are seven planets and only seven, because there are seven openings in the human head to let in the light and air: two eyes, two ears, two nostrils, and a mouth. And the seven metals and various other examples also show that there have to be seven. Besides, the stars are invisible to the naked eye; therefore they do not influence human events; therefore, they are useless; therefore they do not exist. (*Quod erat demonstrandum.*) Quoted in Frank H. Knight, "Intelligence and Democratic Action," p. 57.)

The event occurred in 1610—long after man had supposedly emerged from the darkness of the Middle Ages to the light of the Renaissance.

That type of reasoning has not yet disappeared. It has survived in fields other than astronomy, in lands other than Italy, and times even more enlightened than the 17th century.

Today, for example, one can still find economists who argue as follows: (1) Monopoly power exists in theory but is rare in practice; (2) it cannot be measured with elegant precision; (3) being unmeasurable, it cannot possibly be widespread; (4) even if it were widespread, it would be held in check by interindustry competition, the corporate soul, the gales of creative destruction, countervailing power, congressional investigations, and Presidential admonition; and (5) in any event, there is no urgency for public action until further research has unearthed the "final answers."

Now, Mr. Chairman, I do not happen to take this rosy view of things. Conceding the fact that monopoly power is never absolute—that no system of price administration is ever foolproof—I submit that concentrated economic power is a fact of American life. It exists; it is pervasive; it is dangerous. It poses what I consider the No. 1 domestic problem of our time—the prevalence of private socialism in what we like to think of as a free enterprise economy.

Let me explain the different types of market power—conglomerate, vertical, and horizontal—by using the General Motors Corp. and the auto industry as an example. And I will confine myself to that industry and that company for purposes of illustration.

(1) Conglomerate power: This means that a firm's operations are so widely diversified that its survival no longer depends on success in any given product market or any given geographical area. Its absolute size, its sheer bigness, is so impressive that it can discipline or destroy its more specialized competitors.

General Motors, of course, possesses conglomerate power. Until recently part of the giant Du Pont empire, this corporation is not only the largest automobile company in the world, but also a significant factor in diesel locomotives, buses, trucks, refrigerators, electric ranges, auto financing, batteries, earthmoving machinery, et cetera.

This corporation could decide to enter the ice cream industry—intent on capturing 20 or 40 or 100 percent of the sales—and succeed in this endeavor. It would matter little whether GM was indeed an efficient ice cream manufacturer or whether its ice cream was indeed tastier than more established brands.

By discreet price concessions, saturation advertising, and attractive promotional deals, it could commit its gargantuan financial power to the battle until only so much competition as GM was prepared to tolerate would be left in the industry.

Remember that, in good years, the annual profits of General Motors are roughly as big as the combined assets of Borden and National Dairy.

Put differently, in a poker game with unlimited stakes, the player who commands disproportionately large funds, is likely to emerge victorious—regardless of ability, virtue, or luck. He has the one asset the others lack, viz, the power to bankrupt his rivals. Given the laws of probability, his power alone tends to be decisive.

Now, let me skip vertical power and move on to (2) horizontal power, which is market control in its pristine classical form. It consists of dominance over an industry—in relative, percentage terms—and is manifested in entry controls, price leadership, and follow-ership, and other assorted forms of oligopolistic cooperation.

General Motors, with its more than 50-percent control over the automobile industry, is a prize example of horizontal power. Its decisions what to produce, where to produce, how to produce—what price to charge, what target profit to aim at, what means of raising capital to employ—these and similar decisions have a profound impact not only on its fellow oligopolists, but the whole automobile industry, the American businessman, the American consumer, the American worker, and the American economy.

These are decisions which affect the general public, but they are made by a private government—subject to only the loosest public control and involving only the remotest participation of our democratic citizenry.

This horizontal power is manifested in different forms:

(a) Pricing, for example. General Motors sets its prices so that—over the long run and assuming “standard volume” (operations at roughly 80 percent of capacity)—they will yield an average profit (after Reuther and after taxes) of 15 to 20 percent on invested capital.

This is called target-rate-of-return pricing. It is the same cost-plus system of pricing used in the regulated industries—with this difference: the rate of return allowed a public utility is determined by a Government regulatory commission, whereas the General Motors rate is determined by the company itself. It is not imposed by the autonomous forces of the marketplace as in a competitive industry; it is not imposed by a public regulatory commission; it is the private exercise of discretionary power by a corporation with dominant control of the market.

Not only does General Motors possess this market control, but, as the Kefauver committee hearings showed, it has been amazingly successful since World War II in exercising such control and achieving its self-determined and predetermined target rate of profit.

That it was able to do so is partly due to the slavish pliability of its major rivals. The latter have simply not chosen to challenge GM's price leadership, and contented themselves to follow, within rather narrow limits, the lead of the industry's giant.

I will skip the illustrations. I think this committee is familiar with them.

(b) A second manifestation of horizontal power is in the field of product design. While the automobile industry in the days of Henry Ford I was an arena of price competition—with companies reaching out for "the other 95 percent of the market" by competitive price reductions, the rise of General Motors ushered in a diversion of the industry's competitive energies into nonprice rivalry.

Whereas Henry Ford told his customers that they could choose any color automobile as long as it was black, the industry, by 1960, was offering more than 300 different passenger models, and the manager of GM's Chevrolet Division boasted that his factories were turning out a custom-made car for almost every buyer.

Chevrolet, he said, offers the buyer so many combinations and permutations of body style, color, trim, and equipment options that (without counting accessories) Chevrolet could have produced its entire 1960 output of 1,850,000 passenger cars without making any 2 of them exactly alike.

Price cutting to tap new layers of domestic or foreign demand had become an anachronism, only to be replaced by advertising outlays, annual model changes, and the horsepower race. The automobile, no longer a mere vehicle for transportation, was made a complex and luxurious amalgam of superengines, tailfins, quadruple headlights, and a cornucopia of chrome. Inevitably, its cost of production and price increased steadily and alarmingly.

Again I will skip the documentation of this proposition.

(c) Now, a third manifestation of horizontal power—and, Mr. Chairman, if I may underscore this, I think it is terribly important—the export policy of these companies:

How should American automobile companies supply their overseas markets? Should they utilize and expand their domestic facilities, or rely on their foreign subsidiaries? Should General Motors supply its overseas market from Detroit, Flint, or Lansing, or from the Opel factory in Germany, the Vauxhall factory in Great Britain, or the Holden factory in Australia? Should Ford turn to River Rouge, or to Dagenham, England, and Cologne, Germany?

The choice that is made has an obvious impact on the volume of private investment at home, on employment, on purchasing power, on economic growth—and even on Government tax receipts.

Shortly after World War II, according to press reports, General Motors was contemplating the marketing of a new "small" car to be produced at a new plant built somewhere in the United States. This was the Holden, and its production facility was eventually located in Australia.

This decision apparently became a policy trend in the industry. In 1958, J. Wilner Sundelson, manager of facilities and operations planning, Ford International Division, openly said:

\* \* \* in our planning, we have taken the view that vehicle exports from the United States, which are playing a declining role in Europe, will virtually vanish. \* \* \* Given the geographic penalty of the U.S. exporters in the European market \* \* \* it will readily be understood why we do not anticipate selling many U.S.-made cars in 1970 in the Common Market. Not only vehicles and vehicle components but parts and accessories will be exported from the United States in limited quantities.

In 1961, Frederic G. Donner, chairman of the board of General Motors, echoed these sentiments:

\* \* \* we will build cars and trucks in the United States for the home market and for those markets that want American-type cars, and we will continue our long-time policy of building cars abroad for sale in our overseas markets.

No wonder that American automobile exports between 1950 and 1959 declined from 120,000 to 104,000, while GM's Opel exports from Germany increased from 25,000 to 169,000, the German Ford exports rose from 8,000 to 65,000, and Chrysler's Simca exports from France rose from 7,000 to 121,000.

No wonder that the percentage share of American automobile exports declined radically not only in Europe and the world at large, but also (and significantly) in the Latin American market at our back door.

Again I say that the effect of these decisions by American companies had an obvious effect on domestic production, employment, payrolls, growth, tax receipts, and the U.S. balance of payments.

In commonsense terms, ask the people of Detroit. They understand the implications of this. The answer is jobs, payrolls, purchasing power, and the economic welfare of the State of Michigan.

(d) Market results: What are the results of these kinds of policies?

Let me try and approach an answer by talking first about the domestic effects, and secondly about the international effect.

Now, in the domestic market, the effect of this pricing and product design policy became obvious between 1955 and 1959, with the tremendous increase in imported cars. These imports from Europe increased in number from 57,000 to 668,000, and their relative share of the American market rose from less than 1 percent in 1955 to more than 10 percent in 1959.

The reasons, according to a survey of the National Automobile Dealers Association, was that the imports were cheaper to operate and gave better gas mileage, et cetera. Again, the record shows the relative prices of the European imports held the line, whereas, of course, the prices of American models kept going up. American cars became ever larger gas guzzling monsters sold at ever higher prices to the American public.

In the international arena, too, there is dramatic evidence that the Big Three's price, product, and export policies have caused the United States to lose out in world markets.

In the motor vehicle exports to the world at large (excluding the United States), according to the Department of Commerce, the U.S. share has declined from 41 percent in 1954 to 26 percent in 1960. At the same time, Germany's share rose from 16 to 24 percent, and that of the other OEEC countries from 15 to 25 percent.

Even in Latin America, again, an area in which we enjoy massive advantage, and which by geography and tradition is so closely tied to the United States, the U.S. market share declined from 81 percent in 1954 to 65 percent in 1960, while the shares of the other countries, like the United Kingdom, Germany, and the OEEC countries, kept going up.

Put differently, the "short fall" in U.S. automobile exports between 1954 and 1960 amounted to some \$656 million. That is, if American exporters had been able to command the same share of world markets in 1960 as they held in 1954, the United States would have earned an additional \$656 million through automobile sales abroad. This is the largest "short fall" of any manufactured commodity group—followed by iron and steel, industrial machinery, agricultural machinery, and tractors; again, highly concentrated industries.

Clearly, then, the Big Three have priced and designed themselves out of world markets on the one hand, and have made the conscious decision to supply oversea markets from their foreign subsidiaries, on the other. The impact of these private corporate decisions on domestic production, employment, and growth require no elaboration.

Now, Mr. Chairman, by using General Motors and the Big Three in the auto industry, as an example—and no more than an example—I have tried to illustrate the existence of the vast discretionary power in the hands of some large corporations.

That power—

as Justice Douglas once said—

can be used with lightning speed. It can be benign, or it can be dangerous.

In a democracy, dedicated to free competitive enterprise, such power should not exist. It should be decentralized.

It should be scattered into many hands, so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability, of a few self-appointed men.

The fact that they are not rapacious robber barons, but respectable and social minded, is irrelevant. The fact that they are imbued with the "corporate soul"—a sense of social responsibility—may qualify them to decide what is good for General Motors; it does not entitle them to determine what is good for Detroit or good for the United States.

Such decisions, in a democratic economy, are the function of the competitive marketplace. And when a corporation or group of corporations become so big that they are immune from the regulation of competition—so big that they constitute what amounts to a private government—then those corporations are too big for their own good, and certainly too big for society's good. They then become an instrument of private socialism which is incompatible with both free enterprise economics and political democracy.

I shall have specific recommendations what to do about that situation in the question period, Mr. Chairman.

Chairman PATMAN. Thank you, Dr. Adams.

Dr. Alfred E. Kahn is next, I believe.

**STATEMENT OF DR. ALFRED E. KAHN, PROFESSOR OF ECONOMICS,  
CORNELL UNIVERSITY**

Dr. KAHN. Yes, Mr. Chairman.

I will try to summarize my statement orally.

Chairman PATMAN. The statement of each one of you will be inserted in the record at the time of your appearance, and then you may comment as you desire.

Dr. KAHN. Thank you.

(Statement referred to follows:)

**STATEMENT ON MARKET POWER IN RELATION TO ECONOMIC GROWTH**

(By Alfred E. Kahn, professor of economics, Cornell University)

As I understand it, the Joint Economic Committee's present sequence of hearings is concerned principally with the current state of our economy, in particular with such questions as whether the recovery of the last 18 months is coming too soon to a halt, and what if anything can be done to sustain the expansion of economic activity and in so doing to make fuller use of a still too large volume of idle labor and plant. Such relatively immediate questions necessarily cause you to focus your attention principally on current issues of fiscal and monetary policy, because these are by far the principal instruments of policy for exerting relatively immediate and short-run influences on the pace of economic activity.

In contrast, the questions to which the committee has turned in the last day or so, concerning as they do the basic structure of our economy, the adequacy of the continuing stimuli it provides for expansion and of the limitations it imposes on the antisocial exercise of market power, are inevitably longer run in character. The policies it calls into question are not of a kind that can or should readily be varied with the stage of the business cycle, to sustain a halting business recovery or prevent a threatened recession. Indeed, they may even complicate the problems of economic stabilization: growth in a free society (perhaps equally in controlled economies as well) naturally proceeds in waves and spurts, and the institutions of free enterprise that promote innovation and expansion probably also accentuate short-run instability in some ways.

At the same time, I think there is a particular compatability, here and now, in mid-1962, between the various goals of long-run growth, price stability, and reinforcing and extending the current, halting recovery, that makes it important for this committee to consider not merely our current monetary and fiscal policies but also the adequacy of our market institutions to the promotion of these various purposes. I say this for two reasons. The first is that somewhere in the mid-1950's the American economy apparently came to the end of a long boom—a 10- to 15-year boom, depending upon whether one includes the World War II period. The consequence of this relatively long-run change is that the remedy for the principal economic problems that have been troubling us since that time—sharply reduced rates of expansion of gross national product, a trend to a decreasingly full utilization of our human and physical plant, rising unit costs of production translated, at least at certain times and in particular sectors of the economy, into rising prices—is not in my opinion to be found merely in short-term stimulants for effective demand, important though I regard such stimulants to be at this time. Second, we have become sensitized in the last 5 years or so to the dangers of creeping inflation, a growing sensitivity forced upon us by our changed balance-of-payments situation, among other factors. It becomes important therefore to ask more fundamental questions of how and whether a sustained general expansion can within the framework of our present market institutions be rendered more surely compatible with stability in the general price level, with an improved rather than a deteriorated competitive position of American products in world markets.

It is not necessary for my purposes to examine at this point the important and controversial question of whether the private economy alone can in the next decade, even with the assistance of such stimuli as tax reductions and reforms, bear the major burden of this expansion, or whether, alternatively, the remedy for the termination of a boom powered primarily by private expenditures must be a corresponding expansion of public effort. Nor can I here enter



into the equally important controversies about the respective merits of devoting additional resources to the satisfaction of private market or public needs. It seems to me that in any event there can be no disputing the particular relevance at this juncture of considering the extent to which the structure of our private markets is conducive to long-term growth, and the ways in which their growth potential might be improved. This, it seems to me, is the relevance of the particular subject that I have been asked to discuss: does the existence of centers of market power in important areas of our economy, in both labor and product markets, impede economic growth?

The first possible connection between market power and economic growth is one that this Committee has already considered at great length in its enormously valuable hearings, studies and reports on "Employment, Growth, and Price Levels." This is the possibility, variously described and characterized, that market power may itself be responsible for a persistent tendency for costs and prices to rise, even when the level of aggregate demand in the economy at large falls short of what would be necessary to maintain adequately full employment.

The principal significance for economic growth of this tendency is of course that the goal of price stability tends in these circumstances to counsel monetary and fiscal policies restrictive of further expansion of aggregate demand, even though resources remain incompletely utilized; and if the experience of the 1940-55 boom shows anything, it shows that our economy grows most rapidly when it is subject to continuing pressures of demand on productive capacity.

There is no room for doubt that market power played a significant role in the disturbing increases in the general price indexes during the 1955-58 period. As I pointed out in a statement to this committee on February 3, 1959:

"It was an unmistakable sign of monopoly power that the steel industry could raise prices in 1957, with operations slumping, and again mid-1958, when it was working at less than 60 percent of capacity; it was equally a sign of monopoly power that the steel workers' wages (and the industry's unit labor costs) could have been boosted in those circumstances—in the second instance with well over 100,000 steel workers unemployed."

The continued increase in the price of new automobiles after 1955, when sales ran continuously below that 1955 peak, was, I averred, another "sign of ineffective price competition. The contrast between the behavior during the recent recession of the prices of aluminum and steel on the one hand and copper and zinc on the other, of crude oil on the one hand and of petroleum products on the other is simply inexplicable except in terms of the different degrees of market control over these groups of goods. I have no doubt either that some part of the rise in prices of services, which has played so important a role in boosting the cost of living, itself reflects wage and price administration, rather than the mere upward pull of demand."

The more thorough investigation and explanation by Prof. Charles L. Schultz of the inflationary tendencies of these years, expounded in a study prepared for this committee, which places heavy emphasis on the sharply increased demand for producers' durable goods in the 1955-57 period, likewise rests heavily on market power—a power reflected in the failure of prices and wages in other sectors of the economy to decline, in the tendency instead for wages elsewhere to rise in imitation of wage trends in the booming sectors, and in the so-called ratchet effect, resulting from the downward rigidity of prices and wages in producer durables after the booming demands subsided.

On the other hand, it is as yet not at all clear to what extent the 1955-58 experience was unusual, to what extent instead the tendency to market-power inflation is really chronic in our economy. As I pointed out in my earlier statement to this committee, there were bases for the former interpretation: witness, for example, the lingering inflationary influence in the steel industry of a 3-year labor contract, signed when demand was still strong and providing for annual increases in wage costs far greater than the historic growth of productivity, increases that went into effect in subsequent years when demand steadily declined. Moreover, while it is certainly clear why monopoly power in product markets would tend to produce levels of price higher than those that would prevail if markets were more competitive, it is less clear why monopoly power should be expected to produce prices continuously rising relative to the competitive. Monopoly power is the power to hold price above cost, however defined; it is not the power continuously, year by year, to raise prices relative to cost, or to exact perpetually widening profit margins.

Finally, the course of prices in the last 4 years no longer affords much support for the market power inflation thesis. The wholesale price index has been stable. The consumer price index and GNP deflator have continued to rise, but at a diminished rate, and it is doubtful that a cross sectional analysis of their components would show any correlation between price increases and concentration of market power.

I do not suggest that the market power inflation thesis should therefore be laid to rest. On the contrary, I believe that some such inherent tendencies exist, though I think they still await a wholly convincing explanation and demonstration. It hardly answers the market power inflation thesis to point out that wage and price increases have abated in a period when monthly unemployment has chronically exceeded a (seasonally adjusted) 5 percent of the labor force—entirely apart from part-time work and the withdrawals from the labor force that seem to occur when job opportunities diminish—and when the rate of utilization of our productive capacity has failed to break a long-run downward trend. That thesis does not deny that a sufficient constriction of aggregate demand can hold wage and price increases in check; on the contrary, it is its very essence that market power poses the dilemma for public policy of having to choose between the goals of price stability and full employment. The fact that we have apparently come close to achieving the former at the sacrifice of the latter does not prove, in contradiction of that hypothesis, that we can have both simultaneously.

In short, my suggestion about market power inflation is a modest one. First, the only verdict I am prepared to recommend at this stage is something like a Scotch one—"extent of guilt not proved." And second, I would like to see the committee reexamine the question in light of our experience during the 2½ years since it published its excellent staff report on "Employment, Growth, and Price Levels," to try to come closer to a determination of whether the 1955-58 experience was more or less unique, or the relative price stability we have had since reflects nothing more than our having chosen to impale ourselves on one rather than the other of the horns of the dilemma.

We can hardly take satisfaction from relative stabilization of prices in a period that witnessed one aborted recovery—the committee is in a sense trying to find out whether the number is now two—one recession, and a failure to break the long-run decline in the percent utilization of our productive plant. We might usefully remind ourselves that the original concerns about the behavior of so-called administered prices, tracing back to the 1930's, revolved not around any alleged tendencies to rise chronically, but around their resistance to downward pressures in periods of recession, declines in demand being reflected in reduced production rather than reduced prices. Those earlier controversies were never wholly resolved either, and I do not attempt to resolve them here. But they do suggest two relevant observations.

First, while I think most economists would agree it is highly doubtful that prices more flexible on the downside would prevent, cure, or even moderate general recessions, it is almost certainly true that if rigid prices in periods of excessive unemployment engender an understandable reluctance on the part of the Government to ease credit, reduce taxes, or expand its spending, in the fear that any such efforts would upset the precarious price balance, then recession price rigidity does, in fact, pose a definite obstacle to recovery. If prices went down in recessions, there would certainly be less hesitation on the part of the Government about trying to expand effective demand. And second, rigid prices may have quite a different overall significance in periods of general and widespread economic decline, when it is quite possible greater downward price flexibility might accentuate rather than moderate the general deflation, and in periods of merely inadequately rapid growth such as our economy has experienced in the last 5 to 7 years.

For if there is one point about the relationship of prices to growth on which I think most economists would agree, it is the point that Dr. Nourse has been expounding for the last 25 years: that one essential for economic progress in a private enterprise economy is the aggressive pursuit of price-reducing policies by its leading business firms. And this brings me to the second, and in my judgment more important, of the possible relationships between market power and growth that I wish to call to your attention today. I refer to the implications of market power with respect to the dynamic quest for new, cost-reducing processes and products, the unremitting probing of the longrun elasticity of demand by continuous price reductions over time, that are a prerequisite of satisfactory growth in a private enterprise economy.

Many words have been devoted to the general question of whether monopoly or competition is more conducive to economic growth. Much of this discussion has been illuminating, not because it has answered that question, but because it has demonstrated that it is unanswerable as stated. Everything depends on what kinds of monopoly or competition one has in mind, and where. To illustrate the latter, monopoly is probably a prime obstacle to economic progress in many underdeveloped countries of the world today—market power in the hands of entrenched, protected, quasi-feudal and entirely unaggressive, unprogressive, and unenterprising propertied classes. On the other hand, monopoly power was probably an important contributor to economic growth in late 19th century Japan and Germany; there monopoly power enjoyed by an emerging entrepreneurial class, intent on borrowing the best of foreign technology or developing and applying its own, probably conduced to higher levels of saving, capital formation and research than would have been achieved under more purely competitive conditions.

In the same way, the limitations on competition that give a successful innovator some protection against immediate imitation and deprivation of the fruits of his efforts, the prospect of temporary monopoly profits that result from successful, risk-taking innovations, and the business size, integration, and financial resources necessary for the conduct of continuing, longrun research efforts—all these elements and kinds of monopoly are, within limits, doubtless necessary for progress in the American economy today. But, it is equally true, the monopoly power that results from collusion and combination, from private or governmental restrictions imposed on competition, the market power that arises or is exerted precisely to ward off the profit- or wage-depressing effects of technological progress itself or of the entry of new, lower cost supplies, can only be obstructive of economic progress.

It is unnecessary to try to answer the general, and in my opinion meaningless, question of whether monopoly or competition is more conducive to economic progress in order to recognize that the cause of progress is not served by an industry that reacts to declining demand or to intensified competition from lower cost suppliers by raising or even just maintaining its prices, reducing break-even points, or seeking tariff protection. The same observations obviously apply also to unions that push up wages in the face of mounting unemployment, or pose unreasonable obstacles to the introduction of technological improvements. Economic growth in these circumstances requires instead more intensified competitive pressures and efforts, reductions in prices and unit wage costs rather than increases.

It is at this point that the obstacles posed by monopoly to the processes of economic expansion merge with the problem of market power inflation. Growth requires cost-reducing innovation and a passing on of some of those savings in lower prices to consumers. So does overall price level stability. If instead the benefits of above-average productivity advances are eaten up by wages and profits in the industries experiencing those advances, it is highly likely that the average price level will rise, and that a drag will be exerted on economic growth. Prices in the rapidly progressing lines remaining constant, there is no reason for consumers to buy more of their product; therefore labor will inevitably be displaced by the technological progress. Since the wages of the displaced workers have in effect been taken over in higher profits, rents and wages of the laborers that remain employed, the technological advance is not covered into the expanded purchasing power that would be required to absorb those workers in alternative employment.

Wages in other industries are unlikely to fall under pressure of these additional workers seeking jobs there, partly because wages are highly inflexible on the downside, and partly because the pattern of wage increases in the rapidly advancing sectors will operate instead to force them upward elsewhere as well, regardless of the state of employment there. Absorption of the technologically displaced workers will therefore require an expansion of aggregate money demand that can come only by some infusion of additional purchasing power from the outside, the failure of prices to decline in the rapidly advancing industries having eliminated the possibility of the required expansion of aggregate demand being generated automatically by the process of technological change itself. If such an infusion of additional purchasing power sufficient to absorb the displaced labor is, in fact, forthcoming, wages and prices generally are likely to rise rather than fall. So, once again, the economy faces the dilemma of having to choose between higher levels of unemployment or a general price increase.

The essential point is that given rigid prices in the rapidly progressing industries, there is no automatic tendency to reemployment of the technologically displaced workers in those very lines; to the extent instead that competition forces prices to fall as costs fall, the economy has an automatic tendency to absorb the unemployed in expanded output without the need for governmental or other external stimuli.

In light of these considerations, the fact that reported corporate profits declined in relationship to sales and to total national income in the 1950's does not necessarily absolve the limited price competition in many of our leading product markets of all responsibility for the inflation of 1955 to 1958 or the relative stagnation since that time. The price increases, as Professor Schultze pointed out, were in considerable part attributable to the attempt of our highly concentrated industries to recoup rising unit costs and to preserve accustomed profit margins as the percentage utilization of their capacity declined. The fact that the attempt was incompletely successful does not mean that it was healthy for the economy for it to have been made. Boosting or even maintaining prices, trying to get by on accustomed, conservative profit margins and low break-even points is not the way to restore profits as a percentage of sales or to promote more rapid economic growth in the presence of excessive productive capacity. Indeed, if made by many firms, the effort could well have been self-defeating, having had the net effect of reducing the buying power of the consumers' dollar and putting on Government a correspondingly greater responsibility for promoting recovery and fuller employment. The only possible cure for low profits, as this committee itself recently suggested in its annual report of March 6, 1962, is a fuller use of capacity; the price policies of the last several years have not contributed, but have instead detracted from the achievement of that goal.

It is much easier to expose the ways in which market power blocks economic expansion than to propose effective, practicable remedies. The available weapons of public policy are almost all indirect. All of them have inadequacies and limitations. But there is no reason to believe that together they would prove insufficient if—and this is the critical condition—they were resolutely applied, in recognition of the overriding public interest in economic growth combined with reasonable price stability. First, there are of course the antitrust laws. They are important; they do help. And, as is perfectly apparent, there are also important aspects of market power—notably noncollusive oligopoly pricing and union influences on wages—that they are presently incompetent to handle. The laws could of course be reframed to bring these kinds and manifestations of market power within their jurisdiction. But as I stated to the committee several years ago, I am frankly uncertain that there can be demonstrated either the efficacy or the need for such measures as could practically be adopted, or the practicability of such measures as might significantly reduce market power.

Second, and more important, the Government should—whether it can find the will to do so is another matter—stop its all-too-prevalent practice of resolutely stepping in to prevent competition every time a price threatens to decline, a profit making to be squeezed, a job to be lost.

I refer to such steps—most of them uncomfortably reminiscent of NRA—as the mandatory quotas placed on the importation of crude oil in the last several years; the progressive cutbacks of petroleum production by State authorities in the name of conservation, cutbacks that hold up prices and protect marginal, high-cost producers from a deserved competitive extinction, and also encourage drilling of grossly excessive wells, the annual costs of which are estimated to run into hundreds of millions of dollars; the whole attempt to remedy the evils of rural poverty and agricultural income instability by supporting prices, a method that helps least the farmers that need help the most, while denying consumers at home and abroad the benefit of the astounding technological progress of our farms; the whole complex of controls by which the various regulatory agencies, most obviously in the transportation fields, keep the companies under their charge from competing with one another; the invocation of heightened barriers against imports under the escape clauses of our reciprocal trade agreements; the resort to fair trade; and so on. I do not suggest that the problems with which these various policies attempt to deal are susceptible of easy solution. But I do suggest that they are far too often resolved in the easy way from the standpoint of the interests directly involved—by protection and insulation—and the wrong way if the Government is to give adequate heed to the broader public interests in economic growth and general price level stability.

It is no less true of governmental than of private efforts that if the general price level is to be held stable, individual prices must be permitted to fall; and that if constantly new and better ways of doing things are to be introduced, then there must be permitted some injury to, or at least discommoding of, private parties who have an interest in the older and less efficient ways of doing things. If we truly want growth under private enterprise combined with price stability, then we must permit price competition fuller play, especially when it hurts. We must give the railroads greater freedom to compete with other transportation media; and, for exactly the same reason, it seems to me we must give the proposed coal pipelines the right of eminent domain that they require in order to realize the potential of this existing technological advance in competition with the railroads.

An important step in this task would be the enactment of the trade agreement legislation that the President has requested. Even with our present levels of import duties, probably nothing has been more effective in recent years in halting the wage-price spiral in automobiles—and to a lesser extent in steel—than imports. By exposing our industries to the competition of the burgeoning and aggressive industries of the Common Market, as well as giving them freer access to that growing market, we can supply not just a negative check on market power at home but a much-needed positive competitive spur to innovation and growth.

These proposals are essentially negative and permissive. As is appropriate in a private enterprise economy, the principal function of Government would be to release (and to refrain from restraining) the competitive energies and efforts of private individuals. This is especially true in the area with which my present statement is concerned, that is to say, in handling the problem of private economic power. I cannot conclude without setting forth my strong opinion, however, that there is much also that the Government can and must do on its own initiative to promote growth. I refer here not merely to the importance of reconsidering how tax, procurement, and monetary policies might better be adapted to assist rather than hamper small, growing companies. In addition, I would emphasize the desirability of growing governmental assistance to research, both pure and applied, and particularly to research in areas such as housing and the services, which have on the one hand made a disproportionately large contribution to price-level increases since World War II, and are on the other far too dispersed and small scale in their organization to be able to conduct research themselves; increased governmental efforts in the areas of education, in retraining and improving the skill of our growing labor force, and improving the mobility of displaced workers; and direct intervention in such areas as urban transport. All these would not only make a major direct contribution to economic growth, but would in my judgment also impose dynamic limitations on entrenched market power and improve the effectiveness with which our private, competitive economy meets the challenges of the 1960's.

Dr. KAHN. Before beginning my contribution of this discussion of the relationship of our market structures and the problem of monopoly in particular to economic growth, I wonder if I may suggest, at least as an expression of my own opinion, that, important though I regard this problem of market power, and in fact it is my professional function and area of specialization to regard it as important, I think it would be extremely unfortunate if at least my remarks—I cannot speak for the other gentlemen at the table—left the impression that our tax, our fiscal, and our monetary policies are not likewise of critical importance in affecting the rate of our economic growth both in long-run terms, and also at this particular juncture in the development of the American economy.

Nothing I will say here is intended to suggest, for example, that a tax reduction would not be desirable today.

And when I get to a very brief discussion of possible approaches to the problem of market power, I think it will be abundantly clear that there are not available, practically available, basic changes, basic reforms, of our markets, such as would solve the problem of the halting recovery in which I think we now find ourselves.

I do not see any incompatibility between saying, on the one hand, that we must continuously give emphasis to the structure of our economy, the functioning of our markets, the effectiveness of the competitive private enterprise system in contributing to economic growth, and on the other hand that we must emphasize the great importance of credit policy, of fiscal policy, in posing obstacles to growth, acting as a drag on growth, as the President has put it, and in the present juncture of the economy acting in my opinion as a definite drag on full recovery.

With that introduction, I will attempt briefly to summarize my remarks.

While this committee's principal attention this month is directed toward the question of the adequacy of our present recovery, the question of whether it is grinding to a halt, and whether, therefore, there ought to be changes in our monetary and fiscal policies, it seems to me particularly important today to consider also the adequacy of our market institutions.

I say this for two reasons.

First of all, I think it is fairly clear that somewhere in the mid-1950's—I do not care whether one dates it in 1955 or 1957; it cannot be any later than 1957, and I would suggest 1955—the American economy apparently came to the end of a long boom in economic activity.

That boom was a 10-year boom, or a 15-year boom, depending upon whether one wants to include the World War II period. This is a familiar cyclical phenomenon throughout American history, and I think we make a mistake if we regard the development since 1955 or since 1957 as simply a short-run inventory kind of phenomenon that can be very simply resolved by supplying short-term stimulants for effective demand.

The symptoms of this long boom on the one hand and of the termination of that boom on the other are very familiar. The President made most of those symptoms familiar to us in the campaign in 1960. We have since 1955 witnessed sharply reduced rates of expansion in our gross national product, a definite trend, which, incidentally, is clearly documented in the report of this committee issued in March of this year, toward decreasing full utilization of our human and physical plant, and a tendency to rising unit costs of production translated into rising prices.

The second reason why we must look to our market structure is, as this committee has become very much aware in the last few years, the threat that more satisfactory rates of growth may involve a renewal of creeping inflation. And we are increasingly sensitive to this danger because of the problems of our balance of payments, among other reasons.

In these circumstances I think it is very important for this committee to ask fundamental questions about whether a sustained and improved general expansion of our economy can, within the framework of our present market institutions, be rendered more truly compatible with stability in the general price level; with an improved rather than a deteriorated competitive position of American products in the world markets.

So, for this reason, it seems to me of particular relevance at this time to consider the extent to which the structure of our private mar-

kets is conducive to long-term growth consistent with reasonable price stability.

Now, there are two possible ways in which market power in our economy may bear unfavorably upon economic growth. And I document these at considerably more length in my prepared statement.

The first is the possibility, variously described and characterized, that market power itself may be responsible for a consistent tendency for costs and prices to rise, even when the level of aggregate demand in the economy falls short of what would be necessary to maintain adequately full employment.

The significance of this tendency for economic growth is of course that our goal of price stability tends, in these circumstances, to counsel monetary and fiscal policies that are restrictive of economic expansion.

Now, I think there is no room for doubt that market power did play a significant role in the disturbing increases in the general price level during the 1955 to 1958 period. I allude in my prepared statement to a statement that I made before this committee on February 3 of 1959, on precisely the subject. As I pointed out at that time, it was a clear evidence of monopoly power in product markets and monopoly power in labor markets that the prices of automobiles and steel continued to edge upward in the 1955 to 1958 period, even when the demand for both products peaked out in 1955.

The number of cars sold in 1956 was less than in 1955. It remained well below the 1955 level throughout all the remaining years. In fact, we have just this year come to a year that is not quite as good as 1955. Yet the price of an automobile by any test—I agree completely with Professor Adams—went up continuously in this period.

The case of steel is even more clear; 1955 was the peak steel year. There was less steel sold in 1956 than in 1955, less in 1957 than in 1956, and less in 1958 than in 1957. Steel wages went up, when we had over 100,000 workers out of work; and steel prices likewise continued to go up in these circumstances.

I refer also in my statement to the excellent monograph prepared by Prof. Charles Schultze for this committee in explanation of the inflationary tendencies of these years, in which he supplies a much more sophisticated and I think valid explanation of the phenomenon. But his explanation, too, relies very heavily upon market power.

Now, while still on this one subject, the relationship of market power to the possible danger of chronic inflation, I want to bring certain qualifications of the argument to the committee's attention.

One, we really do not know to what extent 1955 to 1958 was unusual. I pointed out in my own statement 3 years ago that there were many reasons to think that these years were in fact atypical: witness, for example, the effect of the 3-year labor contract in automobiles signed in 1955, which then carried over into increasing costs of 1956, 1957, and 1958. Or the 3-year contract in steel, signed in 1956, when demand was still high, which again carried over into wage and price increases in 1957, 1958, and 1959.

Second, I think the committee should recognize that prices have not increased in the last 4 years, at least wholesale prices have not increased, that the rate of increase in the deflator of the gross national product has diminished, the rise in the consumer price index has

slowed down, and I am quite certain that one would no longer find any clear relationship between the behavior of prices and concentration in product markets from 1958 or 1959.

I am not suggesting that the market power inflation thesis should be laid to rest. On the contrary, I think that there are such inherent tendencies in our economy. And I certainly do not think that it answers the market power inflation thesis to point out that wage and price increases have abated in the last few years, when we have had too much unemployment.

The whole point of the thesis is that we may face a dilemma of having to choose between very high unemployment, on the one hand, and price instability on the other. The fact that we have apparently come close to achieving price stability in a period when we have failed to sustain adequately high employment certainly does not disprove the hypothesis of administered price inflation, because what that hypothesis states is that we cannot have both simultaneously.

In short, my suggestion about market power inflation is a very modest one. The only verdict I am prepared to make is a Scotch verdict, or even a more academic verdict: "Extent of guilt not proved."

But I would like very much to see this committee carry on the really extraordinarily important work that it terminated about 2½ years ago in its various studies of "Employment, Growth, and Price Levels," to try to come closer to a determination of whether the 1955-58 experience was more or less unique, or whether the relative price stability that we have had since reflects nothing more than our having chosen to impale ourselves on one rather than the other of the horns of the dilemma.

I think it useful for the committee to remind itself that the whole controversy about administered prices started in the 1930's. And at that time what we were worried about was not any tendency to chronic inflation in administered price sectors of the economy, but the failure of those prices to decline in periods of business recession. The stability of prices in these sectors during the last four years, in a period when we have had a chronic underutilization of capacity, may be just as bad as the administered price inflation about which there has been so much more publicity in recent years.

There is one point about the relationship of prices to economic growth on which I think most economists would agree. It is the point that Dr. Nourse has been expounding for the last 25 years; that one essential for economic progress in a private enterprise economy is the aggressive pursuit of price-reducing policies by its leading business firms.

And this brings me to the second and in my opinion more important question about the possible relationships between market power and economic growth that I want to call to your attention today.

I refer to the implications of market power with respect to the dynamic quest for new cost-reducing processes and products, the unremitting probing of the long-run elasticity of demand by continuous price reductions over time, that are in my opinion a prerequisite of satisfactory growth in a private enterprise economy.

Now, there has been an enormous amount of discussion in the economic literature about whether monopoly or competition is conducive to economic growth. And I think it is a meaningless question.



There are certain kinds of monopoly that are useful for economic growth. I think that the kind of protection that the patent system gives, which is a kind of monopoly protection, while I would not at all accept all of the aspects of our patent law—I think the law needs reform in certain respects—still this kind of monopoly is conducive to growth within certain limits.

I think also to have firms that are large enough and stable enough and have a long enough perspective to engage in long-term research is conducive to economic growth. So certain kinds of monopoly in certain situations within certain limits are conducive to growth.

On the other hand, it is equally true that monopoly power that results from collusion, from combination of businesses, from private or governmental restrictions imposed on competition—the market power that arises or is exerted precisely to ward off the effects on profits or on wages of technological progress itself, or of the entry of new lower cost supplies, can only be obstructive of economic progress.

And I would say that the same observations obviously apply also to unions that push up wages in the face of mounting unemployment or pose unreasonable obstacles to the introduction of technological improvements.

In my statement I next present the thesis that the avoidance of inflation, on the one hand, and reliable, economic growth without Government infusions of purchasing power, on the other, both require this one phenomenon that we have not adequately witnessed in our economy in the last few years: declining prices in those of our industries that have experienced the most rapid expanding productivity.

Now, my explanation of this is rather lengthy and complex, and I think perhaps it would burden our time, since we have other gentlemen waiting, to bring it forth here. But the point is a very simple one.

If prices do not decline even in those areas in which we have had above-average rises in productivity, we are going to face a mounting problem of technological unemployment. These industries are not going to generate the increased consumer purchasing power necessary to absorb those workers. These workers are going to be a drag on the market. They might be absorbed, conceivably, if wages fell elsewhere. But wages will not fall elsewhere.

So the only way you can absorb these technologically displaced workers, if prices will not fall in these areas, is by turning to some such external source of stimulation as Government spending.

And here, I think, is the crux of the relevance of market power to the question that is posed before us today: Does our private enterprise economy have within itself a sufficient capacity to account for economic growth without turning continuously and in increasing degree to Government for assistance?

Incidentally, I am not satisfied that because corporate profits have declined in relationship to sales and to national income in the 1950's—I am not satisfied that this proves that there is no problem of administered prices.

The price increases of 1955-58, as Professor Schultze pointed out, were in large measure attributable to the attempt of our highly concentrated industries to recoup their rising unit costs and to preserve

their accustomed profit margins as percent utilization of capacity declined.

The fact that this attempt was not completely successful does not mean that it was healthy for the economy for the attempt to have been made.

This is precisely the kind of unenterprising, unaggressive, uncreative price policy, high margins at low volumes, that defeats the purposes of economic growth, and that defeats the purposes of having larger profits as well.

I will turn now to my concluding page, and say only a few words about what possible routes one may take to try to eliminate these impediments to economic expansion.

Let me say at the outset: I know of no simple answers. I know of no policies that can be suggested that promise both to be practicable and obviously and satisfyingly completely successful.

And it is for this reason, incidentally, that I emphasized at the beginning of my statement the importance also of monetary and fiscal policies. Sure, it would be wonderful if another White House Conference on Labor-Management Problems—and I attended the last conference and can speak with some knowledge about its limitations—it would be wonderful if another such conference or 10 more such conferences solved the wage-price problem. I think the conferences are useful. I think we must continue to have them. But I think we delude ourselves if we think that we can fundamentally change the processes of price and wage making in our economy by such conferences or indeed by anything that Congress can do. And for this reason I think it inevitable that this committee also give heed to what the Government can do, not merely with respect to market power, but by direct use of fiscal and monetary policies.

To come back to my text, there is no reason, however, to believe that the various kinds of policies that I will suggest, briefly, would prove insufficient if they were resolutely applied.

First, look at the antitrust laws. They are useful. I do not have anything very novel to say about them. The laws could be reframed to make them stronger in dealing with the things they cannot now handle, noncollusive oligopoly and union influences on wages.

But as I stated to the committee several years ago, and here I am sure I will disagree with Mr. Adams, I do not really believe we are going to get such a change in the antitrust laws. And I am frankly uncertain that we would get much better behavior of our economy if we did make the antitrust laws more stringent in dealing with oligopoly or with big unions. They might have the opposite effect. I do not believe one can really establish the efficacy or the need. And I do not want to waste my time tilting with windmills.

Second, and more important, the Government should—whether it can find the will to do so is another matter—stop its all too prevalent practice of resolutely stepping in to prevent competition every time a price threatens to decline, every time a profit margin threatens to be squeezed, every time a job threatens to be lost.

I refer to such steps, most of them uncomfortably reminiscent of NRA, as the mandatory import quotas put on crude oil in the last couple of years, and the cutbacks of production by State authorities. For month after month flowing wells in Texas have been producing

at 8 days a month, roughly at eight-thirtieths of their capacity, which has the effect not only of holding up prices, but protecting inefficient high-cost producers from a deserved competitive extinction, and also, by the way, encouraging the drilling of a grossly excessive number of wells, the costs of which are estimated to run to hundreds of millions of dollars each year.

I refer to the whole complex of controls by which our various regulatory agencies, especially in the transportation fields, keep the companies under their charge from competing with one another.

I refer to invoking heightened barriers against imports under the escape clauses of our reciprocal trade agreements.

I refer to fair trade, and so on.

I do not suggest that the problems with which these various policies attempt to deal are susceptible of easy solutions, but I do suggest that they are far too often resolved in the easy way, from the standpoint of the interests directly involved, by protection and insulation, and the wrong way, if the Government is to give adequate heed to the broader public interest in economic growth and general price level stability.

A third important step would be the enactment of trade agreement legislation that the President has requested. I refer, as Professor Adams does, to the fact that probably nothing has been more important and effective in recent years in halting the wage-price spiral in automobiles, and to a lesser extent in steel, than imports.

We must expose our industries to the competition of the burgeoning and aggressive industries of the Common Market, as well as offer them the opportunity of participating in the growth of that market.

Fourth, I do not want to conclude without mentioning an entire additional area of Government policies that seems to me of at least equal importance. And this is my last point. There is much also that the Government can and must do on its own initiative to promote growth. I refer here not merely to the importance of reconsidering our taxes, our procurement, and our monetary policies, and considering how they might better be adapted to assist rather than hamper small, growing companies.

In addition, I would emphasize the desirability of growing Government assistance to research, both pure and applied, and—let me emphasize this—particularly to research in areas like housing, and the services, which on the one hand have made a disproportionately large contribution to price level increases since World War II, and on the other hand, like agriculture, are far too dispersed and small scale in their organization to be able to conduct research themselves.

I refer to increased governmental efforts in the areas of education, in retraining and improving the skills of our growing labor force, and improving the mobility of displaced workers; and direct intervention in such areas as urban transport.

All these would not only make a major direct contribution to economic growth, but would, in my judgment, impose dynamic limitations on entrenched market power and improve the effectiveness with which our private competitive economy meets the challenges of the 1960's.

Senator PROXMIRE (presiding). Thank you very much.

The chairman unfortunately had to leave. He has asked me to take the chair.

Senator PROXMIRE. Dr. Lanzillotti, we will hear from you next. I understand you are head of the Department of Economics of Michigan State University.

**STATEMENT OF DR. ROBERT F. LANZILLOTTI, PROFESSOR AND CHAIRMAN, DEPARTMENT OF ECONOMICS, MICHIGAN STATE UNIVERSITY**

Dr. LANZILLOTTI. Yes, sir.

Senator PROXMIRE. We are very happy to have you with us. You may proceed.

Dr. LANZILLOTTI. I am very glad to be back here again, and to express my views on this particular subject.

As the other members of the panel have done, I would like to submit my statement for the record. I would like to summarize some of the important points that I have in here, and to underscore some of those statements.

Senator PROXMIRE. Without objection, your statement will be put in full in the record.

Dr. LANZILLOTTI. Thank you, Mr. Chairman.

(Statement referred to follows:)

**STATEMENT BY DR. ROBERT F. LANZILLOTTI, PROFESSOR AND CHAIRMAN, DEPARTMENT OF ECONOMICS, MICHIGAN STATE UNIVERSITY**

**INDUSTRIAL CONCENTRATION AND THE OBJECTIVES OF THE FULL EMPLOYMENT ACT OF 1946**

During the past few years, there has been an increasing degree of agreement that continued high concentration in manufacturing industry persistently aggravates and undermines the ability of monetary, fiscal, and tax policies to maintain full employment and stable prices in the American economy. While the question of whether concentration is increasing, and how fast, is not regarded as settled among economists in this field, the recent report of the Antitrust and Monopoly Subcommittee of the Senate Judiciary Committee should serve to reduce uncertainty on the issue. Between 1947 and 1958 the share of industrial output held by our 200 largest companies rose from 30 to 38 percent; this change cannot easily be explained away as a temporary aberration. Nor can the fact that large companies with employees of over 2,500 account for over 50 percent of industrial output and pay 47 percent of the total salaries and wages in manufacturing industry. Even if one questions the data as an accurate measure of a trend, at the very least the data provide persuasive evidence of the persistent high degree of concentration in the industrial economy.

Increasingly the hard core of the problem of industrial concentration, and its impact on the realization of the objectives of the Full Employment Act, is showing through and can no longer be dismissed as uncorrectable. Concentration of industrial output and its logical and inevitable accoutrements—discretionary pricing power, administered prices, administered production, and collusive behavior—are the visible and inescapable bones of the problem. Since technical jargon and overabundance of words oftentimes may obscure meaning on a problem such as this, it is my intention to be as brief and specific as possible in developing the foregoing propositions.

First of all, permit me to emphasize and underscore what I believe to constitute basic economic and political considerations governing any useful discussion of the problem currently before the committee; namely, the overriding importance in our goals of economic management of full employment and operation of existing plants at or near capacity utilization.

Businessmen and economists alike today recognize high output as a fundamental inducement to investment, whereas low output and idle, or unused, ca-

capacity seriously dampen incentive to invest. I hope that we have also advanced to the point where it is no longer controversial to argue that high employment accompanying high output levels is importantly related to a high rate of economic growth, and vice versa.

One of the painful lessons of the past decade is that a national economic policy designed to promote the stabilization of prices by relying directly or indirectly on deliberately continued unemployment has little chance of permanent success. More important, pursuit of this policy has meant a reduction in the rate of economic expansion of the U.S. economy. The lack of wisdom in such a policy has been thoroughly exposed by the activities of this committee, which, if I sense matters correctly, have contributed to a wider general understanding of the problem we face.

But, you may ask, what does this have to do with the relationship between economic concentration and economic growth? Just this. In the aftermath of the exposure of the fallacy of a national policy for inflation control predicated upon reduction in the rate of utilization of industrial capacity, this very restrictionist approach has been instituted as a fundamental corporate policy by large, pace-setting firms in the concentrated sectors of industry.

In effect, what has occurred over the past decade is that a thoroughly discredited policy of national economic management has been adopted as an operational policy of business management in firms that are large and have a substantial measure of control over their price situation. Indeed, corporations following a restrictionist policy have been accorded a great deal of applause and acclaim in the business community for their soundness, and their business acumen in being better able to stabilize prices and profits over cyclical swings. This bit of irony has had unfortunate but nonetheless predictable consequences. The aggregative effect of private restrictionist production policies by economically powerful corporations has produced what we wish to eschew, a national restrictionist posture.

This policy incorporates the target-pricing-target-profits approach which uses a "standard volume" of plant utilization. "Standard volume" actually means leaving idle as much as 20 to 30 percent of plant capacity as a production "norm." Who are the firms that pursue such a policy? They are the really large manufacturing companies in the United States, which operate under conditions where entry of new competitors is difficult and concentration has persisted. These are the industries where, for technical reasons, large aggregates of capital are required, where patents are important, and economic and marketing advantages accrue from large-scale operations over and above the technical efficiencies of a single plant. Corporations of this type have a recognized latitude or discretionary power in price and production policy.

One of the important characteristics of corporate price and production policy that follows the above line is the planning of capital investment with some built-in or planned excess capacity as a normal operating policy. Predetermined profits targets become a kind of "fixed cost" in this policy, influenced by a predetermined return on capital to support longrun investment plans. The absolute size of the targets is not the important thing, though they tend to be relatively generous. Under the circumstances investment considerations calling for a specific profit rate becomes the basic determinant of price policy, to deliver the flow of funds to meet the desired rate of new investment. The impact on economic growth and stability of large firms freezing minimum profit rates in their pricing policy is shown in Professor Schultze's excellent treatise for this committee. You will recall that he uses the freezing of profit rates to help reconcile the phenomena in the 1950's of credit stringency, recession, and price advances.

My position so far is this: The industrial sector of our economy is becoming more and more rigid and inflexible in its pricing and investment decisions. In part, this is attributable, especially in the large concerns, to rigidities in costs, the "fixed" commitments to stockholders and employees, long-term arrangements with suppliers and customers, and tacit understandings with competitors, which increasingly bind and constrain pricing, production, and investment decisions. What emerges is a tendency for existing price structures, however arbitrary, to become self-justifying.

The effect of these tendencies, in turn, has been to induce the really big manufacturing companies to behave more and more like public utilities, which is a very distressing development for a free enterprise system. One is obliged to ask: Do frozen profit rates, based upon cost-plus pricing, restricted production, with market-sharing overtones, characterize a promotive and innovative policy? I think not. This kind of approach essentially means pricing to satisfy overt

existing and foreseeable demand. It is "accommodational" pricing not promotional. It is neither experimental nor creative. In brief, pricing along these lines is sterile as an inducement to higher consumption, production, employment, and rate of economic growth.

Another question to be asked is: How are our industrial concerns likely to behave under this approach in inflationary and recessionary periods? I believe the answer is that both at full or near-full employment, and also in times of falling demand, we shall experience inflation in concentrated industries. A monolithic policy like that described will lead to inflexible and even irrational economic behavior. At times it will unwittingly lead to a callous disregard of the impact of discretionary corporate power on the stability of the economy.

The recent abortive attempt at a \$6-per-ton increase by United States Steel in the face of falling demand and stiffened foreign competition illustrates the point. Mr. Roger Blough's explanation and justification essentially was: "We had to have the price increase if we were to meet our profits target."

A corporate policy of creating idle capacity and unemployment; that is, basing pricing decisions on a planned underutilization of capacity by upwards of 20 to 30 percent over the long run, in my view, collides head on with the higher national objective of full employment and full use of industrial capacity. Can we expect to have a higher rate of economic growth and full employment when corporations in the concentrated sector of the economy gear their own operations to a level substantially short of full utilization?

This situation points up a principal defect in our antitrust laws; that is, their inability to cope effectively with market power created by large corporations acting unilaterally and jointly. In particular, I have in mind those cases where 8 firms or less account for 50 percent of market supply, or the top 20 count for 75 percent. This situation characterizes approximately two-fifths of our national markets and approximately one-fourth of the value of shipments of all national manufacturing industries.

Industries that have become concentrated and calcified, and that tend to undermine the objectives of national economic policy, are also the administered-price industries. This committee examined this problem extensively several years ago, so it should not be necessary to repeat the findings of that inquiry. Suffice to say that there is a rigidity and lack of responsiveness of administered prices to changes in demand and economic conditions generally due to jointly acting dominant companies. More responsiveness in prices and costs in the concentrated industries, would, in my opinion, be conducive to a higher rate of plant utilization, higher employment, and higher rate of economic growth.

Instead, however, we find more and more evidence of collusive conduct among ostensible competitors, including some of our largest and best known corporations. The widely publicized conviction of a number of electrical equipment manufacturers and the imprisonment of seven corporate executives for what *Fortune* magazine calls "The Incredible Electrical Conspiracy," highlights the cogency of the problem. The executives of these firms decided that operations at substantially less than full capacity could be profitable if collusive agreements could be reached on prices, market sharing, and bid rotation.

Unfortunately, the electrical equipment conspiracy is not simply an isolated case of collusive conduct on pricing, market sharing, and production quotas. The 1961 study of identical bidding by this committee discloses suspect pricing in bids received by Federal agencies, which is almost pervasive in certain basic industries. I would expect that the report of the Attorney General to be released tomorrow will show just how widespread the practice has become. We should not be surprised at this development. Such behavior follows very logically and inevitably from highly concentrated industries. Identical bidding is simply another index—the sealed-bid version—of administered prices.

In order to demonstrate the logical chain of events flowing from concentrated industries, it is most useful to examine the structure and behavior of particular industries over time. I have not been able to make such an analysis for all of the industries included in the committee's report, but have analyzed the situation in one of the most important industries covered by the study—the chemical industry. (See R. F. Lanzillotti, "Pricing Chemical Products: Some Economic Considerations," Symposium on the Law and Economics of Pricing Chemical Products, American Chemical Society, March 1962, pp. 101-113.)

The situation in chemicals is roughly as follows: In 1958, in one-half of the subindustry groups (as classified by the U.S. Census of Manufacturers) the top eight firms accounted for over 75 percent of total industry output. (See the

forementioned concentration report of the subcommittee of the Senate Judiciary Committee, pp. 87-89.)

According to one of the most respected authorities on the economics of the industry, Prof. Alfred E. Kahn, a major reason for this degree of concentration is that "size breeds size." Historically, the fewness of sellers "has produced communities of interest among them," that has been "conducive to a kind of peaceful coexistence, with market relations friendly, if not collusive."

This collaboration among the few has followed several lines—the formation of joint ventures, marketing of products through established firms in the field, patent pooling, buying and selling raw materials at preferential discounts to one another, and active participation in a network of international cartel agreements. Very recently, the Chairman of the Federal Trade Commission disclosed also an important maze of joint ventures in various chemical and chemical-related industries which is very sobering indeed. The hoped-for rivalrous action in the petrochemical field is seriously weakened by these modern versions of the old trusts.

The basic questions raised by joint ventures are: What is the probable effect of joint ownership by competitors on the vigor of competition generally, and on pricing and production policies in particular? Is it reasonable to expect that partners in an industrial marriage at certain stages of the productive process will vie for business like strangers when they reach the marketplace?

It is little wonder that the chemical industry has come into conflict with the antitrust laws more frequently than any other industry. While overt cartels for dividing markets, limiting production, and agreements on prices have been dissolved, so far as the record goes, the habit of collaboration persists.

To illustrate, the committee's report on ostensible competitive, i.e., sealed bids, discloses that out of a total of 73 transactions, identical bids cropped up in all except 5 cases.

In the 65 transactions where identical sealed bids were turned in, in most cases most of the bidders tendered identical bids, including identical discounts and other terms of sales.

Close examination of the frequency of identical bids for particular companies discloses that certain firms made identical bids with one or more other bidders in a very high percentage of the time. For example, New Jersey Zinc, American Zinc, and Eagle-Pilcher, made 42, 38, and 34 identical bids, respectively, in as many bid attempts.

Also it is noteworthy that, with the curious exception of 21 identical bids on sodium fluoride, the larger the number of bidders, the greater the probability of differentials in bids.

Usually, when identical bid prices, even under sealed-bid procedures, are questioned, the defense offered is that "under competitive conditions, with fully informed buyers, the price of a standardized commodity will be a uniform price, since no well-informed buyer would pay more than another." This might be a valid explanation in a truly open, competitive market, at a given moment of time, with a given state of demand and supply, and given identical knowledge of the market by all sellers and buyers.

Take the situation of the chemical industries where concentration of production remains in the hands of a relatively few large firms. It is, of course, conceivable that under these circumstances each of the few large sellers might regard the present prices (or book prices) as his "best guess" or "safest guess" of what rivals would bid on future calls for bids. This is at least theoretically possible, especially if each of the bidders is content with his share of the market at last-bid prices.

How can we tell, then, if identical bid prices are due to competition or to collusion (tacit or overt)? A complete answer requires an examination of the history of the industry, including types of products, number of sellers, past conspiratorial behavior, importance of patents, nature of demand, supply, costs, and related factors.

An examination of the chemical industry on those counts discloses repeated efforts by leading companies to nullify competition through flagrant instances of monopoly pricing, collusion, and illegal use of patents. Given the persistent high degree of concentration, in chemicals and others with jointly acting firms, plus the increasing use of joint ventures (through which more subtle forms of cooperation are possible), is it reasonable to ask: How did past bid prices and book prices become identical in the first place? Were they driven to identity by the pressure of each firm attempting to gain a larger share of the market, to reach for new accounts, and greater profits?

Second, since sealed bids are called for opening at some future date, and for delivery at or during some future period, how then can sellers independently figure prices over periods of fluctuations in cost and demand conditions and persistently emerge with identical prices down to the nearest fraction of a penny?

Information theory, and good commonsense, suggest that data available to sellers and buyers on future market conditions are not that perfectly known to produce identical expectations all the way around. The probabilities of such identity due to chance alone is very low indeed.

It doesn't require sophisticated economic analysis to recognize that such cases of identical bidding are fairly conclusive evidence of some type of collusive arrangement that flows from highly concentrated markets. It is precisely the kind of rational behavior to expect under the circumstances. The fact that probative conspiratorial evidence, such as uncovered in the electrical cases, is not available, does not alter the finding of collusion in the economic sense, nor, indeed, should it in the legal sense.

In sum: restrictionist production, administered pricing, identical sealed bidding, and jointly acting sellers in highly concentrated markets, these are the cloth of which the monopoly problem is made. Only if we face the problem squarely can we put vigor into our antitrust program and restore viability to the marketplace.

Dr. LANZILLOTTI. During the past few years—and if I sense matters correctly here this morning, there has been an increasing degree of agreement that continued high concentration and all of the trappings of high concentration in manufacturing industry aggravates and undermines monetary policy, fiscal policy, and tax policies, in their efforts to maintain stability, to promote growth, and stable prices.

I think this would be a fair summary of the statements which we have had so far here this morning.

Now, we could argue endlessly this morning, I think, the question of whether economic concentration is growing or not. I propose that we do not get into any statistical arguments on that.

I do think, however, that the recent report of the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee discloses some rather sobering statistics. The 200 largest corporations, from 1947 to 1958, increased their share of U.S. markets from 30 to 38 percent.

I do not believe that this change can be easily explained away as a temporary aberration. Even if one questions the accuracy of these data as a measure of a trend in our economy, at the very least, the data provide very persuasive evidence, in my view, of a persistent high degree of concentration in certain sectors of our economy.

It is my view that the problem of concentration and its impact on the national objectives we have been talking about this morning, that is, growth and stability, is showing through. We cannot any longer consider this problem as uncontrollable.

Concentration of industrial output and the logical and inevitable accoutrements that you get with it—those that Professor Adams and Professor Kahn have alluded to—discretionary pricing power, administered prices, administered production, and collusive behavior—are part of the visible and inescapable bones of this problem.

I do not wish to get into a lot of technical jargon about this, nor an overabundance of words, because I think it may obscure the points I am attempting to make.

I would like, first, to underscore what I believe to be the basic and fundamental consideration, from the economic standpoint as well as the political standpoint, governing any useful discussion of this



problem—the overriding importance in our goals of economic management of full employment and the operation of existing plants at or near full capacity.

I think that businessmen, like economists, recognize today that high output is a fundamental inducement to investment, and low output or idle and unused capacity dampens that incentive to invest.

One of the painful lessons we learn over the past decade, and the one which was mentioned in the discussion here earlier this morning, is that a national economic policy designed to promote stabilization of prices by relying directly or indirectly on deliberately continued unemployment has little chance of permanent success.

More important, for the purposes of the subject before the panel and the committee this morning, it has meant a reduction in the rate of economic growth and expansion in the U.S. economy.

The lack of wisdom in such a policy has been thoroughly exposed by the activities of this committee; and, if I sense matters correctly, your hearings and reports also have contributed to a wider general understanding of the problems we face.

You may ask: What does all this have to do with the subject of concentration, monopoly, and growth? Well, just this: In the aftermath of the exposure of the policy I discussed a moment ago, as a national policy for inflation control, predicated upon the reduction in the rate of utilization of our capacity, and underemployment, this very restrictionist approach has been instituted as a fundamental corporate policy by large pace-setting firms in the concentrated sectors of our economy.

What I am saying, in effect, is that here we have a national policy that is being thoroughly discredited as promotive of stability, growth, at stable price level, and on the other hand, we have witnessed, developing along with this, corporations that have been able to adopt this restrictionist approach to production and price policies, as an operational objective, an operational policy, of these corporations.

Indeed, I think we have witnessed in the business press and elsewhere that these firms that follow what we might call a restrictionist production and price policy, have been accorded a great deal of applause and acclaim, for being better able to stabilize prices and profits over cyclical swings.

This is a bit of irony which I think has had very unfortunate, but nonetheless predictable, consequences.

Senator BUSH. May I just interrupt at this point?

We do not usually do that; but I would like you to define this thing called restrictionist production policy and national restrictionist policy. This is very interesting.

Dr. LANZILLOTTI. Yes, sir.

A little earlier, you were questioning Dr. Nourse about overemphasis on and overconcern about inflation, and about tax policies, fiscal policies, and monetary policies, as have been explained by this committee, and discussed by this committee in earlier hearings, that had an unemployment bias. They had a bias that amounted to underutilization of national production capacity.

What I am saying is that such a policy is a restrictionist approach—for stability purposes. We have been concentrating on the inflation-

ary problem, and in so doing we have ended up with a policy which embodied what I would call restricted output, or if you will, underutilization of capacity.

Dr. Adams and Dr. Kahn earlier referred to, in the private sector, a target rate of return approach—production policy set with 60 to 75 percent of capacity as the normal, as the target, as the optimum, if you will.

Now, what I am saying is that it is a rather curious bit of irony that what has been discredited as a national policy of restrictionism in terms of utilization of our capacity for the purposes of insuring stability, has been adopted by large, powerful corporations as a private policy. These firms, I think, have been important enough, and their impact on the economy has been sufficiently great, to bring about in the aggregate the very effect that we did not wish to bring about, as a national policy, namely, underutilization of capacity.

Senator BUSH. Just one question, there.

You are not suggesting, for instance, that in steel, let us say, which is running at a rate very short of capacity now—

Dr. LANZILLOTTI. Yes, sir.

Senator BUSH (continuing). That that is a deliberate restrictionist policy on the part of this industry or these corporations, are you?

Dr. LANZILLOTTI. Yes, Senator; I am.

Senator BUSH. You are?

Dr. LANZILLOTTI. Yes, sir.

Senator BUSH. That is what I wanted to bring out.

Dr. LANZILLOTTI. Yes, sir. I am saying that these firms are sufficiently large, they are sufficiently powerful, to be able to gear their operations, to tool up, and on the basis of statements made by steel executives, statements made by the General Motors Corp., they gear their operations to earn a target return, a profits return, on their investment, predicated upon a utilization of 60, 75, or 80 percent of capacity as the norm. This is precisely what I am saying, Senator.

Senator BUSH. And you are saying, really, then, that today they could be doing much better, could be turning out much more steel, than they are doing, because of the restrictionist policy that they employ?

Dr. LANZILLOTTI. Senator, you express it much more clearly than I do. This is precisely what I am attempting to put across.

Senator BUSH. Then I am much more surprised.

Senator PROXMIRE. You are not saying the optimum rate is necessarily 65 or 70 percent. The break-even point for steel, Gardner Means testified to us—he has not been contradicted—may be 35 or 40 percent. Some say it will be a little higher. But the optimum rate might be up as high as 85 or 90 percent.

McGraw-Hill testified to us that in general in industry, and they are talking about manufacturing industry, the optimum operation is around 90 percent, that after that you get such a full utilization your marginal costs begin to rise.

So I would think that if McGraw-Hill is just roughly right, even though the steel companies operate at 65 percent of capacity and can be very happy and pay good dividends and make quite a bit of money, they would be a lot happier if they could maximize their profits and go on up.

Is that not correct?

Dr. LANZILLOTTI. Senator Proxmire, I admire your grasp of the economics of this problem.

I would like to return the question with the question: What do you mean by "optimum"? Are you speaking of an optimum in the sense of the least cost? Or that particular rate of operation which the firm's engineers would particularly like to see the plant operate at? Or are you speaking of an optimum in terms of higher national objectives?

Senator PROXMIRE. I am speaking of optimum in the technical way McGraw-Hill does, that point of operation at which you maximize profits. For most firms, according to McGraw-Hill, it is about 85 to 95 percent. This seems to be the average.

Dr. LANZILLOTTI. This emphasizes only the cost side of the picture, Senator. And even though, as you put it very well, marginal costs or incremental costs begin to rise beyond that, it does not mean, of course, that there are not profitable operations beyond what engineers may stipulate as an engineering optimum.

Senator PROXMIRE. I pressed McGraw-Hill on this. They said generally if firms went above 90 percent, they actually would reduce profits on the overall.

In other words, that you get to a point where your marginal costs exceed your marginal revenue.

Dr. LANZILLOTTI. Well, that I think is considerably beyond the point which you would term "optimum." I think what you are saying is that the per unit costs may be larger in that range.

But certainly not total profits going down, until you reach the point where, as you indicate, incremental costs exceed incremental profits; which is quite beyond that.

And I would merely submit that during the periods of the war and postwar periods, when plants were being operated, at what may seem to be an impossible rate of 104 and 105 percent of capacity, these corporations were very profitable indeed. I think the record is quite clear on this point.

So that the point which we are currently discussing, namely, "Would it be possible for these corporations to operate profitably at a higher rate of utilization?"—yes.

The basic point I am making is that they are able to set a lower rate at which they can make satisfactory profits. I do not know that they are intending to make what you would call maximum profits.

I would like to have them drive for maximum profits. But I would like to have them do that under the discipline of the marketplace, rather than, as Dr. Adams and Dr. Kahn have indicated, on the basis of their own private discretionary power.

Senator PROXMIRE. Well, now, Senator Bush and I have interrupted the usual procedure of the committee, which I think works quite well. And in fairness, I think, to the other members, why do you not go ahead with your paper, and we will come back to this?

I think this is extremely provocative. You finish up, and then come back, and we will all get into it.

Dr. LANZILLOTTI. Very well.

Senator, my position, so far, is this: That the industrial sector of the economy is becoming more rigid and more inflexible in its pricing, its production, and in its investment decisions.

I have pointed out, in the paper here, what I believe are the reasons why we have developed this inflexible and rigid posture in the private sector of manufacturing industry.

I think a point that Professor Adams has touched upon here is significant: In effect, what does the foregoing mean? These large corporations, in effect, are behaving in the nature of public utilities. I think this is a very distressing development for a free enterprise system.

I am obliged to raise the question: Do frozen profit rates that are a part of this target rate of return approach, standard-volume pricing, cost-plus pricing, restrictive production, and market sharing, characterize a promotive and an innovative policy, which is characteristic of a free enterprise system?

I think not. This kind of approach, it seems to me, essentially is pricing to satisfy the demand you can see, the demand which is foreseeable. It is what I call "accommodational" pricing.

It is not the kind of pricing that Dr. Kahn was alluding to earlier, that is going down the demand curve, and as Henry Ford I did, probing demands, trying to expand the market. It is neither experimental nor creative.

In brief, it is sterile as an inducement to higher consumption, to higher production, to higher employment, and a higher rate of economic growth.

In my paper, I have posed the question: How are firms following this kind of a policy, which I call a restrictionist approach, likely to behave under conditions of recession, under conditions of inflation, or under conditions which we now face?

I conclude, on the basis of the studies that have been made, that we shall experience, in these industries, inflation in the face of recession. We shall experience inflation in times of general inflation in the economy. And, at times, I am very distressed to point out, it will, albeit unwittingly, lead to what I consider a callous disregard of the impact of this power on the general stability of the economy.

As I noted, this may be unwitting. It even may be what you would call irrational economic behavior. Nonetheless, the results are what count. I would cite as an example that the recent abortive attempt at the \$6-per-ton increase in steel, in the face of declining demand and stiffened foreign competition, which, I think, proves the point.

What was President Roger Blough's, Chairman Roger Blough's, explanation and justification for the corporation's action? It was merely: We had to raise our prices in order to realize those target profits that we had set for ourselves.

He did not say that we are going to experiment with lower prices, attempting to increase the rate of production and increase the volume, and increase the employment. He said: We had to raise our prices in order to get the profits that we felt we needed.

I think that a policy of this type, creating idle capacity and unemployment, basing decisions on planned underutilization of capacity, upward of 20, 30, 35 percent over the long run as a norm, collides head

on with the higher national objective of full employment and the full use of industrial capacity.

I would raise the additional question: Can we expect to have a higher rate of economic growth and full employment when corporations in the concentrated sectors of the economy gear their own operations to a level substantially short of that?

The rest of my paper indicates the manifestations, if you will, of these particular policies, in terms of: How will they price? What will be their production policies?

I concentrate, in the latter part of the paper, on this question of pricing. The panel is emphasizing, today, the matter of more imaginative pricing, which I would stress.

I take as purely an illustration, the chemical industry. I have utilized some of the data of a report of this committee last year on identical bids, and have attempted to illustrate what results in an industry which, as Professor Kahn in one of his studies on the chemical industry has pointed out, is a very highly concentrated industry.

Concentration in this industry has persisted at a high level. You have in this industry today what you have had in the past—collusive behavior of various sorts.

The identical bidding that we have witnessed in the chemical industry persists. I have here a couple of tables which the committee staff have reproduced, if you are interested. The committee might like to have these available for the discussion period, since they show in detail the identity of bids by chemical companies under the sealed-bid procedures for a period of 5 years—1955-60.

Senator BUSH. On Government contracts?

Dr. LANZILLOTTI. Yes, Senator.

You will find that this industry, which I took as an illustration, because it happens to be one that is very important in the economy, and where we look for innovations of various types, has a long record of identical bidding. Specifically, this industry is characterized in sealed bid procedures (which are supposed to be competitive bids) of virtually identical prices over the period 1955 to 1960, as published by this committee. You will find that out of a total of 73 calls for bids, identical bids cropped up in all except 5 cases. I invite the committee to examine the tables in detail.

Could I request the chairman to have this exhibit inserted in the record?

Senator PROXMIRE. Yes. Without objection, this will be printed in the record. It is only three pages.

(Tables referred to follow:)

TABLE 1.—Identity of bids on 73 chemical transactions, 1955-60

| Item<br>(1)                                                        | Date<br>(2)   | Number<br>of bid-<br>ders<br>(3) | Number<br>of identi-<br>cal bids<br>(4) | Bid basis<br>(5)                                                                                       | Unit price<br>(6) | Total price<br>(7)    | Total price<br>net of<br>discount<br>(8) | Percent of difference,<br>identical and nonidentical<br>(9) |
|--------------------------------------------------------------------|---------------|----------------------------------|-----------------------------------------|--------------------------------------------------------------------------------------------------------|-------------------|-----------------------|------------------------------------------|-------------------------------------------------------------|
| Copper sulfate (10,000 pounds).....                                | Oct. 27, 1955 | 7                                | 5                                       | All f.o.b. destination.<br>(4) 1 percent 20 days.<br>(1) ¼ of 1 percent 20 days.                       | -----             | \$1,734.00            | \$1,716.66                               | (0.11 to 1.5 percent.)                                      |
| Sodium fluoride (420,000 pounds).....                              | Sep. 24, 1957 | 21                               | 21                                      | (1) 1 percent 30 days.                                                                                 | -----             | -----                 | 1,729.67                                 | No difference.                                              |
| Solvent, electric equipment cleaner<br>(2,400 gallons).            | June 1, 1959  | 6                                | 3                                       | All f.o.b. destination.<br>do.....                                                                     | \$0.133<br>1.74   | 60,090.00<br>4,176.00 | 1,716.66                                 | (-18.9 to +20.6 percent.)                                   |
| Tetracycline hydrochloride capsules:<br>Lot 1 (5,640 bottles)..... | Mar. 20, 1955 | 5                                | 5                                       | do.....                                                                                                | 19.58             | -----                 | -----                                    | No difference.                                              |
| Lot 2 (6,084 bottles).....                                         | June 6, 1955  | 5                                | 5                                       | (1) 2 percent 10 days.<br>(4) 2 percent 15 days.<br>All f.o.b. destination.                            | 19.58             | -----                 | 1 19.29                                  | Do.                                                         |
| Lot 3 (19,872 bottles).....                                        | June 20, 1955 | 5                                | 5                                       | (1) 2 percent 90 days.<br>(1) 2 percent 15 days.<br>(3) 2 percent 30 days.                             | 19.58             | -----                 | -----                                    | Do.                                                         |
| Lot 4 (3,000 bottles).....                                         | June 27, 1955 | 5                                | 5                                       | All f.o.b. destination.<br>(1) 2 percent 120 days.<br>(1) 2 percent 15 days.<br>(3) 2 percent 30 days. | 19.58             | -----                 | -----                                    | Do.                                                         |
| Lot 5 (6,750 bottles).....                                         | Dec. 7, 1955  | 4                                | 4                                       | All f.o.b. destination.<br>(1) 2 percent 15 days.<br>(1) 2 percent 30 days.                            | 19.58             | -----                 | -----                                    | Do.                                                         |
| Lot 6 (28,992 bottles).....                                        | June 21, 1956 | 5                                | 4                                       | All f.o.b. destination.<br>(3) 2 percent 20 days.<br>(4) 2 percent 30 days.                            | 19.58             | -----                 | -----                                    | -2 percent. <sup>1</sup>                                    |
| Lot 7 (29,862 bottles).....                                        | July 30, 1956 | 6                                | 5                                       | All f.o.b. destination.<br>(3) 2 percent 30 days.                                                      | 19.58             | -----                 | -----                                    | Do. <sup>1</sup>                                            |
| Lot 8 (50,400 bottles).....                                        | Oct. 10, 1956 | 6                                | 4                                       | All f.o.b. destination.<br>(3) 2 percent 30 days.                                                      | 19.58             | -----                 | -----                                    | -9 to -2 percent. <sup>1</sup>                              |
| Detergent, laundry powder:<br>Lot 1 (3,000 pounds).....            | Nov. 15, 1957 | 6                                | 3                                       | All f.o.b. destination.<br>(3) 1 percent 20 days.<br>(2) ¼ of 1 percent 20 days.                       | .1257             | -----                 | 1 1.245<br>1 1.1254                      | (-7 to +30.2 percent. <sup>1</sup> )                        |
| Lot 2 (17,000 pounds).....                                         | do.....       | 6                                | 3                                       | All f.o.b. destination.<br>(2) ¼ of 1 percent 20 days.<br>(3) 1 percent 20 days.                       | .1166             | -----                 | 1 1.155<br>1 1.163                       | (-8.2 to +41.5 percent. <sup>1</sup> )                      |
| Lot 3 (16,000 pounds).....                                         | do.....       | 8                                | 8                                       | All f.o.b. estimation.                                                                                 | ( <sup>2</sup> )  | -----                 | -----                                    |                                                             |

|                       |                |   |                              |     |            |                |
|-----------------------|----------------|---|------------------------------|-----|------------|----------------|
| Lot 4 (9,000 pounds)  | do.            | 8 | (3) 1 percent 20 days        | (3) | 22,804.00  | No difference. |
|                       | do.            | 8 | (2) 1/4 of 1 percent 20 days | (2) | 21,384.00  | Do.            |
| Lot 5 (7,000 pounds)  | do.            | 8 | (1) 1/2 of 1 percent 20 days | (1) | 22,720.50  | Do.            |
|                       | do.            | 8 | All f.o.b. destination       | (4) | 43,898.40  | Do.            |
| Lot 6 (5,000 pounds)  | do.            | 7 | (3) 1 percent 20 days        | (3) | 83,616.00  | Do.            |
|                       | do.            | 7 | (2) 1/4 of 1 percent 20 days | (2) | 62,616.00  | Do.            |
| Lot 7 (89,000 pounds) | do.            | 9 | (1) 1/2 of 1 percent 20 days | (1) | 83,616.00  | Do.            |
|                       | do.            | 9 | All f.o.b. destination       | (4) | 99,414.00  | Do.            |
| Lot 8 (88,000 pounds) | do.            | 9 | (3) 1 percent 20 days        | (3) | 1182       | Do.            |
|                       | do.            | 9 | (2) 1/4 of 1 percent 20 days | (2) | 1,1174     | Do.            |
| Zinc oxide (pounds)   | Sept. 28, 1951 | 2 | (1) 1/2 of 1 percent 20 days | (1) | 1584       | Do.            |
|                       | Oct. 8, 1951   | 2 | All f.o.b. origin            | (4) | 1384       | Do.            |
| Lot 2                 | do.            | 2 | (3) 1 percent 20 days        | (3) | 1053       | Do.            |
| Lot 3                 | do.            | 2 | (2) 1/4 of 1 percent 20 days | (2) | 1742       | Do.            |
| Lot 4                 | Dec. 24, 1951  | 3 | (1) 1/2 of 1 percent 20 days | (1) | 1742       | Do.            |
| Lot 5                 | Dec. 21, 1951  | 3 | All f.o.b. destination       | (4) | 1742       | Do.            |
| Lot 6                 | Jan. 21, 1952  | 3 | (3) 1 percent 20 days        | (3) | 1841       | Do.            |
| Lot 7                 | Mar. 25, 1952  | 3 | (2) 1/4 of 1 percent 20 days | (2) | 1841       | Do.            |
| Lot 8                 | Jan. 18, 1952  | 3 | (1) 1/2 of 1 percent 20 days | (1) | 1742       | Do.            |
| Lot 9                 | Feb. 20, 1952  | 3 | All f.o.b. origin            | (4) | 1841       | Do.            |
| Lot 10                | May 19, 1952   | 3 | (3) 1 percent 20 days        | (3) | 1742       | Do.            |
| Lot 11                | do.            | 3 | (2) 1/4 of 1 percent 20 days | (2) | 1841       | Do.            |
| Lot 12                | Apr. 20, 1954  | 3 | (1) 1/2 of 1 percent 20 days | (1) | 145,807.20 | Do.            |
| Lot 13                | do.            | 3 | All f.o.b. destination       | (4) | 38,476.80  | Do.            |
| Lot 14                | Aug. 24, 1954  | 3 | (3) 1 percent 20 days        | (3) | 8,610.00   | Do.            |
| Lot 15                | do.            | 3 | (2) 1/4 of 1 percent 20 days | (2) | 67,334.40  | Do.            |
| Lot 16                | Nov. 16, 1954  | 3 | (1) 1/2 of 1 percent 20 days | (1) | 41,328.40  | Do.            |
| Lot 17                | do.            | 3 | All f.o.b. origin            | (4) | 33,667.20  | Do.            |
| Lot 18                | Jan. 11, 1955  | 3 | (3) 1 percent 20 days        | (3) | 30,996.00  | Do.            |
| Lot 19                | Jan. 10, 1955  | 3 | (2) 1/4 of 1 percent 20 days | (2) | 62,524.80  | Do.            |
| Lot 20                | Mar. 11, 1955  | 3 | (1) 1/2 of 1 percent 20 days | (1) | 51,690.00  | Do.            |
| Lot 21                | do.            | 4 | All f.o.b. destination       | (4) | 9,619.20   | Do.            |
| Lot 22                | Sept. 28, 1951 | 3 | (3) 1 percent 20 days        | (3) | 51,690.00  | Do.            |
| Lot 23                | Oct. 8, 1951   | 3 | (2) 1/4 of 1 percent 20 days | (2) | 22,809.60  | Do.            |
| Lot 24                | do.            | 3 | (1) 1/2 of 1 percent 20 days | (1) | 21,384.00  | Do.            |
| Lot 25                | Dec. 25, 1951  | 3 | All f.o.b. origin            | (4) | 22,720.50  | Do.            |
| Lot 26                | Dec. 21, 1951  | 3 | (3) 1 percent 20 days        | (3) | 42,898.40  | Do.            |
|                       |                | 3 | (2) 1/4 of 1 percent 20 days | (2) | 83,616.00  | Do.            |

See footnotes at end of table.

TABLE 1.—Identity of bids on 73 chemical transactions, 1955-60—Continued

| Item                                                           | Date          | Number of bidders | Number of identical bids | Bid basis                                                                                                                      | Unit price | Total price | Total price net of discount | Percent of difference, identical and nonidentical |                           |
|----------------------------------------------------------------|---------------|-------------------|--------------------------|--------------------------------------------------------------------------------------------------------------------------------|------------|-------------|-----------------------------|---------------------------------------------------|---------------------------|
| (1)                                                            | (2)           | (3)               | (4)                      | (5)                                                                                                                            | (6)        | (7)         | (8)                         | (9)                                               |                           |
| Zinc oxide (pounds)—Continued                                  |               |                   |                          |                                                                                                                                |            |             |                             |                                                   |                           |
| Lot 27.....                                                    | Jan. 21, 1952 | 3                 | 3                        | All f.o.b. destination.....                                                                                                    | \$0.1742   | \$33,616.00 | (4)                         | Do.                                               |                           |
| Lot 28.....                                                    | Mar. 25, 1952 | 3                 | 3                        | do.....                                                                                                                        | .1742      | 83,616.00   | (4)                         | Do.                                               |                           |
| Lot 29.....                                                    | Jan. 18, 1952 | 3                 | 3                        | do.....                                                                                                                        | .1841      | 99,414.00   | (4)                         | Do.                                               |                           |
| Lot 30.....                                                    | Feb. 26, 1952 | 3                 | 3                        | do.....                                                                                                                        | .1841      | 86,158.80   | (4)                         | Do.                                               |                           |
| Lot 31.....                                                    | May 19, 1952  | 3                 | 3                        | do.....                                                                                                                        | .1742      | 125,424.00  | (4)                         | Do.                                               |                           |
| Lot 32.....                                                    | do.....       | 3                 | 3                        | do.....                                                                                                                        | .1841      | 145,807.20  | (4)                         | Do.                                               |                           |
| Lot 33.....                                                    | Apr. 29, 1954 | 3                 | 3                        | do.....                                                                                                                        | .1336      | 38,476.80   | (4)                         | Do.                                               |                           |
| Lot 34.....                                                    | do.....       | 3                 | 3                        | do.....                                                                                                                        | .1435      | 8,610.00    | (4)                         | Do.                                               |                           |
| Lot 35.....                                                    | Aug. 24, 1954 | 3                 | 3                        | do.....                                                                                                                        | .1336      | 67,334.40   | (4)                         | Do.                                               |                           |
| Lot 36.....                                                    | do.....       | 3                 | 3                        | do.....                                                                                                                        | .1435      | 41,928.00   | (4)                         | Do.                                               |                           |
| Lot 37.....                                                    | Nov. 16, 1954 | 3                 | 3                        | do.....                                                                                                                        | .1336      | 33,667.20   | (4)                         | Do.                                               |                           |
| Lot 38.....                                                    | do.....       | 3                 | 3                        | do.....                                                                                                                        | .1435      | 30,996.00   | (4)                         | Do.                                               |                           |
| Lot 39.....                                                    | Jan. 11, 1955 | 3                 | 3                        | do.....                                                                                                                        | .1336      | 62,524.80   | (4)                         | Do.                                               |                           |
| Lot 40.....                                                    | Jan. 10, 1955 | 4                 | 4                        | do.....                                                                                                                        | .1435      | 51,660.00   | (4)                         | Do.                                               |                           |
| Lot 41.....                                                    | Mar. 11, 1955 | 3                 | 3                        | do.....                                                                                                                        | .1336      | 9,619.20    | (4)                         | Do.                                               |                           |
| Lot 42.....                                                    | do.....       | 3                 | 3                        | do.....                                                                                                                        | .1435      | 51,660.00   | (4)                         | Do.                                               |                           |
| Carbon dioxide gas (148,000 pounds) -                          | Dec. 14, 1955 | 4                 | 4                        | do.....                                                                                                                        | .0435      | 8,750.00    | (4)                         | Do.                                               |                           |
| Dry ice (250,000 pounds)                                       | Nov. 22, 1957 | 4                 | 4                        | do.....                                                                                                                        | .035       | 1,104.60    | (4)                         | (+6 to +8.4 percent.)                             |                           |
| Weed oil (140 gallons)                                         | May 27, 1955  | 9                 | 4                        | do.....                                                                                                                        |            |             |                             |                                                   |                           |
| Brush killer (200 gallons).....                                | June 25, 1956 | 9                 | 2                        | (1) 2½ percent, 30 days.<br>All f.o.b. destination.....                                                                        | 1,306.00   | 1,306.00    | (4)                         | (-21.5 to +11.7 percent.)                         |                           |
| Soil sterilant, dry form (6,000 pounds).                       | do.....       | 5                 | 2                        | (1) 1 percent, 20 days.<br>(1) 2 percent, 30 days.<br>All f.o.b. destination.....                                              | 879.60     | 879.60      | (4)                         | (-22 to +0.3 percent.)                            |                           |
| Lot 2 (400 pounds).....                                        | do.....       | 5                 | 4                        | (1) 1 percent 30 days.<br>(2) 2 percent 20 days.<br>All f.o.b. destination.....                                                | 1,480.00   | 1,480.00    |                             | (-20.5 percent.)                                  |                           |
| Ammonium salt of dinitro secondary butyl phenol (500 gallons.) | do.....       | 8                 | 3                        | (2) 2 percent.<br>All f.o.b. destination.....                                                                                  | 3,976.56   | 3,976.56    | \$1,459.60<br>1,459.60      | (4)                                               | (-1.8 to +17.6 percent.)  |
| Brush killer and soil sterilant (10,000 gallons.)              | Jan. 21, 1958 | 19                | 7                        | (1) 1 percent 30 days.<br>(1) 2 percent 20 days.<br>All f.o.b. destination.....                                                | 5.45       | 54,500.00   | 53,410.00                   |                                                   | (-10.2 to +34.7 percent.) |
|                                                                |               |                   |                          | (10) 2 percent 30 days.<br>(1) 2 percent 30 days.<br>(2) 1 percent 30 days.<br>(2) 1 percent 20 days.<br>(1) 5 percent 30 days |            |             | 54,005.00<br>51,575.00      |                                                   |                           |



|                                                        |               |    |    |                                                                                                                                                                                                                                                   |          |           |                                                                               |                           |
|--------------------------------------------------------|---------------|----|----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|-----------|-------------------------------------------------------------------------------|---------------------------|
| Lot 2 (5,000 gallons).....                             | Jan. 2, 1938  | 17 | 6  | All f.o.b. destination.....<br>(8) 2 percent 20 days.....<br>(1) 1 percent 30 days.....<br>(4) 5 percent 30 days.....<br>(1) 2 percent 30 days.....<br>(2) 1 percent 20 days.....                                                                 | 5.45     | 27,250.00 | 26,706.00<br>26,988.00<br>25,890.00<br>-----<br>-----<br>-----                | (-10.3 to +34.6 percent). |
| Lot 3 (2,500 pounds).....                              | do            | 18 | 17 | All f.o.b. destination.....<br>(17) 2 percent 20 days.....<br>(1) 2 percent 30 days.....<br>(7) 2 percent 20 days.....<br>(1) 2 percent 30 days.....<br>All f.o.b. destination.....<br>(1) 2 percent 20 days.....<br>(1) 1/8 percent 20 days..... | 2.90     | 7,250.00  | 7,105.00<br>7,105.00<br>3,528.00<br>3,528.00<br>-----<br>6,223.40<br>5,494.30 | (+19.4.)                  |
| Lot 4 (1,000 pounds).....                              | Jan. 21, 1938 | 18 | 17 | All f.o.b. destination.....<br>(7) 2 percent 20 days.....<br>(1) 2 percent 30 days.....<br>All f.o.b. destination.....<br>(1) 2 percent 20 days.....<br>(1) 1/8 percent 20 days.....                                                              | 3.60     | 3,600.00  | 3,528.00<br>3,528.00<br>-----<br>5,508.00<br>-----                            | (-19.4.)                  |
| Dinitro ortho secondary butyl phenol<br>(600 gallons.) | June 26, 1938 | 14 | 7  | All f.o.b. destination.....<br>(1) 2 percent 20 days.....<br>(1) 1/8 percent 20 days.....                                                                                                                                                         | 5,508.00 | 5,508.00  | -----<br>-----<br>-----                                                       |                           |

<sup>1</sup> Discount calculated on basis of unit price, where total price bid is not given.

<sup>2</sup> No identical bids.

<sup>3</sup> No discount.

<sup>4</sup> No discount on identical bids.

Source: Compiled from "93 Lots of Bids Involving Identical Bids Reported to Department of Justice by Federal Procurement Agencies in the Years 1935-60," Joint Economic Committee, Congress of the United States (August 1961) pp. 18-39.

TABLE 2.—Frequency of identical bids by companies as published by the Joint Economic Committee of the U.S. Congress

| Companies<br>(1)                          | Number of<br>bids made<br>(2) | Number of<br>identical bids<br>(3) | Percent identical<br>bids<br>(4) |
|-------------------------------------------|-------------------------------|------------------------------------|----------------------------------|
| New Jersey Zinc Sales Co.....             | 42                            | 42                                 | 100.0                            |
| American Zinc Sales Co.....               | 38                            | 38                                 | 100.0                            |
| Eagle-Pleher Co.....                      | 34                            | 34                                 | 100.0                            |
| L. H. Butcher Co.....                     | 8                             | 5                                  | 62.5                             |
| Charles Pfizer & Co.....                  | 8                             | 5                                  | 62.5                             |
| Upjohn Co.....                            | 8                             | 8                                  | 100.0                            |
| Bristol Laboratories, Inc.....            | 8                             | 8                                  | 100.0                            |
| E. R. Squibb & Co.....                    | 8                             | 8                                  | 100.0                            |
| Lederle Laboratories, Inc.....            | 8                             | 8                                  | 100.0                            |
| Stauffer Chemical Co.....                 | 8                             | 3                                  | 37.5                             |
| Braun Knecht Helmann Co.....              | 7                             | 1                                  | 14.0                             |
| Los Angeles Chemical Co.....              | 6                             | 4                                  | 66.6                             |
| Allied Chemical & Dye.....                | 6                             | 6                                  | 100.0                            |
| F. M. Speckman Co.....                    | 6                             | 4                                  | 66.6                             |
| Perf Products.....                        | 6                             | 3                                  | 50.0                             |
| Alex C. Fergusson Co.....                 | 6                             | 3                                  | 50.0                             |
| Plex Chemical Corp.....                   | 6                             | 3                                  | 50.0                             |
| Trilo Chemical Works.....                 | 6                             | 0                                  | -----                            |
| Consolidated Chemical Works.....          | 6                             | 0                                  | -----                            |
| The Clarkson Laboratories.....            | 6                             | 0                                  | -----                            |
| Standard Agricultural Chemicals, Inc..... | 6                             | 3                                  | 50.0                             |
| Van Waters & Rogers.....                  | 5                             | 5                                  | 100.0                            |
| Dow Chemical.....                         | 5                             | 4                                  | 80.0                             |
| California Spray Chemical Corp.....       | 5                             | 1                                  | 20.0                             |
| Chipman Chemical Co.....                  | 5                             | 3                                  | 60.0                             |
| Chicago Sanitary Products Co.....         | 4                             | 0                                  | -----                            |
| Pacific Guano Co.....                     | 4                             | 1                                  | 25.0                             |
| Oregon Agricultural Chemicals.....        | 4                             | 4                                  | 100.0                            |
| Ben's Farm Store.....                     | 4                             | 2                                  | 50.0                             |
| Wilbur-Ellis Co.....                      | 4                             | 2                                  | 50.0                             |
| Norkern Corp.....                         | 4                             | 2                                  | 50.0                             |
| P. B. Gast & Sons.....                    | 3                             | 3                                  | 100.0                            |
| Blackson Chemical Co.....                 | 3                             | 3                                  | 100.0                            |
| Arthur S. Lapine & Co.....                | 3                             | 3                                  | 100.0                            |
| American Agricultural Chemical Co.....    | 3                             | 3                                  | 100.0                            |
| Seebee Paint & Chemical Co.....           | 3                             | 3                                  | 100.0                            |
| Sandtner-Valentine Chemical Co.....       | 3                             | 0                                  | -----                            |
| Associated Lead & Zinc Co.....            | 3                             | 3                                  | 100.0                            |

Source: Listing from source given in table 1.

Senator PROXMIRE. In other words, there were identical bids in all but five out of how many?

Dr. LANZILLOTTI. Seventy-three, sir.

Senator PROXMIRE. I see. Thank you.

Dr. LANZILLOTTI. Now, as I was pointing out, I invite you to examine for yourself all the details on this bidding relationship for these commodities that were included in the Joint Economic Committee's report on identical bidding.

Senator BUSH. What types of commodities are these, here? Are they unusual chemicals, or are they more or less standard stock stuff?

Dr. LANZILLOTTI. A lot of it, I would say perhaps most of it, does represent what you would call stock stuff. Standardized commodities.

Senator BUSH. I mean zinc oxide I see down here. I do not know anything about chemicals, and very much less about zinc oxide. But it is a very common thing, is it not? I mean everybody makes it, and there is no secret about it, and it is sort of like salt, is it not?

Dr. LANZILLOTTI. It is, Senator.

Senator BUSH. It has those characteristics?

Dr. LANZILLOTTI. It does have those characteristics. And usually when the identical bids are questioned, you get a reply which takes off from that question: Well, aren't these really the "milk" business, the run-of-the-mill type of product, highly standardized? And would you not expect that the prices would be identical?

Well, my reply is this: When we call for sealed bids, the reason why we ask for sealed bids under Federal procurement procedures is precisely to provoke, to bring about, as low a price for the public as we can. And private industry does the same thing when it calls for sealed bids.

The point is this: Under what circumstances would you possibly get identical bids of this type? Well, they would only come about under what we would call competitive conditions that include all sellers guessing that every other seller is going to bid the next time around exactly what he bid the last time around; namely, the book price. All sellers have the same view of the way in which the demand is going. All sellers are faced with the same cost conditions.

I think that what you really conclude when you examine these is that you have to answer certain questions: How did these book prices that all of these firms say they are following become identical in the first place? There must have been some causal relationship, here, some background, some reasons why the prices were identical in the first instance.

Senator BUSH. Have you ever asked them, any of them, to explain it to you?

Dr. LANZILLOTTI. Yes, sir. I have.

Senator BUSH. What do they say?

Dr. LANZILLOTTI. On how they became identical?

Senator BUSH. Yes.

Dr. LANZILLOTTI. Their explanation is: We follow competition. I think it is an unsatisfactory answer.

Part of the answer on this identical sealed bid procedure, if we wish to get into it, is that we have a clash of laws which were designed to protect the public from unscrupulous public servants, and which require that the bids, after being made, under sealed procedures, be made public.

These firms have replied: If our bids could be kept secret and were not made public, we might be inclined to be more competitive in our bidding.

Senator BUSH. That is an interesting development.

Dr. LANZILLOTTI. It suggests what we know exists in the American economy, that if firms can discriminate in price and keep their price concessions secret, they will do so.

Well, I do not wish to take any more time. I merely would summarize with the statement that restrictionist production, administered pricing, identical sealed bidding, and jointly acting sellers, are the cloth of which the monopoly problem is made.

I feel that only if we face up squarely to the problem can we put vigor into the antitrust program, supplementing and complementing the policies of the monetary authorities and fiscal authorities and restore a general viability to the market place.

Senator PROXMIRE. Thank you very much, Dr. Lanzillotti.

Our next witness is Professor Richard Barber, of Southern Methodist University.

We are very happy to have you here, sir. You are a professor of law?

**STATEMENT OF DR. RICHARD J. BARBER, PROFESSOR OF LAW,  
SOUTHERN METHODIST UNIVERSITY**

Dr. BARBER. Yes, sir.

My statement is rather long, and I do not propose to burden the committee by reading it.

Senator PROXMIRE. Then, without objection, it will be printed in the record, and you can summarize it.

Dr. BARBER. Thank you, Mr. Chairman.

(Statement referred to follows:)

**STATEMENT BY RICHARD J. BARBER, ASSISTANT PROFESSOR OF LAW, SOUTHERN  
METHODIST UNIVERSITY**

My remarks are limited principally to a consideration of current public policies as they relate to the problem of industrial organization. In outline, these are my conclusions as I review the activity of the Federal Government in this area:

(a) That in spite of our professed interest in antitrust activity, the fact is that the antitrust laws have been and are being enforced with neither vigor nor imagination;

(b) That the administrative agencies, charged with the regulation of such key industries as transportation and communications, continue to flaunt the competitive standard and to encourage monopoly; and

(c) That in its transactions with the private sector of the economy, the Government, particularly the Department of Defense, aids and abets concentration and denies to smaller firms fair business opportunities, particularly insofar as research and development is concerned.

Each of these points will be developed more fully as this paper progresses.

**I. ECONOMIC ASPECTS OF CONCENTRATION**

Let me at the outset, however, comment very briefly on some of the economic implications of industrial concentration—matters which my fellow panelists have already discussed at greater length.

As I survey the domestic economic scene, I am struck by several features that are of immense significance in considering our public policy toward competition. Most important, in my estimation, is to note the simple fact that while few of our manufacturing markets are clearly dominated by a single firm, typically a very small number of firms account for most output in our key industries. The 1954 Census of Manufactures showed that of 426 four-digit product categories, in 112, 4 companies, or fewer, accounted for at least half of the total value of shipments. And actually this grossly understates the matter, for it fails to allow for the relative importance of the various products and segregates those which are really competitive (e.g., cane and sugar). In a recent study Professors Kaysen and Turner attempted to compensate for these kind of deficiencies; they concluded that of 147 manufacturing and mining industries with national markets, 104 were "concentrated" (in the sense that the 8 largest sellers account for at least 33 percent of total market sales). Included in this grouping, as the following list indicates, are such vital industries as autos, steel, most of the other metals, chemicals, rubber tires, flat glass, synthetic fibers, cigarettes, electrical machinery, computing machines, diverse other transportation equipment, etc.

*Percent of value of shipments accounted for by largest 4 companies, selected industries, 1958*

|                                               | Percent          |
|-----------------------------------------------|------------------|
| Passenger cars.....                           | 99               |
| Synthetic organic fibers, noncellulostic..... | ( <sup>1</sup> ) |
| Telephone switching equipment.....            | ( <sup>1</sup> ) |
| Sheet (window) glass.....                     | 95               |
| Locomotives and parts.....                    | 92               |
| Electric lamps (bulbs).....                   | 90               |
| Primary aluminum.....                         | 82               |
| Cigarettes.....                               | 80               |
| Metal cans.....                               | 80               |
| Power and distributing transformers.....      | 80               |
| Computing machines.....                       | 77               |
| Wheel tractors and parts.....                 | 72               |
| Tires and tubes.....                          | 71               |
| Sheet ingots and semifinished shapes.....     | 71               |

<sup>a</sup> Withheld by Bureau of the Census to avoid disclosure. Concentration ratio very high.

Source: Report of the Senate Antitrust Subcommittee, "Concentration Ratios in Manufacturing Industry, 1958," 87th Cong., 2d sess. (1962).

What we have here then is an enumeration of our most basic industrial sectors—each dominated by a very few firms (and keep in mind that this listing excludes the regulated utilities).

Within these oligopolistic arenas only a very restricted type of competition prevails. As studies of various sorts have well demonstrated, price competition is uncommon, becoming more rare as the degree of concentration increases. What rivalry that does exist is confined to nonprice matters, like advertising, product design, the creation of a favorable corporate image, and so forth. Prices remain largely uniform among the rival sellers, with changes being effected from time to time in a coordinated fashion. For example, in 1956 the Ford Motor Co. initially announced an average price increase on its 1957 models of 2.9 percent. Two weeks later General Motors increased its 1957 model prices by an average of 6.1 percent. A week later Ford revised its prices upward to match almost dollar for dollar General Motor prices.

To the outside observer this sort of arm-in-arm conduct suggests that it must be the product of actual collusion between the managers of the respective organizations. Actually, as economic theory has indicated, this need not necessarily be the case. Where a small number of firms function in the same market, each accounting for a significant share of sales, a kind of "spontaneous coordination" can occur. Each firm, knowing that its fate is intrinsically intertwined with that of its principal competitors, learns that it cannot operate on its own and thus we come to have something like the circumstances of nuclear stalemate.

The longer that companies coexist under such conditions, the less likely they are to engage in anything approaching the price warfare that we have come to expect as the hallmark of a competitive system. Executives of these corporations are frank to admit that price manipulation is not an appropriate instrument of warfare, and indeed they speak more in the fashion of ministers of foreign powers than of aggressive businessmen. What they are interested in typically is preserving their position in the market and achieving over the long run what they feel is an acceptable rate of profit. Professor Lanzillotti, who along with others has done considerable work in this field, has concluded that a target return on investment is probably the dominant price goal of large corporations (e.g., in the case of General Motors, 20 percent on investment after taxes).

When it is recognized that target-return pricing is a longrun objective, it is easy to see why firms in a position to establish such an objective so rarely reduce prices when recession occurs. Their formula recognizes that there will be periods of inadequate profit, but seeks to compensate for this in periods of expansion. Instead of slashing prices in an aggressive manner to increase sales during periods of curtailed business activity, the dominant firms simply hold on, anticipating better days to come. As demand declines at the prevailing price, output falls and with it employment and corporate profits. The economic contraction hence is accentuated and prolonged and an undue share of the burden for accomplishing an upswing is shifted to governmental fiscal and tax

policies. Certainly greater price flexibility would assist, to some extent, minimizing cyclical gyrations and in shortening their duration. Lower concentration, and a greater degree of competition, thus would distinctly complement our other policies designed to achieve full employment and expand productive opportunities.

No sensible person expects, of course, that antitrust intervention achieve anything approaching the conditions of the classical competitive. Modern technology requires large productive units and we cannot expect to atomize the economy and at the same time maintain optimal efficiency. The fact is that we can have a great deal more competition, with many companies of roughly equal size in the respective markets than is now the case without sacrificing economies of scale. In the automobile industry, for instance, authoritative studies demonstrate that a firm supplying about 10 percent of total market demand can attain minimum production costs. This is not true of an organization such as General Motors is not efficient; it is only to that a company in this industry need not be anywhere nearly as large as General Motors to reflect maximum attainable efficiency. (I suggest that this is amply demonstrated by the performance of American Motors.) In the mobile context, this would suggest that we could have perhaps as many as 10 firms, about equal in size, rather than the present situation in which (General Motors and Ford) together account for about 80 percent of new sales. And a similar argument can be advanced in the case of most industries.

The inquiring observer is entitled to ask at this point, though, whether they really make any difference if we had 10 auto producers rather than the 2-firm domination. No one can give a precise answer to this sort of question. Nevertheless there is much evidence to suggest that the larger the number of equal participants, the greater are the probabilities of something approaching full-scale competitive conditions.

This could at least mean a greater opportunity for product and service variations (e.g., the compact car). And it could very well generate more price competition. Where an industry is dominated by two large firms, chances of widespread price cutting are very slim; but where there are many it is entirely probable that from time to time one of the group will decide its fortunes can be improved with a price adjustment. There are many instances of this to be found, but a review of airline fares is illustrative. Here we find that coach rates are typically placed in effect only when the carrier fronts a rival. Moreover, the most aggressive fare offerings have been on the east coast where many air carriers compete with one another. In other parts of the country, where the number of participants is less, one carrier's fares are commonly much higher and more stable. The implication for the economy as a whole are, I think, considerable.

In my estimation the extent of competition in the American economy has been greatly accentuated through vigorous antitrust action without need for any sacrifices in efficiency. The result would be more flexibility in price and a better allocation of resources.

This sort of conclusion, I would hope, should not be at all surprising to those who are familiar with our Nation's history. We have long professed our belief in competition as the best means of accomplishing our political and economic objectives. Our Federal and State antitrust laws reflect this attitude. The Congress has been particularly concerned with insuring opportunities for smaller business, and Presidents and major departments have time and again assured us that competition should be encouraged, not suppressed, and opportunities for smaller business guaranteed. In the rest of this paper I propose to examine whether, in fact, our performance lives up to our declarations. On the whole, I think it does not.

## II. ANTITRUST ENFORCEMENT

Any adequate appraisal of the Federal Government's activities in relation to competition and monopoly must consider three facets of the question. First, what is the character of our contemporary antitrust enforcement? Second, what are the effects of the work of the various regulatory agencies? And, third, what are the implications of Government procurement? I propose to turn to each of these matters in turn.

Let me first take a brief look at the work of the Antitrust Division of the Department of Justice. As you know, it is the principal enforcement agency in the field of antitrust, charged with the responsibility of enforcing the Sherman Act. Looking back over the last year and a half, one finds an extremely unsatisfactory performance. The cases initiated in number are many (60 cases were commenced in the calendar year 1961; in 1960, the comparable number was 90, but of these 39 involved the heavy electrical conspiracy). In character, however, they reflect little enforcement imagination and seem, by and large, unlikely to have any significant impact on reducing the level of prevailing concentration. I do not wish to imply that the work of the Division has been unimportant, certainly not. What I do suggest, however, is that the resources of this agency are not being employed to their fullest potential.

Of the 60 cases begun in 1961, 28 involved so-called per se violations (most notably price fixing, but also including allocations of territories, and bid rigging—the latter a variant of price fixing). Most of these were hard-core, overt conspiracies in which the Government usually possessed uncontradictable evidence of law violation. In many of these cases, the defendants did not dispute the charge, pleaded guilty or nolo contendere, and were fined. All too frequently, the fines constituted little more than a slap on the wrist. The firms were chastised, held up to modest public ridicule, and told to sin no more. Some of the major participants were fined, or jailed; and as the heavy electrical goods companies are learning, large money damages may be incurred. But even to the extent that prosecution of the per se offenses is a significant deterrent, we should not lose sight of the elementary fact that the most important problems stem from the highly concentrated industries, not those in which explicit collusion is usually found.

Let me again emphasize that I am not implying by the tone of these remarks that price fixing, bid rigging, and the rest of the offenses involved should go unpunished. The question I raise is whether more utility could not be obtained through the greater utilization of scarce enforcement resources in other kinds of cases.

The work of the Antitrust Division in suppressing corporate mergers is of much greater importance, although I think it deserves emphasis that this is essentially only preventive in nature: it does not usually reduce existing levels of concentration. In the calendar year 1961, the Department of Justice filed 19 cases, seeking to block or set aside corporate consolidations. Most of these were of consequence and involved firms of substantial size, whose affiliation promised reduced competition. Interestingly, however, two of the more important of these cases (one involving American Smelting & Refinery Co. and the other the Penn-Olin joint venture) were brought during the final days of the preceding administration. And actually as the year progressed one finds that the antimerger work of the Antitrust Division gradually slackened, a trend that persists to the present time (only six merger cases have been filed so far during 1962, well below the 1961 rate). What explains this curtailment in activity is not altogether clear. Nor is there any apparent explanation for the growing number of what strikes me as minor cases involving price fixing and other per se offenses. Among the "vital" product markets involved in recent cases alleging overt conspiratorial behavior, for instance, are ice show productions, venetian blinds, service station prices in Washington, and Kosher food products in New York City.

Increasingly it seems that the Justice Department, either for reasons of its own or because of larger political considerations, is confining its attention to less important issues and hence is contributing little to the achievement of a more competitive, less concentrated economy. In an interview in June with Anthony Lewis, a reporter for the New York Times, Assistant Attorney General Lee Loevinger admitted that his Antitrust Division was simply carrying on the enforcement policies of the preceding administration. He said "it just doesn't seem like the time to file any breathtaking, world-shaking cases—even if we were ready to." Another Department official was quoted in the same article as saying: "It is probably true that we are affected by business uncertainties to the point where we are holding up cases with a novel or uncertain character approach. We are sticking pretty much to the predictable, to the established lines."

Although I am aware, as we all are, of the criticism being leveled at the administration by business spokesmen, in part because of the recent steel price episode, I seriously question whether in shifting its policy emphasis and in disregarding major cases, the Department of Justice is living up to its legal and

moral responsibility. If the Antitrust Division is to perform a truly useful role, it must launch cases which have as their objective divestiture and other kinds of basic structural reorganization and relief that will reduce prevailing levels of concentration in our most important industries.

Until the Government seeks aggressively to obtain a more competitive climate in key industries, there will be room for participants in the less highly concentrated industries to feel they are the victims of a double standard. The gasoline station operators who agree upon prices at which they will sell their products are speedily brought within the criminal reach of the law. But the major oil companies which are able to achieve coordination in price, because of the concentrated character of the industry, go free. Both should be brought within the law.

While the Department of Justice is beset by administrative problems (its staff is too small for the job, and at the moment the Antitrust Division is operating far beneath authorized manpower levels), and while the law as written and interpreted is not nearly so clear as one would like, the fact remains that there is considerable room for improved enforcement that will lead to a more competitive market tone.

The situation is similar when one turns to the Federal Trade Commission. While this agency is possessed of considerable expertise in business regulation and thus should be in a position to contribute substantially to the attainment of the competitive goals, it has long been noted for its ineffectiveness. Although it handles a large volume of work, it continues to be bogged down in insignificant cases. During the fiscal year 1961, the Commission issued 410 complaints, but nearly three-quarters of these involved deceptive practices (primarily technical violations of the wool, fur, and textile labeling laws); only five new merger complaints were filed. Since July 1960 only six antimerger cases have been initiated, and only three between January 1961 and the middle of August of this year. This sorry performance has prompted one member of the Commission, Philip Elman, to say that there is in effect here "a kind of Gresham's Law (where the) trivial and inconsequential cases leave little room for, and tend to drive out, the substantial and significant." If the Commission is to perform a useful function in reducing existing concentration levels, it must allocate its enforcement resources more wisely. Like the Justice Department, the Commission's talents must be more productively employed.

### III. THE ROLE OF THE FEDERAL ADMINISTRATIVE AGENCIES

Over the years, a number of Federal administrative agencies have been created to regulate certain industries—most notably, transportation (including airlines, motortrucking, railroads, water carriers, pipelines), communications, and banking. The hope was that in this manner the behavior of these industries would be rendered compatible with the broader public interest in spite of their purportedly monopoly character. In actuality, however, the performance of the administrative agencies has been sorely disappointing. The agencies have not been able or willing to compensate for the lack of the inhibitions and rigors that competition imposes. Moreover, and of considerable importance, all too frequently the regulatory boards have begot monopoly, deliberately or through studied acquiescence, and curtailed what little competition typically reigns in these sectors.

Any effort to accommodate the antitrust policies of our country with the conduct of the various agencies is fraught with the utmost difficulty. Occasionally Congress will admonish these boards to consider the antitrust laws in reaching decisions, particularly those which involve mergers. More frequently, however, Congress has failed to indicate clearly whether, and if so and to what degree, the antitrust policies must be considered in resolving certain kinds of specific questions. In the approval of mergers involving motor carriers, for example, the pertinent statute declares that mergers may be approved if they are "consistent with the public interest." The Supreme Court has interpreted this phrase to mean that the Interstate Commerce Commission must weigh antitrust considerations in reaching its decisions, but that the antitrust features need not be given primary or exclusive weight; they are only factors to be considered along with all other relevant matters. The net result has been to leave antitrust policy in a very subordinate position, with the courts holding that the agencies' disposition of the antitrust issues is determinative. This places the administrative bodies on a pedestal and permits them, as they now so usually



do, to reduce their treatment of antitrust issues to little more than a ritual.

This is true even where the law does not expressly vest the regulatory board with a final say in the matter. As an example, take the recent case involving the merger of the Philadelphia National Bank and the Girard Trust Corn Exchange Bank, the city's second and third largest banks which together have about 37 percent of commercial bank assets in the four-county metropolitan area. Under the Bank Merger Act, this consolidation required the approval of the Comptroller of the Currency. Pursuant to law he sought the opinions of the Attorney General and the Federal Reserve Board, both of whom advised that the merger would result in a substantial lessening of competition and a tendency toward monopoly. Nevertheless, the Comptroller approved the transaction. The Antitrust Division took the case to court and earlier this year District Judge Clary upheld the merger. While he did not feel bound by the Comptroller's finding, it is perfectly clear, from a close reading of his opinion, that he was strongly persuaded by the earlier determination. "The courts," he observed, "have uniformly held that once Congress has reposed its confidence in the expertise of a particular department, the courts (sic) should not substitute its judgment in the place and stead of the department involved."

More vivid illustrations will be provided if and when the ICC and CAB approve the various proposed airline and railroad mergers with which they are presently confronted. The consolidation of American Airlines and Eastern Airlines for instance, will bring together the second and fourth largest domestic trunk carriers and eliminate much competition, particularly in the northeastern part of the country. Nevertheless, and in spite of the Board's efforts in the years beginning in 1955 to open up new routes to competition from other, smaller lines, Chairman Alan Boyd has, during the past year, made several speeches encouraging mergers and suggesting strongly that the Board will be favorably disposed to consolidations that will substantially reduce competition in the industry. The point need not be developed at length in this context, but I offer the conclusion, based upon a rather close look at the evidence in the case, that if the American combination is approved, it will greatly inhibit airline competition and hamper the development of a more balanced airline industry.

It again deserves emphasis that if this merger is approved by the CAB (or if any of the pending railroad mergers are allowed by the ICC), the courts will not substitute their judgment, even though the CAB (and the ICC) is unlikely to give the antitrust factors very little more than a passing mention. I would be less disturbed if the evidence available indicated that the Board (and the other administrative agencies) could reasonably be expected to exercise its regulatory functions with dispatch and efficiency. But this cannot be anticipated. For another example, although the Federal Communications Commission has long had jurisdiction to regulate international carrier rates, it has never done so. This is why many people believe that the attempt to justify the Telstar proposal on the ground that the FCC will regulate its operation is humorous.

What emerges from this survey is that we have deeded to the control of a number of administrative agencies the authority to regulate large and vital sectors of the economy (together accounting for something like 15 percent of our national income) without imposing adequate safeguards. In the process, the competitive ideal has been frustrated; the agencies have been permitted to encourage monopoly; and all of this without substituting effective economic regulation for the kind of demands imposed by the enterprise system.

#### IV. GOVERNMENT PROCUREMENT, PARTICULARLY RESEARCH AND DEVELOPMENT

Any effort to assess the relationships between Federal Government activities and industrial concentration must incorporate a consideration of procurement policies and practices. As we know, Federal purchases of goods and services as a share of the gross national product have increased steadily over the years, rising from 1.2 percent in 1929, for example, to 5.7 percent in 1939 and then in the post-war years after declining for a brief period to 6.7 percent in 1947, rising once more until today it makes up about 11 percent of GNP (\$57.0 billion in 1961).

As a consequence, the way in which these large flows of Federal funds are allocated can have a very serious impact in (a) accentuating, or reducing, or maintaining any given level of industrial concentration; (b) fulfilling or frustrating the congressional policy which declares, as expressed in the Small Business Act, that "the Government should aid, counsel, assist, and protect insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise. \* \* \*

Preserving fair access to Government research and development programs is just as important to fulfillment of national objectives as the procurement of goods themselves. Indeed it may be more important; speaking in 1956 former Attorney General Herbert Brownell pointed out that we must be deeply concerned "with the future of competitive enterprise, and it is important that its share of this (research) activity be administered to promote competition within the limits possible under the urgency and complexity of the defense program. However, although there is inadequate factual information upon which to judge the effect of Government subsidization of research, what indications that are available warn that the Government expenditures may not counter to the industry trend toward concentration, but in some degree may even reinforce it. \* \* \* The disproportionate share of total industrial research and development in the largest firms may foreshadow a greater concentration of economic power in the future. An adequate supply of technical manpower is the first prerequisite to any research and development program. Such programs themselves are basic factors in the development and expansion of our business economy. Therefore, a present concentration of such manpower and programs means that in the future an increasing share of anticipated improved technologies and new product lines will be introduced by the industrial giants."

Moreover, R. & D. leads to the creation of new products and technologies, and invariably when the Government elects to purchase these items in quantity it returns to the developer for their manufacture. Once an organization gets its nose under the R. & D. tent, it can readily enlarge its position through further developmental activity and ultimately hold a preferred position in manufacture. And this is not necessarily confined solely to purchases by the Government, for many products developed originally for special needs have clear civilian applications. These can range from such a simple item as the new type of sunglasses with straight sidepieces developed by the American Optical Co., for the Air Force under a \$367,000 contract to such large and important items as radar, jet airplane design (the Boeing 707, the first jet passenger in service, is a mere modification of the jet tanker used to fuel jet bombers in flight), penicillin and other antibiotics, blood plasma substitutes, silicon transistors, a variety of miniature electronic components, and so on through a very long list. If the smaller companies are effectively excluded from the Government R. & D. picture, the longrun implications for competition can be grave.

Over the years, valiant efforts have been made to gain a larger share of Government dollar outlays for smaller firms. Congress has created the Small Business Administration and the principal executive departments have pledged their diligence in insuring that smaller firms will be given a chance to obtain business from the Government. How successful this has been, though, remains an open question. In the fiscal year 1961, for example, the Department of Defense spent about \$23 billion with business firms for work in the United States. Of this amount, small business firms received approximately 16 percent (29.6 percent in the case of Army purchases, 15.5 percent for the Navy, and 9.3 percent for the Air Force). During the first three quarters of the fiscal year 1962, small business was awarded about 16 percent of total dollar outlays by the Department of Defense and its constituent services, with most of this, as usual, concentrated in transactions of less than \$10,000.

Whether this performance is good or bad is a matter which I do not wish to explore at this time. What I want to do, rather, is compare the situation in respect to military procurement generally with the specific case of research and development. Here the evidence strongly suggests that the smaller organizations have been seriously disadvantaged relative to their larger rivals and that the military services have made little serious effort to provide small companies with fair opportunities for doing the desired work.

#### *General information on research and development*

Outlays for research and development in the United States constitute one of the most dynamic forces in the economy. Between 1953 and 1961, for example, while the gross national product was rising only 43 percent, outlays for R. & D. from all sources rose by about 300 percent. Even more recently R. & D. has been accelerating at a faster rate than most other sectors of the economy; from 1957 to 1961 gross national product went up 18 percent, R. & D. outlays by about 50 percent. In 1961, the best available estimate indicates that \$15 billion was spent on R. & D. This compares with a little over \$14 billion in the prior year and with only \$10 billion as late as 1957. Reasonably detailed data show that while

the Federal Government provides about two-thirds of all funds for the performance of R. & D. the predominant share of the work itself is performed not by the Government but by private industry. Appendix table 1 indicates this more fully.

Digging beneath the surface, further analysis reveals that the performance of R. & D. is highly concentrated—almost regardless of the index of concentration employed. In 1959 (this is the latest year for which detailed information is now available) the 406 companies with 5,000 or more employees (3 percent of the total number of firms with R. & D. programs) accounted for 86 percent of aggregate R. & D. activity. At the other extreme, the 10,600 companies with less than 1,000 employees (90 percent of the total number of firms with such programs) performed only 6 percent of industrial R. & D.

Furthermore, most small companies have no R. & D. programs at all and of those that do, their outlays for this purpose are extremely small (nearly half of these companies spent less than \$10,000 on research in 1959). The big companies thus do most of the work, and indeed, the biggest of the big companies do almost all of the R. & D. And this concentration of activity is even more intense than is concentration generally. For instance, while the 100 corporations with the largest R. & D. programs accounted for 81 percent of aggregate R. & D. these same firms accounted for only about 41 percent of total sales within their respective industrial categories. Related data are contained in appendix table 2.

One finds as well that the bulk of R. & D. outlays are concentrated within a very few industrial categories and have rather specialized scientific objectives. In 1959, of \$9.6 billion spent on R. & D. in industry, over \$3 billion were in aircraft and parts, with another \$2.2 billion in electrical equipment and communication. The heaviest emphasis is on development and applied research as distinct from basic research. About 70 percent of total outlays in this sector are for development and another 20 percent for applied research. Basic research, by contrast, receives less than 10 percent of the total. Moreover, the physical and mathematical sciences dominate the scene, making up about 60 percent of total funds for basic research in 1959, and accounting, of course, for virtually all of the expenditures for development and applied research.

What emerges, therefore, in this kind of picture: amounts spent for R. & D. have been rising rapidly in recent years, with most of the funds flowing from the Federal Government; the bulk of the actual performance is done by private industry; within industry a small number of firms do most of the work and get most of the money appropriated by the Federal Government for this purpose; the principal portion of our attention is focused on a very few industrial sectors, principally those related to missiles, aircraft, and electronic and communication equipment; and little work is being done on basic research and very little on the life sciences.

Putting up two-thirds of the funds and engaging in considerable research on its own, the Federal Government rather obviously is principally responsible for the character of contemporary R. & D. In the present fiscal year it is estimated that the Federal Government will spend \$12.4 billion for this function, with \$7.2 billion, or 58 percent, of this originating with the Department of Defense; NASA will add another \$2.4 billion, or 19 percent; and the AEC an additional \$1.4 billion, or 11 percent. Together, then, these three agencies account for nearly 90 percent of all Federal outlays for R. & D. and it is their interests which naturally exert the largest influence on R. & D.

The way in which these agencies, particularly the Department of Defense, handle their contracting for R. & D. is thus of critical importance in evaluating the position of smaller firms in the overall picture. Here, for the sake of brevity, I will look primarily at the performance of the Military Establishment.

Just 6 years ago, in the fiscal year 1956, expenditures for EDTR (experimental, development, test, and research work—the military terminology for R. & D.) accounted for only 13.5 percent of all military procurement. Gradually this has increased, spurred on by missile and space-related projects, with the result that by fiscal 1959, EDTR accounted for 22.6 percent of total procurement. Since then it has risen less sharply to 25.7 percent in 1961. Among the individual services there are sharp differences in the relative importance of research activity. In fiscal 1961, although the Army spent merely 12 percent of its money on EDTR and the Navy 20 percent, the Air Force spent 36 percent and accounted for about two-thirds of all military funds allocated for this purpose.

In the distribution of funds for research work, small business concerns receive a disturbingly small amount of the total awards. Indeed, by comparison, military awards to small firms for procurement of hardware appear extremely generous. In fiscal 1961, small businesses received only 2.9 percent of total awards for EDTR—and this reflects a steady decline over the last 6 years, as appendix table 3 demonstrates.

Even among those corporations which are fortunate enough to share in the Department of Defense largess for research and development there is a similar degree of pronounced concentration. Of awards for EDTR in the fiscal year 1961, which in the aggregate totaled \$6.025 billion, eight corporations accounted for one-half of the total, with General Dynamics and Lockheed Aircraft Corp. together making up over 19 percent. More generally, one finds that the largest 20 recipients accounted for nearly three-fourths of all EDTR awards during the year. And this sort of pattern is true even if awards for all agencies of the Federal Government are included. The 300 manufacturing companies with the largest programs for R. & D. performance accounted for 99 percent of all Federal research and development activity in 1959. Looked at in a different way, judged by the size of the firm doing the work, one also finds that the largest firms did most of the Federal outside research. Concerns with 5,000 or more employees accounted for over 90 percent of all Federal financing in this area in 1959. (See appendix table 4.)

Not only is defense-related research activity concentrated in the hands of a very small number of firms, but a similar pattern is noticeable on a geographic basis. In fiscal 1961, California alone was the situs of over 41 percent of EDTR awards. New York accounted for another 12 percent and along with Massachusetts, Washington, and Colorado these five States recorded nearly 70 percent of all Defense Department activity. Quite properly the Department of Defense, in a rather surprising declaration, acknowledged this year that "a region that gains a long head start in a new and expanding field of procurement is bound to enjoy an enduring advantage, especially when R. & D. is a primary element." As this comment recognizes, the award of funds for R. & D. gives rise to a sort of snowballing process in which the award produces competence that becomes the basis later for still further awards, for ultimate production, and for civilian applications.

One contention frequently advanced by both industry spokesmen and officials of the Department of Defense, however, is that the kind of figures noted here fail to take account of subcontractors. Smaller firms may actually do substantial portions of the work involved, so the argument goes, although the money may flow through a large prime contractor. While perhaps a plausible argument on its face, a close look at the available evidence suggests strongly that very little subcontracting takes place in the R. & D. area. The National Science Foundation, in its comprehensive survey in this field, reports that in 1959 only 10 percent of all funds allocated by the Federal Government for research purposes was actually spent by firms with less than 5,000 employees, including less than 5 percent by firms with fewer than 1,000 employees. (It is important to emphasize that this evidence is based on questionnaires submitted to firms which ask them to report whatever research they actually do with Federal funds; i.e., the prime contractor would not report, therefore, on work which he did not in fact do, such as where part of the job was let to a subcontractor.) Certainly this indicates that whatever subcontracting does occur is insignificant and does not alter the intense concentration of Federal outlays that we have noted earlier.

There is still another question, however, which must be considered. The point is commonly made, particularly by those in the Defense Establishment, that only the largest firms possess the requisite technological skills and that the smaller firms are excluded, not because they are small, but because they lack the requisite know-how. One Defense Department official expressed this to me by saying, "The best evidence that the small firms do not have the proper skills is that they do not obtain a larger proportion of contracts for R. & D."

But this assumes that all firms, regardless of size or familiarity, are given an equal chance to secure R. & D. ends—and this is not presently the case. Naturally, the larger firms do have many outstanding people on their payrolls; but the smaller firms are not devoid of scientific skill. In fact, many of them are composed of individuals who formerly worked for the giant corporations. At the moment it is estimated that there are over 3,000 small research and development organizations in the United States, and the work that many of them have done is impressive. (Jewkes' study found that several major inventions, including continuous hot-strip rolling, DDT, and terylene polyester fibers, were developed

by relatively small organizations, not to mention the many inventions of independent inventors, like radio, cellophane, insulin, penicillin, streptomycin, and the jet engine.) To write off the smaller firms, as many of the Defense Department procurement people seem to have done, is thus of questionable wisdom.

This is not the place to attempt to assess the relative capacities of small and big organizations to do scientific work. But it is appropriate here to indicate that the processes employed by the Department of Defense in awarding contracts for R. & D. are such as seriously to discriminate against the smaller concerns. The existing contract procedures for R. & D., as employed by the Armed Forces, do not require any broad dissemination of information relating to anticipated contract awards. No formal advertising takes place for research and development. Only a limited amount of information seeps out through the synopsisizing requirement. As a consequence, the negotiation of R. & D. contracts is generally conducted with only a very few participants who have been invited by the contracting authorities.

The uninvited either are unaware negotiations are underway or are rebuffed if they even seek out information that would enable them to make a proposal relative to the job under consideration. Most contracts for R. & D. are thus awarded on either a sole-source basis or after discussions and negotiations with a very small number of contestants, competing with one another—not on the basis of price—but via comparison of their project proposals. The winner in this race is the firm that can produce the most glamorous and promising drawings. But at present this is largely a closed race, and only the largest companies are permitted to enter the starting gate.

In part, the secrecy of R. & D. contracting is evidenced by the fact that during the first 9 months of fiscal 1962 only 36 percent of the dollar amount of procurement awards was even publicized to small business—and this in spite of congressional policy which declares formal advertising, not just publicity, to be the usual means of Government procurement. Although Congress has made many exemptions to this general rule, in the Small Business Act of 1961 it required that all procurements which need not be formally advertised must be synopsisized in the Department of Commerce Business Daily. Yet in the first three quarters of fiscal 1962, only 22 percent of all contract awards were so announced. The problem is even more serious in the specific case of EDTR. While more detailed data would be helpful, it is known that in the first 9 months of fiscal 1962 only 16 percent of the dollar value of all research and development awards was made on a competitive basis. And actually only 3.2 percent of such awards was made on a competitive price basis. The absence of competition and the lack of effective publication go together.

As I have indicated above, the Small Business Act of 1961 makes it the duty of the Secretary of Commerce to publicize notices in the daily Department of Commerce synopsis for all proposed defense procurement actions of \$10,000 and above, with specified exceptions.

Implementing this requirement, the Department of Defense has adopted regulations which provide that "every specific procurement of research and development projects shall be publicized in the Commerce Business Daily \* \* \*." On the face of it, this seems to open up research and development contracting to public gaze, and to give firms, small or large, that might be interested in working on a project, a chance to participate in the early stages of selection. However, another provision in the Armed Services Procurement Regulation (ASPR) authorizes contracting officers to request proposals "only from sources which have been technically evaluated and found qualified to perform research and development in the specific field of science or technology involved." Indeed, ASPR 3-107.4 provides that solicitations to enter into negotiations may be limited to a single source where prior technical evaluation has been made. But technical evaluation, though it might imply a comprehensive screening of all interested parties, fairly informed, actually involves an extremely limited process; the appropriate survey is typically made by the contracting officer (complemented by engineering personnel) simply on the basis of what information he already has at his disposal. What this means is that a firm which has previously done work in the same general area has a clear inside track on the new contract for the simple reason that it is known to the contracting official. And under the existing regulations, no other firm need be given an opportunity to participate in the award. Moreover, even where procurement is not limited to a single source, usually only a very few firms are asked to submit proposals. In these instances of limited source procurement the relevant synopsis, if and when it is published, only recites

that a contract is being awarded to a named firm or that "competition" is limited to named companies; all others are told bluntly to stay away.

Consequently, the Department of Defense and the contracting services are not now in a position to say that smaller firms are lacking in the kinds of scientific knowledge required to do work on EDTR projects. They simply do not know. They deal only with the established concerns and exclude from consideration anyone else. While everyone agrees that we want to use the best resources available in the performance of complex research, there is serious doubt as to whether we are actually doing so; the large firms, though generally capable and possessed of great talents, have no monopoly on technical expertise. Yet the Defense Department presently acts as if they did.

It is my considered judgment, on the basis of the inquiries I have made, that the Department of Defense could do a much better job in broadening the base of R. & D. awards if it revised its procedures to give all comers an opportunity to demonstrate their competence in respect to given research undertakings.

#### *The aftermath of R. & D. contract awards*

As was suggested earlier, a contract for the performance of research and development is only the beginning of the story. If the effort has its intended purpose and results in a usable item of hardware, production opportunities lie immediately ahead. And in most instances the large company anticipates that it will earn its largest returns at this stage of the process. When the contract for production is let, it is common for the organization that did the pertinent research to be awarded the new production contract. Defense Department officials admit frankly that the developer is in a preferred position, its familiarity with the product deemed to make it the most efficient manufacturer. And frequently this will be the case.

Yet once the product has been developed and detailed plans and specifications prepared and submitted (as the usual R. & D. contract requires) it is rare that other qualified firms cannot produce the item. But not infrequently they are simply denied the opportunity to bid. This kind of situation was reviewed recently by the Subcommittee for Special Investigations of the House Committee on Armed Services in respect to the Navy Department procurement of a radio known as the AN/PRC-41. There the Navy planned to grant a sole source, a \$4.4 million contract for production to the developer; another company sought to bid, but until a Member of Congress intervened strenuously in its behalf it was denied the opportunity; when it did attempt to bid it was handicapped because the developer had not submitted the detailed specifications and drawings required for manufacture; and ultimately the Navy did make the award to the company it had first favored. This is a typical example; thousands of others like it could be found. Once a company does the relevant R. & D. work, it will normally be awarded the production contract—a practice that thus tends to entrench further the initial pattern of concentration. (For the fiscal year 1961 the largest six recipients of EDTR awards from the Defense Department were also at the top of the ladder for non-EDTR procurement.)

When one considers also that many of the products developed under contract with the Government (e.g., chemicals, drugs, a variety of products and new processes) have immediate or long-term civilian applications, the significance of patent policy becomes readily apparent. This is a complex question and raises a host of other issues and I will not attempt to treat them more than superficially on this occasion. It is widely known that the Department of Defense does not generally seek a patent on products developed under its research contracts; it permits the developer to secure the patent even where Government funds may have represented all or nearly all of the costs incurred (and even where, as is usually the case, the project was financed on a cost-plus basis). The Defense Department simply takes back a nonexclusive, royalty-free license.

In following this course of action DOD not only departs from the policies of other Government agencies (like NASA and AEC), which take title to the patent, but also contradicts the procedure employed by private companies in dealing with their own employees and subcontractors. When they supply funds or facilities for research they require the subordinate to assign title to whatever patents that are acquired in the process. By following a different course the Defense Department (and NASA, if proposed legislation is adopted) seems likely to insulate still further the position of the big concerns with which it does most of its research contracting. And, as has been indicated, many defense-financed projects have civilian uses, so that the patents acquired may give the firm a dominant position in the civilian market as well as in military and Government sales.

One other facet of the Government-financed R. & D. sector deserves brief mention—namely, the fact that so little effort is made to exploit the vast quantities of information gained in the performance of research and development. Various Government agencies are presently provided small sums of money to publish abstracts of research reports. But the reporting standards are low: many reports are never submitted at all, in spite of contractual requirement; most are written in a fashion suggesting that the researcher wished to keep the information secret (which, no doubt, is a common objective); the technical abstracts are of little help, and of none to businessmen as distinct from scientists (and it is the businessman who must sense a possible use before the information can be placed at the disposal of the society).

In short, we are getting far less from our research expenditures than we could if the information so obtained were disseminated more widely, in more digestible form. This entire matter requires much fuller attention. But it may be at some time that Government will have to create a special agency charged with the task of collecting, analyzing, and exploiting the massive quantities of research findings we are now accumulating.

## CONCLUSION

If we sincerely want to reduce the prevailing levels of concentration in the American economy, as I believe we can and should in order to improve our chances of attaining our generally desired objectives (including those declared in the Employment Act), then the preceding survey should suggest many topics for further inquiry by this committee. The contradictory nature of our Federal policies in dealing with the whole matter of industrial organization warrants exposition and fuller analysis. What must be understood is that we cannot reduce monopoly and encourage competition by stirring together in one pot timid antitrust enforcement, monopoly incitement by the principal administrative agencies, and procurement practices that tend unduly and unfairly to favor the largest companies.

The way in which we handle our allocation of funds for research and development provides as good a test as any of our determination to enlarge the opportunities for smaller firms and in this way take a short step toward reducing concentration. Procedures can and should be developed that will give all businesses, new or long established, and regardless of size, a just chance to participate in the selection process and to perform R. & D. for the Federal Government. Such an opportunity does not now in fact exist, and most of the contracts are going to the biggest concerns, promising serious adverse consequences over the years to come. This situation can be corrected, freer competition can exist, increased concentration can be prevented—but not if we permit our present inconsistent and inadequate policies and practices to continue. Reforms are sorely needed and this committee is in an ideal position to stimulate their adoption.

APPENDIX TABLE 1.—*Intersectoral transfers of funds used for performance of research and development, by source and performer, 1960-61 (preliminary)*

[Millions of dollars]

| Funds provided by—                              | Sectors—Funds for performance of R. & D. |          |                           |                              |          | Percent distribution, R. & D. sources |
|-------------------------------------------------|------------------------------------------|----------|---------------------------|------------------------------|----------|---------------------------------------|
|                                                 | Federal government                       | Industry | Colleges and universities | Other nonprofit institutions | Total    |                                       |
| Federal Government.....                         | \$2, 060                                 | 176, 130 | 1 \$890                   | 1 \$140                      | \$9, 220 | 65                                    |
| Industry.....                                   |                                          | 4, 370   | 50                        | 70                           | 4, 490   | 32                                    |
| Colleges and universities <sup>2</sup> .....    |                                          |          | 210                       |                              | 210      | 2                                     |
| Other nonprofit institutions <sup>2</sup> ..... |                                          |          | 50                        | 70                           | 120      | 1                                     |
| Total.....                                      | 2, 060                                   | 110, 500 | 11, 200                   | 1 280                        | 14, 040  | 100                                   |
| Percent distribution R. & D. performance.       | 15                                       | 75       | 8                         | 2                            | 100      |                                       |

<sup>1</sup> This amount includes funds from the Federal Government for research centers administered by organizations under contract with Federal agencies.

<sup>2</sup> Data include State and local government funds. All data are based on reports by the performers.

Source: National Science Foundation, "Reviews of Data on Research and Development," No. 33, April 1962, table 3, p. 4.

APPENDIX TABLE 2.—Percentage of total R. & D. performance funds and total federally financed research and development accounted for by the 4 and 8 companies with the largest dollar volume of R. & D. performance, by industry, 1959

| Industry                                                    | Percent of R. & D. performance |                 | Percent of federally financed R. & D. |                 |
|-------------------------------------------------------------|--------------------------------|-----------------|---------------------------------------|-----------------|
|                                                             | 1st 4 companies                | 1st 8 companies | 1st 4 companies                       | 1st 8 companies |
| Food and kindred products.....                              | 37                             | 55              | (1)                                   | (1)             |
| Textiles and apparel.....                                   | 58                             | 70              | (1)                                   | 100             |
| Lumber, wood products, and furniture.....                   | 42                             | 55              | (1)                                   | (1)             |
| Paper and allied products.....                              | 44                             | 58              | (1)                                   | (1)             |
| Chemicals and allied products.....                          | 45                             | 56              | 86                                    | 91              |
| Industrial chemicals.....                                   | 63                             | 79              | 87                                    | 92              |
| Drugs and medicines.....                                    | 45                             | 67              | 79                                    | 94              |
| Other chemicals.....                                        | 28                             | 45              | (1)                                   | 57              |
| Petroleum refining and extraction.....                      | 50                             | 73              | 62                                    | 66              |
| Rubber products.....                                        | 85                             | 91              | 90                                    | 99              |
| Stone, clay, and glass products.....                        | 51                             | 70              | 45                                    | 71              |
| Primary metals.....                                         | 44                             | 58              | 47                                    | 73              |
| Primary ferrous products.....                               | 59                             | 76              | (1)                                   | (1)             |
| Nonferrous and other metal products.....                    | 56                             | 72              | (1)                                   | 88              |
| Fabricated metal products.....                              | 48                             | 65              | 62                                    | 89              |
| Machinery.....                                              | 48                             | 58              | 64                                    | 79              |
| Electrical equipment and communication.....                 | 63                             | 77              | 64                                    | 81              |
| Communication equipment and electronic components.....      | 60                             | 77              | 63                                    | 80              |
| Other electrical equipment.....                             | 89                             | 91              | 97                                    | 98              |
| Motor vehicles and other transportation equipment.....      | 90                             | 94              | 93                                    | 98              |
| Aircraft and parts.....                                     | 50                             | 71              | 51                                    | 71              |
| Professional and scientific instruments.....                | 62                             | 70              | 71                                    | 81              |
| Scientific and mechanical measuring instruments.....        | 75                             | 83              | 92                                    | 95              |
| Optical, surgical, photographic, and other instruments..... | 64                             | 79              | 63                                    | 81              |
| Other manufacturing industries.....                         | 60                             | 66              | 57                                    | 66              |
| Nonmanufacturing industries.....                            | 33                             | 40              | 69                                    | 73              |

<sup>1</sup> Not available.

Source: National Science Foundation (NSF 62-3), "Funds for Research and Development in Industry, 1959," app. A, table A-11, p. 62.



APPENDIX TABLE 3.—*Awards for experimental, developmental, test, and research work, by type of contractor*

[Amounts in thousands]

| Type of contractor                                                                                             | Fiscal<br>year<br>1956 | Fiscal<br>year<br>1957 | Fiscal<br>year<br>1958 | Fiscal<br>year<br>1959 | Fiscal<br>year<br>1960 | Fiscal<br>year<br>1961 | July 1961-<br>March<br>1962 |
|----------------------------------------------------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|-----------------------------|
| Total experimental, develop-<br>mental, test, and research <sup>1</sup> .....                                  | \$2,404,440            | \$3,256,371            | \$4,031,036            | \$5,230,057            | \$5,551,054            | \$6,023,402            | \$4,299,677                 |
|                                                                                                                | Percent                | Percent                | Percent                | Percent                | Percent                | Percent                | Percent                     |
| Experimental, developmental,<br>test, and research percent of<br>all military procurement <sup>1</sup> .....   | 13.5                   | 16.8                   | 18.1                   | 22.6                   | 25.6                   | 25.7                   | 22.5                        |
| Army.....                                                                                                      | 10.1                   | 9.5                    | 12.4                   | 15.2                   | 15.0                   | 12.3                   | 12.9                        |
| Navy.....                                                                                                      | 9.1                    | 12.0                   | 15.5                   | 17.8                   | 23.0                   | 20.0                   | 10.1                        |
| Air Force.....                                                                                                 | 18.1                   | 23.8                   | 22.4                   | 29.2                   | 32.8                   | 36.3                   | 39.2                        |
| Experimental, developmental,<br>test, and research percent of<br>all procurement from busi-<br>ness firms..... | 13.5                   | 15.9                   | 17.1                   | 21.5                   | 24.6                   | 24.6                   | 21.4                        |
| Army.....                                                                                                      | 10.1                   | 8.1                    | 10.8                   | 13.7                   | 14.1                   | 11.5                   | 12.4                        |
| Navy.....                                                                                                      | 9.1                    | 11.0                   | 14.3                   | 16.7                   | 21.6                   | 18.6                   | 8.9                         |
| Air Force.....                                                                                                 | 13.1                   | 23.0                   | 21.7                   | 28.2                   | 32.0                   | 35.2                   | 38.2                        |
| Small business percent of ex-<br>perimental, developmental,<br>test, and research.....                         | 5.7                    | 4.3                    | 3.7                    | 3.5                    | 3.4                    | 2.9                    | 2.6                         |
| Army.....                                                                                                      | 9.4                    | 9.7                    | 7.1                    | 7.6                    | 6.2                    | 4.7                    | 3.3                         |
| Navy.....                                                                                                      | 8.9                    | 8.4                    | 5.9                    | 5.8                    | 5.5                    | 5.4                    | 8.6                         |
| Air Force.....                                                                                                 | 3.6                    | 2.0                    | 2.1                    | 1.7                    | 1.9                    | 1.6                    | 1.3                         |

<sup>1</sup> Except intragovernmental and outside United States.

Source: Office of the Secretary of Defense, "Military Prime Contract Awards and Subcontract Payments" (July 1961-March 1962), table 7, p. 24.

APPENDIX TABLE 4.—*Federally financed research and development performance, by industry and size of company, 1959*

|                                                                         | <i>Millions of<br/>dollars, 1959</i> |
|-------------------------------------------------------------------------|--------------------------------------|
| Total.....                                                              | \$5, 610                             |
| <i>Distribution by industry:</i>                                        |                                      |
| Food and kindred products.....                                          | (1)                                  |
| Textiles and apparel.....                                               | 7                                    |
| Lumber, wood products, and furniture.....                               | (1)                                  |
| Paper and allied products.....                                          | (1)                                  |
| Chemicals and allied products.....                                      | 284                                  |
| Industrial chemicals.....                                               | 280                                  |
| Drugs and medicines.....                                                | 3                                    |
| Other chemicals.....                                                    | 1                                    |
| Petroleum refining and extraction.....                                  | 24                                   |
| Rubber products.....                                                    | 37                                   |
| Stone, clay, and glass products.....                                    | 2                                    |
| Primary metals.....                                                     | 15                                   |
| Primary ferrous products.....                                           | 2                                    |
| Nonferrous and other metal products.....                                | 13                                   |
| Fabricated metal products.....                                          | 58                                   |
| Machinery.....                                                          | 404                                  |
| Electrical equipment and communication.....                             | 1, 575                               |
| Communication equipment and electronic components.....                  | 842                                  |
| Other electrical equipment.....                                         | 732                                  |
| Motor vehicles and other transportation equipment.....                  | 249                                  |
| Aircraft and parts.....                                                 | 2, 610                               |
| Professional and scientific instruments.....                            | 175                                  |
| Scientific and mechanical measuring instruments.....                    | 123                                  |
| Optical, surgical, photographic, and other instruments.....             | 52                                   |
| Other manufacturing industries.....                                     | 101                                  |
| Nonmanufacturing industries.....                                        | (1)                                  |
| <i>Distribution by size of company (based on number of employees) :</i> |                                      |
| Less than 1,000 (5 percent of total funds).....                         | 276                                  |
| 1,000 to 4,999 (5 percent of total funds).....                          | 276                                  |
| 5,000 or more (90 percent of total funds).....                          | 5, 058                               |

<sup>1</sup> Not separately available but included in total.

Source: National Science Foundation (NSF 62-3). "Funds for Research and Development in Industry, 1959," table III, p. 11.

Dr. BARBER. While I do not want to go over the ground that has been covered so splendidly by my fellow panelists, I think it worth emphasizing that the kinds of industries which they have been speaking of, automobiles, in the case of Professor Adams; steel, noted among other things by Dr. Kahn; chemicals, mentioned by Professor Lanzillotti, are excellent illustrations of the pattern of dominance that exists in our most basic industries.

I have outlined some of this data in a table at the top of page 3 of my prepared statement, merely to suggest the kind of situation that does prevail.

What we have in our industry is typically not a monopoly, but a situation in which a rather small number of firms dominate most of the output, make the critical decisions, and are able to enforce their policies throughout the market or markets in which they function.

As my colleagues have suggested, we have in these industries a kind of "spontaneous coordination" (the term is not mine), something which the lay observer regards as the equivalent of collusion. For example, in 1956—and this example, I might say, is also in Professor Adams' statement—the Ford Motor Co. initially announced an average cost increase on its models of 2.9 percent. Two weeks later,

General Motors increased its 1957 model prices by an average of 6.1 percent.

What happened? Did Ford hold on to its prices in order to increase its share of the market? It did not. A week later Ford revised its prices upward to match almost dollar for dollar the comparable General Motors prices. And Chrysler, I might say, later got in line.

To the outside observer this sort of conduct suggests it must be the product of actual collusion. It could be. I do not make any such allegation.

My own hunch, though, is that this typically stems from the structure of the market. When you have a rather small group of firms, each accounting for a significant share of sales, they tend, over a period of time, to get in step with one another.

I think you could draw analogies to international diplomacy. These firms do not want to, and they openly admit that they do not, consider price warfare a proper instrument of their diplomatic policy. They will compete in advertising, in corporate image, in product design, but not in price.

And this need not necessarily be the product of collusion. It is the product of the structure of the industry.

Senator BUSH. If they did compete in price, somebody is going to win, and you would have even a greater concentration, then, in the winner, than is disclosed in your table here; would you not?

Dr. BARBER. Well, there are, I think, two points to be made.

First of all, the kind of competition that I am looking for in price terms, Senator, would be the kind that would occur in an industry structurally competitive. In other words, I am not starting with the assumption that we would have two or three firms.

My second point is that I am not at all certain that we would have a winner. This seems to me to suggest that in some way we would have, say, an automobile company that could drive out all of its competitors. I do not think that is the case.

Senator BUSH. But the case has been made, here, that in the automobile industry they have driven an awful lot of them out. And they have it down, now, as you say, to where four companies control 99 percent of the business.

I remember 2 years ago there were an awful lot of automobiles.

Dr. BARBER. Yes; and a good bit of the disappearance of companies has come through processes of merger. Mr. Patman yesterday read into the record a statement of the number of mergers which General Motors had made over the years.

Senator BUSH. A lot of the mergers were a result of failures. They could not make a go of it, and so just sold out.

Dr. BARBER. In part. But some are important acquisitions, such as those of Fisher Body and Chevrolet. I think this point may come out as we proceed along, because I know we are short of time.

The situation that I am outlining here, in terms of the lack of price competition, the lack of aggressive pricing action, the refusal to consider this an appropriate instrument of policy, has, it seems to me, very serious implications insofar as broad economic movements are concerned, particularly on the downside. When a company adopts, as a formula, a target of 20-percent return after taxes

on invested capital over the long run, at 70 percent of capacity, what happens when you get a recession? What happens when demand slackens?

Well, sales begin to fall. Employment declines, as do profits.

Under these conditions, one might normally expect that a firm would make some downward adjustment in prices to offset these unfavorable short-run factors.

But if you have a target formula, your response is: "Well, we expect this. There will be good years, which will offset our bad years, and we are not interested in maximizing our return over a year period, or even a 2-year period. We are interested in gaining a certain return on our investment over a long period time."

Consequently there is a sort of a built-in stability factor, insofar as price is concerned.

And I think another important thing to recognize is that the ability of companies to stick with this policy, once they have defined it, stems from the concentrated character of the industry.

Well, against this background of the structure of these concentrated industries, how does our public policy shape up?

First of all, we have to turn to the antitrust laws and see how they are being enforced. Here, as I indicate on the first page, and also in more detail within my prepared statement, I find a highly unsatisfactory performance.

I think the laws are being enforced at the present time in an extremely conservative and cautious fashion. And what activity that does take place is unlikely to have any significant impact on existing concentration levels.

I direct attention to the fact that in the calendar year 1961, of 60 cases that were begun by the Department of Justice's Antitrust Division, 28 involved so-called per se violations, most notably price fixing, bid rigging, and such. Of course, these are clearly unlawful arrangements; they should be punished; they violate the law.

But the question I have is whether we should be putting as much emphasis upon this sector as we are, to the great lack of interest we are displaying in other kinds of problems.

Note also that 19 cases were directed against mergers, an important area of activity, but one which does not usually have the effect of achieving any lower level of concentration. Antimerger litigation is essentially preventive in nature.

The predominant enforcement attention, therefore, is being devoted to kinds of cases that deal with new developments, like proposed mergers, or with manifestly improper kinds of activity, like price fixing. Such kinds of cases should be undertaken. But I ask whether it would not be wiser to devote relatively greater attention to other kinds of issues, those presenting more fundamental economic issues.

And as I look at the current year, I find that the number of cases and the volume of work that the Antitrust Division is doing is declining. Last year, as I noted, the Department of Justice filed 19 anti-merger cases. So far, during this year—and this includes to date—the Antitrust Division has filed six cases.

Examining the list of industries involved in offenses in the per se area, which includes such "vital" product markets as venetian blinds,

the sale of kosher food products in New York City, ice show productions, and service station prices in Washington, I cannot help but think that we are allocating too high a proportion of our resources to triviality, and that we are not dealing with the more important sectors.

Indeed, Assistant Attorney General Loevinger, who testified here yesterday, admitted as much, in June, in an interview with Anthony Lewis, a reporter for the New York Times. In that article, an unidentified official of the Division was quoted as saying:

It is probably true that we are affected by business uncertainties to the point where we are holding up cases with a novel or uncertain legal approach. We are sticking pretty much to the predictable, to the established lines.

I think that well characterizes current activity of the Antitrust Division; it is not going to rock the boat. The Department of Justice seemingly is more interested in preserving business confidence than it is in carrying out the law and deconcentrating industries which, as we have noted, present some very real economic problems.

And if you look at the Federal Trade Commission, the other half of the antitrust enforcement team, you find the same kind of situation. In fact, I regret to note that the Commission appears to be doing less well than under the prior administration.

Indeed, so much of its work is concentrated on very minor offenses, technical violations of the textile-labeling law, for example, that it has prompted one member of the Commission, Philip Elman, to say that there is in effect here—

a kind of Gresham's law, where the trivial and inconsequential cases leave little room for and tend to drive out the substantial and significant.

What we must recognize is that neither of the two principal anti-trust agencies, the Federal Trade Commission and the Department of Justice, is doing a very aggressive job, a very imaginative job. Essentially, they are riding along, attacking the occasional overt and unquestionably evil cases, but not doing anything that will de-concentrate important industrial sectors.

Let me mention briefly the role of another group that is involved in this field, namely the Federal administrative agencies. I will make these remarks very short, but I do think it is important to recognize what has happened.

Congress has deeded to these agencies the authority to regulate a number of important industrial sectors which originate probably about 15 percent of our national income; and of course these are vital industries, mainly possessing the character of utilities, transportation, banking, and so forth.

The theory, of course, was that the agencies would substitute effective economic regulation for the absence of competition. Well, as it has turned out, the agencies, I think on the whole, have encouraged monopoly, on the one hand, and on the other hand have not accomplished effective regulation.

Typically, these agencies encourage merger, as is being done at the present time by the Chairman of the Civil Aeronautics Board, and do nothing effective in the way of regulating rates and other behavior.

This is why I think so many people believe that the attempt to justify the telstar proposal, on the ground that the FCC will regulate its economic implications, is little more than humorous.

Now let me turn to another area, that of Federal Government procurement. And I want to spend a bit more time on this, though the hand of the clock moves much too rapidly.

Here is an area, I suggest, where the Federal Government can have a strong impact, either on increasing concentration, preserving existing levels of concentration, or encouraging freer competition.

Well, what is it doing? We know that the Federal Government's position in terms of procurement of goods and services as a percentage of some figure, such as the gross national product, is rising. It now makes up about 11 percent of the GNP, for example. Within this category, we find that the share absorbed by the defense agencies is large, and has maintained this position for a long period of time. For example, in the fiscal year 1961, the Department of Defense alone purchased over \$25 billion worth of goods and services.

Senator BUSH. What percentage of that?

Dr. BARBER. The percentage of allocations for national defense. Let me give you a figure at an annual rate based on the second quarter of this year; that would be about 9.6 percent of the GNP.

Senator BUSH. No. I was speaking of the total Government. You said they did \$25 billion. What was the total Government procurement?

Dr. BARBER. In 1961, the Federal Government's purchases of goods and services were \$57 billion.

Senator BUSH. So it is a little less than half?

Dr. BARBER. That is right.

Now, within this defense sector, I want to look specifically at the procurement of research and development.

Research and development outlays in the economy as a whole constitute one of the most important and most dynamic items.

On page 17, I am reading, now:

Between 1953 and 1961, for example, while the GNP was rising only 43 percent, outlays for research and development from all sources rose by about 300 percent. Even more recently R. & D. has been accelerating at a faster rate than most other sectors of the economy; from 1957 to 1961, the gross national product went up about 18 percent; research and development outlays by about 50 percent.

Indeed, in the year 1961, the best available estimate indicates that \$15 billion was spent on R. & D., from all sources. But within this broad picture one must sense that the Federal Government plays the dominant role.

If you will look at table 1 of the appendix to my statement, at the end of the paper, you will see this. For the period 1960-61 that of a little over \$14 billion that was spent on performance of research and development, the Federal Government put up 65 percent of the money.

But if you will look down across the bottom, to the lower line, you will see that the Federal Government transfers the bulk of its research and development outlays to industry, to private performers, with the result that industry, though it provides only about 32 percent of all funds for R. & D., does 75 percent of the work. An image thus appears of the Federal Government playing a very large role in this picture, transferring most of its funds to the industrial sector.

Looking at the broad panorama of research and development in the economy, we see that the great preponderance of the work is done by a very small number of firms.

Looking at the bottom of page 17, I note that in 1959—and that is the last year for which really good detailed information is available—the 406 companies with 5,000 or more employees, 3 percent of the total number of firms with R. & D. programs, accounted for 86 percent of aggregate R. & D. activity.

Senator BUSH. That is 5,000 or more employees per company, is it not?

Dr. BARBER. That is correct, Senator.

You will find not only that the performance is rather highly concentrated, as that figure indicates, but if you will turn to page 18, while the 100 corporations with the largest R. & D. programs accounted for 81 percent of aggregate research and development, these same firms accounted for only about 41 percent of total sales within their respective industrial categories.

In other words, you have a situation in which there is a significant degree of concentration, anyway, but in which, in the performance of research and development, the concentration is far more accentuated than it is generally.

Now let me turn to the role that the Federal Government plays in this picture.

Senator BUSH. Is that bad, or good?

Dr. BARBER. I do not wish to draw a judgment on it. I am only reporting it and raising the point. But I do think it interesting when you find that a smaller number of companies do a larger percentage of the work in this area than they have of sales or production.

Let me go back here and point to this statement of the former Attorney General, Herbert Brownell, who, in reviewing this problem and commenting on it in 1956, said, and this is on page 15 of my statement:

The disproportionate share of total industrial research and development in the largest firms may foreshadow a greater concentration of economic power in the future. An adequate supply of technical manpower is the first prerequisite to any research and development program. Such programs themselves are basic factors in the development and expansion of our business economy. Therefore, a present concentration of such manpower and programs means that in the future an increasing share of anticipated improved technologies and new product lines will be introduced by the industrial giants.

In other words, I think we are looking at a situation whose long-run consequences, while now not clear, can be very serious.

To return to the role of the Federal Government, I have noted that in the period 1960-61, the Federal Government put up about two-thirds of all funds spent for research and development in the United States.

Of that amount, the preponderance came from the Department of Defense. If you will look at the budget for the fiscal year 1963, as submitted by the President, you find that anticipated expenditures of \$12.4 billion are reported, up from \$10.2 billion in the prior year.

Of this \$12.4 billion, about 58 percent stems from the Department of Defense, another 19 percent from NASA, and 11 percent from the AEC.

The Department of Defense is thus the most important source of funds. And what does it do with its money in terms of allocation among business units?

Well, you find that in the fiscal year 1961, looking at Department of Defense data, small businesses, defined in the usual technical way, received only 2.9 percent of total awards for EDTR, which is the military terminology for R. & D. And you can take a look at this in more detail, if you wish, in table 3.

I think it worth emphasizing that this is far beneath the share that small businesses get of so-called hardware purchases. In that sector, their relative position is much more significant than it is in R. & D.

This R. & D. performance, if you look at table 3, has been declining for the last several years. For example, small business received as its share of Department of Defense allocations for EDTR, 5.7 percent in 1956. And then there is a steady decline, so that in the 9-month period ending with March of this year it was only 2.6 percent.

Senator BUSH. How about the absolute figures, though—the dollar figures?

Dr. BARBER. I can give you the dollar figure, Senator.

Senator BUSH. Has that declined, or not?

Dr. BARBER. Well, I can get them for you, but we can make some estimate from the fact that we have \$6,023 million for a total in 1961; and we can also give you the detailed figures.

Senator BUSH. If I read it correctly, the total EDTR went up from \$2.4 billion to \$6 billion, and the small business percentage went from 5.7 down to 2.9. That would indicate that they went up in dollar volume, although the percentage declined.

Dr. BARBER. Yes. In dollar volume, in the fiscal year 1956, small business firms received \$137 million for this function. In fiscal year 1961, they received \$161 million. But note that total procurement during that period was rising, as you have pointed out, from \$2.4 to more than \$6 billion.

Senator BUSH. In other words, they did not go down absolutely, but they went down relatively.

Dr. BARBER. That is right. Let us say they are continuing to get a very small piece of this business, a smaller piece than they get generally of military procurement.

In terms of allocation among companies, we find a very highly pronounced concentration. Eight corporations, for example, in the fiscal year 1961 accounted for about one-half of all allocations for research and development; and, indeed, one of those companies accounted for just about 10 percent. Twenty companies took three-quarters of all allocations for this purpose, and if we look at Federal programs generally, you will find that 300 companies took 99 percent of total outlays.

I will not provide the additional detail in which I am certain some of you are interested. I do think, though, it is worth noting that you have here a situation in which a rather small number of companies are getting the great bulk of the funds, that the concentration is more accentuated than it is generally in the economy, and far more than in aggregate military procurement itself.

Now, why is this so? I do not wish to burden you and I discussed some of the reasons for this in my statement.



But let me say this: That the Department of Defense—and I have looked into the question to some extent—has so designed its procedures that small firms simply do not have a fair opportunity to compete for R. & D. work.

I do not wish to suggest what the proper allocation is between big and small. I only say that the procedures now are so devised that the small firms do not have an opportunity to even go in and present their case to do research and development, let alone to get it.

Indeed, you will find, for example, that—and these are general figures—of all work procurement awards made by the Department of Defense, only about 36 percent were even publicized in the fiscal year 1961 and that is in spite of congressional efforts to secure both advertising and, if not advertising, synopsising. The great preponderance are not even publicized to small business.

Is it little wonder, then, when you find that only 16 percent of all awards for research and development made by the Department of Defense are made on a competitive basis, that only 3.2 percent are made on a competitive price basis? I think not.

Senator PROXMIRE. Where did you get that last? 3.2 on a competitive price basis?

Dr. BARBER. 3.2 percent of all research and development awards made by the Department of Defense in the first 9 months of the fiscal year 1962 were on a competitive price basis.

Frankly, I think improvements can be made here. I think that the longrun consequences can be serious. And I think it worthwhile not only going back to the provocative words of Attorney General Brownell, but also keeping in mind that the patent policies in this area mean that the person who does the work for the Department of Defense secures a patent on the work that he has accomplished with Federal money.

Again, I am not judging. I am only suggesting strongly that the longrun implications for both military procurement and the civilian sector are and can be of major consequence.

When we talk about policies respecting industrial concentration, we have to look at our own house. And I think that while the anti-trust enforcement officials have been doing a very timid job, and while the administrative agencies have been encouraging monopoly, the Department of Defense has been engaging in policies that have as their very clear impact increasing levels of concentration, denying opportunities to smaller firms, and in this way tightening up the economy, rather than loosening it, as the antitrust doctrine would seem to suggest.

Senator PROXMIRE. Thank you very much.

Now, I would like to commend you gentlemen on very provocative statements, and very helpful and useful statements.

I am somewhat concerned, though, as to what we can do about it. Mr. Kahn said he did not like to tilt with windmills, and frankly, I feel that to move ahead on this front at all, windmill tilting is one of the few things available, it seems.

For example, the last argument that you made so well, Mr. Barber, that here is an area that you think we can do something about, because this is within the control of Government. However, I am chairman of the Small Business Subcommittee of the Banking Committee,

and we have set-asides for small business, and the President of the United States, early in his administration, directed the Secretary of Defense to see that small business gets a better share of the procurement dollar.

We have done all we seem to be able to do to persuade the procurement officials to do this. We have had them up before this committee, before the Select Committee on Small Business, before the subcommittee of which I am chairman, and gone over and over again with them these procurement procedures they have, without very much success.

Now, when we get into the other area, that you other gentlemen are talking about, we are really up against it. And it seems to me, frankly, that we have to recognize that we are going to have a considerable concentration of economic power in American life, and I think it is going to increase. I think it is going to increase rather sharply. Maybe we can do something about holding down that increase.

One area, obviously, is space. Now, in space, we have the biggest increase in our budget this year, \$1.7 to \$3.7 billion. We had a speech yesterday, a very fine speech, by Senator Cannon, on the floor, in which he pointed out that the military possibilities of space have not been exploited by us.

And I think that this speech is going to catch fire to some extent, and we are going to increase our military expenditures in space.

Fortune magazine estimated space is going to have the impact on our economy within the next 4 or 5 years that the automobile industry has had—very severe and very substantial. But it also emphasized that this is going to be a concentrated impact, that a very small number of firms are going to do the overwhelming amount of work that is going to be done. I think they said something like seven firms are going to do virtually all of it.

R. & D. is the same kind of thing. The big firms have a tremendous advantage in handling research and development work.

The question I would like to ask you gentlemen is this: Recognizing that we have this concentration in industry, and we are probably not going to be able to break up United States Steel or General Motors, although Mr. Romney makes a pretty good case for breaking up General Motors, I am not sure we should follow the suggestions you gentlemen offer.

For example, Mr. Kahn hit hard at price supports for farmers, and at the possibilities of some kind of fair trade for small businessmen to permit them to have a fair margin.

I am inclined to think that this is one area where you will have success, because these people are politically very, very weak, in spite of popular opinion to the contrary. The farmers' political position has been deteriorating very rapidly as the farm population has dropped. I think there is every chance in the next few years that we will abandon the price support system, and then farmers will really be up against it.

Small business has been in serious trouble for the last decade. We had dramatic statistics yesterday that I put in the record from the New York Times, showing that in New York retail proprietors had dropped from 153,000 down to 66,000.

I think if we pursue this kind of theory that you gentlemen are offering us, we are going to end up with a greater concentration than we have now. You are going to get big farms, the loss of the family farm; the Mom and Pop store, which is in trouble, anyway, is going to be replaced by supermarkets; and I am just wondering if the very great thought and clear authority which you gentlemen have in this field is not misdirected, because you are not recognizing the grim political and social realities of life, and not tailoring your advice to us to see what we can do about bringing a greater measure of justice for all of our people in the kind of economic situation in which we are living.

Mr. Kahn, you talked about tilting with windmills. Did you want to go ahead?

Or Mr. Adams?

Senator BUSH. Mr. Chairman, may I first ask what the plan is for the rest of the day?

Senator PROXMIRE. If you would like the panel to come back, perhaps we can arrange that for this afternoon at 2 o'clock. If not, I thought we would go through and try to finish about 1 or so.

Senator BUSH. I cannot stay. It has been a very interesting morning, with very excellent statements. I am very much interested in hearing, now that all of these criticisms have been made very clearly, some of the answers, some of the cures for our problems, if we can, this afternoon. That is what I would like to do.

Senator PROXMIRE. All right. Fine.

Would you gentlemen be able to come back this afternoon?

Senator BUSH. Could we set it as late as a quarter past 2?

Senator PROXMIRE. How about 2:30? Is that all right?

Dr. ADAMS. Of course, Senator Proxmire, if you are correct in your diagnosis, then our qualifications are limited, because we have never met a payroll. We are impractical, abstract dreamers, as you have described us. I would like to dissent from that characterization.

Senator PROXMIRE. I have not characterized you as impractical dreamers by any means. I think the best qualification I have for the Senate is the fact that I taught briefly at Harvard; too briefly. I have the greatest admiration for your qualifications.

But I think I can ask you provocative questions without your feeling that I am trying to insult you at all.

Can you gentlemen come back at 2:30?

Dr. LANZILLOTTI. We would be delighted to.

Dr. BARBER. Yes.

Dr. KAHN. Of course.

Senator PROXMIRE. Since I have asked this question, why do you not go ahead?

Dr. KAHN. I would hate to leave it hanging, Senator Proxmire.

I think in some measure, you are summarizing what I had in mind when I said that I was not interested in tilting with windmills. I was talking at that point about the prospects of fundamentally altering antitrust policy as a means of breaking down major concentrations of economic power.

And while I agree with what you suggested, that I think the country probably would be better off if General Motors were broken up, and I think there is even less doubt that it would be better off if

United States Steel were broken up, I see no prospect of accomplishing it, either under the antitrust laws as they now are formulated, or as I see any prospect of them being reformulated. So to that extent I do agree.

It was for that reason that I made a number of other kinds of suggestions, which fall really into two parts.

One kind of suggestion, with which I think you do have some disagreement, and I know Professor Adams, too: that is, those suggestions among the many which would bear most heavily on small businesses and on agriculture.

And I want to say just one word about that, and then mention the second, that there are many of the other suggestions that I think are essentially neutral as between what they will do to small business on the one hand and big business on the other.

Taking the easier ones first, I do not see any excuse for a tariff on automobiles at all. Now, we do not have much of a tariff. It is pretty low. As I understand it, it is 7 or 8 percent.

Dr. ADAMS. 8½ percent.

Dr. KAHN. 8½ percent. Well, it ought to be zero.

The same thing is true of many chemical tariffs. In many cases you can get an argument, you see, on national defense grounds, and so on, but shifting to the case of quotas on oil, I see virtually no relationship at all between the explicit statements of the military about the extent to which we have to protect our domestic oil industry, and what, in fact, we have done.

The Defense Establishment used to say, "We need something like one million barrels a day of shut-in capacity in the oil industry, protected." We have over 3½ million barrels a day of shut-in capacity now.

We have massive overinvestment in the industry, as you are well aware, encouraged by our tax laws, as well as by these import quotas.

I think, therefore, that if you admit or realistically realize that you are not likely to break up these larger concentrations of power, then it makes it extremely important to pay attention to these other methods of holding the power in check.

And I would think the reciprocal trade agreements program, and especially what the President is asking for, becomes terribly important in dealing not only with our dispersed textile industries, but also with our highly concentrated industries, like steel, automobiles, chemicals, and oil.

Senator PROXMIRE. In your judgment, would the President's trade bill help us in meeting the problem of concentration in the oil industry to any significant extent? Would it enable us to get more competition, so that oil companies would not pump 8 days a month and hold their prices up as they have, the most profitable industry in America?

Dr. KAHN. The President's program, I think, will have no effect whatever on the oil industry, because that seems to be handled under the ODM authority in the interest of national defense. And of course the trade agreement power that the President is asking for is power to negotiate with the Common Market countries, and our principal oil imports are from Venezuela and the Middle East and Canada. So I do not see much prospect that it will have any effect in that direction.

Now maybe there, as well, I am tilting with windmills, and I do not recognize the facts of American political life, that the oil industry is sacrosanct, that we will always have an oil cartel—I am talking about a governmentally enforced oil cartel—and there is nothing we can do about it.

I think if that is true, like Dr. Barber, I would say, "What are we shouting about?" Either we want price stability or we do not want price stability. If we want price stability, some prices are going to have to be permitted to fall.

Senator PROXMIRE. I do not mean to ask one question after another, but it seems to me we have a record.

The economic indicators here show that our wholesale prices have been stable for the last 3 or 4 years, and retail prices have not been increasing very much. They have not been increasing much in at least recent historical terms.

So in spite of this situation which you accurately describe, it seems to me that one way or another, somehow, we have achieved a fair degree of price stability, better than any other comparable country in the world.

Dr. KAHN. Exactly. But our unemployment has not dipped below 5 percent, except for 1 month, so far as I know, seasonally adjusted, in the last 3 or 4 years. And so I think it is fairly clear that we can achieve price stability if we want to keep the economy running on two cylinders.

Senator PROXMIRE. I see your point.

Dr. KAHN. The dilemma is: What happens if we really try to make a dent on this unemployment, which I think the committee itself has recognized is quite inadequately measured by the 5-percent figure?

There is all this part-time work, and there are a lot of people who just disappear from the labor force when jobs are not available. I think the committee itself estimated that probably we have something more like 8-percent unemployment than 5 percent.

Excuse me, Mr. Adams.

Dr. ADAMS. I just wanted to add a footnote.

We have maintained this price stability you talk about, Senator Proxmire, partly at the cost of significant unemployment, and partly at the cost of maintaining world markets. Now, if you examine the share—

Senator PROXMIRE. Cost of maintaining what?

Dr. ADAMS. World markets. We have priced ourselves and designed ourselves out of world markets.

If you look at the U.S. share in industry after industry in the markets of the world, you will find that the U.S. share is falling.

Senator PROXMIRE. Well. In spite of that, I just put in the Congressional Record an hour ago, when I went to the floor, the report in the Washington Post this morning that in the first half of this year our trade surplus, our favorable trade balance, went to \$5 billion on an annual basis which is phenomenal, it seems to me, and it showed, the analysis of statistics shows, that much less than half of that is accountable by foreign aid and that kind of thing.

And this, it seemed to me, is an indication that we are doing pretty well, really.

Dr. ADAMS. In absolute terms, yes; but we might and perhaps we should be doing much better than we are.

Senator PROXMIRE. If we do much better, what are the other countries going to do? To the extent our trade balance is favorable, trade must be unfavorable. They cannot continue forever with their unfavorable balances of trade this big, unless we are going to continue our foreign-aid program indefinitely.

Dr. ADAMS. I think the latter prospect is a good one, if we talk in terms of reality.

Dr. KAHN. Yes.

May I say a word about the balance of payments?

It is perfectly clear that it is an oversimplification to say that America has such a seriously deteriorated competitive position in world markets that it is unable to sell. The facts just do not bear that out. As you have pointed out, we have consistently run an active or favorable balance of trade. But we must remember that one major reason why we have done so is that we have poured out dollars to the rest of the world in various foreign aid, military expenditure programs, and the like. And I am sure that if we reduce those, our exports would decline correspondingly.

The critical question, as of course you are well aware, is: What is the relationship of our favorable balance of trade in goods and services with our unfavorable balance in these unilateral transfers? And there we have run a consistent deficit.

In other words, our balance of payments remains negative by a kind of basic core of about \$2 billion.

Senator PROXMIRE. Well, that is probably because of what you gentlemen pointed out—I am not sure Mr. Lanzillotti and Mr. Kahn did—in the enormous investments that our corporations are making abroad, taking advantage of the market, labor, skill, et cetera. And that kind of private investment abroad has been very substantial.

The fact is that our trade balance has been favorable in spite of all these factors which you gentlemen have been talking about.

Mr. Lanzillotti, did you want to comment on this general question?

Dr. LANZILLOTTI. Yes, Senator; either now or after lunch.

I would not like to leave the impression that it is the consensus of this panel that there is nothing we can do about this problem of concentration. I think there are many things that we might consider.

I do not accept the conclusion which apparently has emerged here, that the level of concentration is uncorrectable. But let us assume for the moment that I did. This does not mean that there are not measures we might adopt to make these highly concentrated industries behave more competitively.

I do not have to accept these competitive bids that are identical. Even if we accepted this concentrated industry, I would like to pursue this question—even within the framework of concentration, what specific things might be done—after lunch.

Senator PROXMIRE. I think that is an excellent point.

I think on these competitive bids there is a lot we can do and should do and must do. I think we can get public indignation on our side. And the documentaiton, I think, you have done here on the chemical industry is extremely persuasive.

Mr. Barber?

Dr. BARBER. I would like to dispel the notion that in some way the antitrust laws as currently drafted, and as interpreted, could not be used, by someone with imagination and with vigor, to reduce levels of concentration. I think the laws could be used in a far more meaningful fashion than they have been.

The fact is that they have not been used to reach out to the problems that are disturbing you and us when we speak of the concentrated industries.

And if we need any documentation of that, I suggest we simply go back over the last several years—and by that I do not mean one or two, but I mean roughly on the order of 20 years—to find any case begun that had as its purpose the reduction of concentration in a major industry; the major cases in this field, Alcoa, Tobacco, Paramount, for example, were all decided in the early postwar period, but were begun long before that.

The fact is that we have not been trying. We have not been using the law.

I do not think we are tilting at windmills. I think we can use the law usefully to deal with these questions.

I say we have not been doing it. And if we want to talk sensibly about this, and meaningfully, then the proper thing to do is to say: Let us use these laws, or get them off the books.

Senator PROXMIRE. When we return at 2:30, I would appreciate it, if you would care to, if you would give us some specific examples.

For example, break up General Motors, break up U.S. Steel, something in the chemical industry, and so forth.

And then there is this other thing you might be thinking about, too: The bugaboo is that this will destroy business confidence and somehow significantly damage the economy.

And while that may be dismissed out of hand, I think we ought to consider whether or not there is any realism behind it. We saw what happened when the President acted with, I thought, great and proper force in the steel situation, and there may have been some adverse consequences there.

Well, I want to thank you gentlemen very, very much.

As I say, I am tremendously pleased with the competence of this panel, and I certainly did not mean, Mr. Adams, to imply anything about not meeting a payroll.

Dr. KAHN. He is just a very difficult character.

Senator PROXMIRE. I am looking forward to seeing all of you gentlemen at 2:30.

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

#### AFTERNOON SESSION

Senator PROXMIRE. I want to thank you gentlemen for coming back and accommodating us this afternoon.

I yield to Senator Bush to kick off this afternoon's questioning.

Senator BUSH. Thank you, Mr. Chairman.

I am sorry I had to leave at 12:30. I hope I didn't miss too much.

Senator PROXMIRE. They were very good, but we adjourned at 20 minutes to 1.

Senator BUSH. I hope my questions don't provoke any repetition.

But going back to Mr. Adams, the question that kept recurring to my mind during your presentation, and especially towards the end, is what do we do about these things?

What is the antidote, what is the cure for the problems that you discussed in here?

For instance, you speak of the decline in American automobile exports, and the increase in imports from abroad, and no wonder that the percentage share of American automobile exports declined radically not only in Europe and the world at large, but also in the Latin American market at our back door.

What is your observation about those facts, and why did this happen, and is there anything we should do about that?

That is rather a pinpoint question and I want to get into the broader question in a moment; but I would like to have your comment on that particular matter because we are faced with this trade bill very soon up here; and this sort of ties into that in a way.

Is it your thought, Mr. Adams, that we should limit the export of capital so as to prevent further development of American industries in Common Market countries, for instance?

It seemed to me from watching this development over the past, I would say, 6 years, or 7 years, I remember making two speeches on the Senate floor, one a year after the other, I think, going back to 1956, in which I pointed out that unless the American manufacturers got busy and produced a small automobile to meet the demand that really existed here, that we were going to have serious trouble in the automobile business.

They took the view at that time that they couldn't do it. They said, "We can't do it" and "We just can't make a car to compete with them."

But after the large influx of foreign cars was stepped up as high as 800,000, at its peak, I believe, they did do it, and they have produced a pretty satisfactory answer to that problem and got it priced down to around \$2,000, and produced a very satisfactory car, made cars available to a lot of people who couldn't afford them before.

Also smaller cars relieved congestion in garages and highways and everywhere else so it shows they can do it.

But what is your feeling about this tendency on the part of that industry and others to go to the Common Market countries, particularly those countries, and establish plants over there?

Have you any comment about that?

#### STATEMENT OF ROBERT F. LANZILLOTTI, ALFRED E. KAHN, WALTER ADAMS, AND RICHARD J. BARBER—Resumed

Mr. ADAMS. Well, Senator, I should preface my remarks, and I don't want to make a speech here, by saying that I may be tilting at windmills but I am sufficiently old-fashioned to believe in the feasibility and the practicality of competition in American industry.

I think again, if we stick to the automobile industry, in 1909, Henry Ford sold some 12,000 automobiles at \$950 apiece.



Senator BUSH. In 19 when?

Mr. ADAMS. 1909.

Senator BUSH. Yes.

Mr. ADAMS. This is Henry Ford the first. In those days the traditional wisdom regarded the automobile as a passing fancy, a craze. The traditional wisdom including the Wall Street brokers said, "You will never sell many more automobiles than 12,000 no matter what you do about price."

But Henry Ford was an industrial radical. He disagreed with the traditional wisdom, and as we all know he turned out to be right and the smart money boys turned out to be wrong.

What was the Henry Ford philosophy, and this ties into the question that you raised with Professor Lanzillotti? Ford's theory was very simple: to cut prices and take a lower unit profit on a larger volume. Each price cut would bring new groups of consumers into the market.

With increased volume would come substantial reductions in unit fixed costs, and the possibility of realizing the economies of mass production.

Each successive expansion of output would make possible new price reductions which, in turn, would attract new customers, and initiate a new phase of the expansion cycle.

As Ford put it himself "Every time I reduce the charge for our car by \$1 I get a thousand new buyers."

Senator BUSH. Isn't that something like what they did in 1957, 1958, 1959, and 1960 here?

Mr. ADAMS. What the automobile industry did?

Senator BUSH. Yes.

Mr. ADAMS. No. Quite to the contrary, Senator.

Senator BUSH. Will you point up the difference?

Mr. ADAMS. Well, the difference is simply this: By 1957 the American automobile industry had become an insensitive oligopoly.

The oligopolists thought they could continue playing this game of turning out larger and larger cars at higher and higher prices to a captive American market.

Now, of course, Senator Bush, your statement on the Senate floor was prophetic. You could see what was coming, but the great executives in charge of our automobile industry couldn't see the danger signs, and eventually they priced themselves out of the domestic market, and they priced themselves out of the international market.

Now, as far as the companies' self-interest was concerned, the pain was minimized, in part, by the fact that they could export production to their foreign plants. But as far as our economy was concerned, the American economy was concerned, this was a painful experience.

Now, you say, "Should the companies be discouraged from investing in the Common Market?"

What I submit to you very respectfully is the thought that we are making it profitable for them to export investment dollars and jobs incidentally——

Senator BUSH. Yes.

Mr. ADAMS (continuing). Rather than American-made goods by affording them a tax haven overseas.

You know that the profits that General Motors makes at its operational plants in Germany are not taxed until they are repatriated.

This is one of the great tax loopholes, and I think something should be done about that.

Senator BUSH. You don't think that is the sole reason that they are attracted to producing in Europe, do you?

Mr. ADAMS. I don't think that is the sole reason; no. But I think it is a very important reason, Senator.

Senator BUSH. We had testimony before this committee last December when the general policy of this new trade bill was being opened up before this committee for a couple of weeks, and the facts came out that wage differentials were a tremendous factor in the manufacture of goods in Europe vis-a-vis the United States and at that time the Department of Commerce showed that the average wage rate in this country for manufacturing was \$2.29 an hour, whereas in the Common Market countries it averaged around 55 cents or something like that, and in Japan 28 cents, I remember, including fringe benefits, and it seemed to me, rightly or wrongly, this was a tremendous inducement for these people, as long as there were no inhibitions about the export of capital, to manufacture over there, to meet the demands in that market.

What is your thought about that? We are talking now about a very important matter which is this question of capital export. What is your observation about that?

Mr. ADAMS. Well, Senator, that wage differential, of course, existed for a long time. It existed in 1948, in 1950, in 1952, and 1954.

Senator BUSH. Yes; but the competition didn't exist.

Mr. ADAMS. If we look at the wage differential we find that it has been narrowing rather than expanding over the years.

It has been narrowing, I can assure you of that.

Senator BUSH. It has been narrowing very slightly, though. I mean ours is still going up, and theirs is going up.

Mr. ADAMS. And Senator, if I may continue, I think this committee is too sophisticated to miss the distinction between high wage rates and high labor costs. There is a difference.

We have always been a high-wage-rate country. This does not mean that our labor costs per unit of output are high. I submit to you, very respectfully, that the highest cost burden borne by American industry today is not high wage rates but the deadly burden of unutilized capacity. It is the overhead cost that is imposed per unit of output by the fact that our steel companies are operating at some 70 percent of capacity. I don't know what the automobile utilization of capacity is, but it certainly isn't full utilization of capacity.

The greatest blow we can strike for cost reduction per unit of output is to increase output and utilize some of the unused capacity in existence today.

Senator BUSH. I agree with you that is highly desirable. But on your point about costs versus wage rates, I mean the National Industrial Conference Board last year made some studies on that and came up with pretty good—I thought convincing—evidence, that while there is a difference between high wage rates and labor costs, that their findings were that in items where you have a high labor content in the cost, that this was definitely a handicap in connection with our export business and with our competitive position vis-a-vis the oversea manufacturers.

Mr. ADAMS. Senator, that has always been true, of course, in those American industries which had a high labor component. But we have traditionally been strong in the export markets, precisely in the mass production industries where the labor factor, where the importance of the labor factor, was a minimum element in the cost structure.

What is the labor factor in chemicals or in petroleum, or even in automobiles or in steel?

I think this is a vastly exaggerated issue, and I am not making any brief here for wage increases beyond productivity increases or anything of that sort.

I am not trying to defend the wage-price spiral in any way. All I am saying is that as a matter of national policy our objective in the concentrated industries ought to be to get the kind of structural organization that will allow the Henry Ford philosophy, the Henry Ford I philosophy, to become operative.

This will be good not only for the country; it will be good for the corporations themselves.

Senator BUSH. What do we have to do to do that, Mr. Adams? I mean, how do we get that structural position that you think is so needed then?

Mr. ADAMS. All right.

Senator BUSH. I think you are right, too. I am not arguing this with you, but only to develop this point.

I think we are facing a very serious situation here, and I am not saying that you gentlemen—some of you have said you think General Motors is too big. I think that is a question we have got to look at very seriously. But where do we go now to implement your thought? How do we correct this structure?

You have made a case—some of you have made the same case, really, that because of the structure they are able to set what you call a profit target or something of that kind, and that everything revolves around that.

Mr. ADAMS. Precisely.

Senator BUSH. What do we do? Is there anything that Congress should do?

Is there anything that the executive branch should do to meet this situation?

What is it?

Do you recommend antitrust legislation in addition to what we have? Two of you, at least, mentioned—Mr. Kahn did, and I think yourself, also; it may have been our friend, Mr. Lanzillotti—mentioned the enormous economic and somewhat monopolistic power of the labor unions. This was touched on in two or three things.

The thing I would like to develop this afternoon, with the tolerance of my good friend over here, is what do we do, what is your recommendation?

You pointed out what you think are the flaws in our situation and made a very plausible case, if not entirely convincing, but still I am impressed with it.

What do we do? What kind of legislation or what kind of executive action do you think should be taken on behalf of our Government?

It is a big subject and I know it is pretty hard to condense.

(Discussion off the record.)

Senator PROXMIRE. We are back on the record, Mr. Adams; go ahead.

Senator BUSH. Let's approach it that way, and anybody who wants to chime in and ask to yield, why let's do it informally, but see if we can develop it.

Mr. ADAMS. Being a devout antimonopolist, I don't want to monopolize the discussion.

Mr. LANZILLOTTI. We will compete if it becomes necessary. [Laughter.]

Mr. ADAMS. I think it would be quixotic to assume that a mere enforcement of the antitrust laws would be enough to achieve the objectives of competition.

I think, as various members of this panel have pointed out, that the Government, by its administrative, executive, and regulatory decisions creates a great deal of the concentration and monopoly that the Anti-trust Division is supposed to combat.

The Defense Department in one day can probably do more damage in the procurement field than the Antitrust Division could correct in a year.

But in the antitrust field specifically, I think the only way to attack concentration is by the old-fashioned method of dissolution, divorce-ment, and divestiture.

The way to eliminate a trust is to bust it.

This is trustbusting in the literal sense.

Now, you may recoil at that idea, and say, "Wouldn't it be terrible; what about the efficiency of the American economy, of American corporate enterprise?"

I would argue very respectfully, Senator, that intelligent trustbusting would enhance efficiency in the American economy.

For example, if United States Steel were broken into three separate parts, this would be good, not only for the steel industry, it would not only promote greater competition, it would be good for United States Steel itself.

I think it is an open secret that United States Steel is not the most efficient corporation in the industry. A single plant like the Gary plant in Indiana is bigger than the entire operation of the National Steel Co. put together, and nobody has advanced the argument that National Steel is an inefficient outfit.

My proposition would be: if National Steel is big enough to be efficient, why can't the Gary plant, standing on its own feet and divorced from 71 Broadway, New York City, do an equally effective job?

I am in favor of technological bigness, to preserve the efficiencies of mass production. What I am opposed to is corporate bigness which exceeds the requirements of technical efficiency. I think the same argument could be made with respect to General Motors.

The Chevrolet Division alone produces 25 percent, I think, of the automobiles consumed in the United States.

Would anyone seriously argue that Chevrolet, if separated from the General Motors family, would not be big enough to perform in accordance with the requirements of technological efficiency?

I doubt it. I have faith in Chevrolet.

Senator PROXMIRE. I have a Chevy, too.

Senator BUSH. Would the research and development program of General Motors be affected adversely by the kind of action that you suggest.

Mr. KAHN. Since I had made a note earlier, I have General Motors "research" and I put research in quotes, I think that the automobile industry is one of the best examples of the lack of necessity for giant-sized business for effective research and innovation.

I should ask Mr. Lanzillotti to support me after I make the general statement because he is the one who has done some writing on automobiles; but I have consulted people who work in the automobile industry and are acquainted with it and they have great difficulty in showing anything of major significance that has come out of General Motors research laboratory.

The development of the gas turbine, one has heard talked about for 20 years, so far as I know, it still is very far from realization, and if it is going to come at all, apparently, it is going to come from Chrysler and not General Motors.

I gather that something like automatic transmission systems was developed by an independent company in the industry, one of the parts manufacturers.

The rear engine, Europe. Air-cooled engines, Europe.

So far as I can see, in automobiles, at least, we don't get any significant innovation from the major companies.

All they do is devote their attention to putting mustaches on the backs of cars or then taking them off.

Truly, they have fallen into this insane cost-increasing method of competition in a way that you couldn't say that was true in electronics where obviously research was important and we might want to raise your question about drugs or chemicals but automobiles, I think, is a poor example of the necessity for centralized companies of the size of General Motors.

Mr. ADAMS. And the same thing is true in steel. In terms of technological progress, certainly, United States Steel, the largest company in the industry, has lagged and not led.

It is not the paragon of virtue in the field of research or innovation.

Moreover, if we can accept the testimony of T. K. Quinn, who used to be a vice president of the General Electric Co., in charge of the appliance division, the same holds true in the electrical field. He, at one time, sat down and detailed each invention in his particular division and showed that these inventions did not come out of the GE laboratories, but came from independent sources, which later became captives of General Electric through corporate acquisition.

Mr. LANZILLOTTI. I must correct you on that, Professor Adams, Mr. Quinn did indicate that the garbage grinder was developed in the General Electric laboratories.

Senator BUSH. That is pretty good, I will say, for that.

Mr. ADAMS. I will accept that footnote, thank you.

Mr. LANZILLOTTI. But not refrigeration and all the important developments—

Senator PROXMIRE. Why don't you have them all finish this question?

Senator BUSH. I was hoping that these gentlemen would comment on the general question.

Mr. LANZILLOTTI. The general point which Professor Adams is making is one I would like to support: That he believes we do have within the framework of section 2 of the Sherman Act the tool to do the job. My friend and colleague, on my right here, Dr. Barber, has said we haven't brought the imaginative suits under section 2 that might be brought.

Part of the difficulty, I assume, on the part of the antitrust authorities who might proceed via section 2 of the Sherman Act, or section 7 of the Clayton Act, is that the courts are not prepared to deliver the kind of divestiture, dissolution, and divorcement of which Professor Adams speaks.

If this is true, and I am not sure that it is, I believe that the Alcoa decision indicates that it is possible, if you give a sufficiently broad interpretation to monopoly power, then it would be possible to bring General Motors under that interpretation.

They are very close to that particular situation, in my view.

If the language of the law is not sufficiently specific as to cover this particular kind of situation, the conglomerate bigness of which Dr. Adams speaks, then I think we should have an amendment to section 2 which would run along the lines that any corporation, or "person" which has dominant power of the type that is being described here this afternoon, that has anticompetitive effects shall also be in violation of the Sherman Act.

In other words, what we would be driving at here is dominant power with anticompetitive effect.

That language is not now embodied in the Sherman Act.

We might specifically amend the statute along these lines. That is the kind of specific thing that I think we could talk about. I am sure there are other things, but I don't wish to monopolize the time and I will pass for the moment, if I may.

Mr. ADAMS. You see in the conglomerate field—I am sorry.

Mr. BARBER. I am confident we could attain a great deal more competition within our basic industries if we simply defined, as our objective, the attainment of individual concerns of the minimum size necessary to attain full technological economies.

Some research has been done on this question, because, of course, it is a fundamental one. I think none of us, certainly not I, want to, in some way, harm efficiency. If we need big companies or a company of a certain size to be optimally efficient, then I don't wish to go below that. But even accepting this as our standard, we could do a great deal more than we are without giving up efficiency.

Professor Joe S. Bain has studied a number of industries and he has reached conclusions consistent with this hypothesis.

A good argument, for example, can be made that in the automobile industry you could have 10 firms of about equal size producing automobiles under fully efficient conditions.

Now, I think that if we were to attain that sort of a situation in the automobile industry we would have a great deal more competition, more opportunity for innovation and I think we would find, based upon observations of similarly less concentrated industries in other parts of the economy, a good bit more price competition—not the sort

of thing that we would read about in classical economics, but certainly a great deal more than we have now.

Let me then for a moment turn to this question of whether we can attain this standard by utilizing the legal tools that we have available.

Well, first of all, it is important to say that the law here is not as clear, not as certain as anyone would like.

There are questions. But, having gone through this material on a number of occasions, I feel that the possibilities of using the law as it stands are much greater than they are typically portrayed by those who, when asked why they did not push harder, in defense say the law is inadequate.

For example, I found that Mr. Loewinger's statement yesterday exhibited a kind of cautious interpretation of the precedents that I believe he knows to be excessively conservative.

I feel that the law, including section 2 of the Sherman Act, section 1 of the Sherman Act, and there are some possibilities there, as well as section 7 of the Clayton Act, could be used to reach the oligopoly situation.

In addition, I think it well to keep in mind that the Federal Trade Commission has authority to enter this field.

It has not done so. It too has been unduly cautious.

I don't want to imply that there is clear sailing, that if we wished to start a suit tomorrow against a major company, such as General Motors, that the road markers would be clearly identified. They would not.

But I do think that the law is sufficiently clear, the outcomes are sufficiently optimistic from the Government's standpoint, so that a suit such as this should be and could be intelligently and reasonably initiated.

Indeed——

Senator PROXMIRE. Could I interrupt to ask——

Mr. BARBER. Yes, sir.

Senator PROXMIRE. Are you suggesting, Mr. Barber, that we might pass a law or we might try to adopt antitrust policy around the thesis that we should break up any firm or prevent any firm from growing to a size that would exceed the optimum minimum?

Mr. BARBER. I am suggesting this as a rough standard.

We need some sort of objective, it seems to me.

Senator PROXMIRE. If you had a situation in which you should decide that an automobile corporation which had half a billion dollars worth of sales, or maybe let's make it smaller than that——

Mr. BARBER. Let's put it in terms of the percentage of the market. I think this would be a more useful criterion.

Senator PROXMIRE. Well, except that varies a lot, it goes way up and way down.

Mr. BARBER. Productive capacity.

Senator PROXMIRE. I think that might be better because you are talking in technological terms and not in terms of market.

Mr. BARBER. Yes.

Senator PROXMIRE. You see that would be an entirely new approach, a refreshing idea.

Frankly, it is new to me. It might be very intriguing if we could adopt it but it seems to me we have a long, long way to go to get en-

forcement of what we have got, let alone get into a concept where we wouldn't let a firm grow beyond what you would call an optimum minimum of production facilities.

How do you prevent it?

What do you do if it is an efficient firm and—

Mr. BARBER. As a practical matter, I suppose, if we were to start on any such program today, that, first of all, we would want to prevent increases in concentration that would exceed estimates of this efficiency point, and secondly, begin to roll back to this efficiency point in those industries that are, (a) the most important, and (b), the most highly concentrated.

Well, as an example, I would think that if we were to adopt some such standard perhaps simply as a statement of policy, that a move in the automobile industry to break General Motors into four or five pieces would be entirely consistent with that standard, and would be entirely feasible and leave us entirely efficient operative units.

Senator PROXMIRE. May I just move ahead?

Senator BUSH. Yes.

Senator PROXMIRE. Did you want to comment?

Mr. LANZILLOTTI. I wonder if I could generalize this particular suggestion that Mr. Barber is making in the form of a question to the committee.

Would it be very rash or radical, do you believe, for us to have a working policy or amendment or philosophy, if you wish, that there would be a presumption of illegality, a violation of section 2 of the Sherman Act, if you will, if for a period of 5 years or longer, a single company persistently supplied more than 50 percent of a market or where, let us say, four firms supplied as much as 80 percent.

Now, that is a specific kind of question.

Do you gentlemen believe that any company should persistently supply more than 50 percent of a market?

This would take care of your cyclical factor, Senator.

Senator PROXMIRE. I would say a couple of things on that.

In the first place, I would say this is fine. It is good to get a specific suggestion because then we can really begin to discuss what we can practically do about it.

But you are getting away from the technological concept, which I think is a very sound one, into something else. I can envision a situation in which the market for some limited kind of commodity might be such that the technologically optimum production might be more than 50 percent.

Furthermore, it would seem to me that if you have this presumption, all GM does is they come to 50 or 49 percent, and they just tell their dealers, "You are out of luck, you won't get another shipment until January 1st," and this isn't very efficient, it is not very satisfying to anybody, especially those of us who like Chevrolets.

Mr. LANZILLOTTI. Senator, I am sorry that we are discussing this completely in the framework of General Motors.

I don't believe there is any desire to discuss the problem only in terms of this particular company.

But even General Motors, as much as it tries, its influence is so persuasive that it pushes over the 50-percent mark.



Indeed it is embarrassed by it. The story in the Wall Street Journal of several months ago (April) indicated, that pushing up to 58 percent this year was giving the corporation great concern.

Well, they themselves are conscious of their enormous power and their influence in this industry. I purposely raise it as a general question, leaving the presumption of illegality of this type to be rebuttable with appropriate kinds of evidence; namely, if there were impelling technological and technical reasons why a given company had to have that particular percentage share of the market, then I think we face another question.

If the technology of an industry is such that only one firm or two firms can most efficiently supply the market then we have another policy, and another philosophy which governs that situation; namely, public utility status.

That is the public utility philosophy. If there is a natural monopoly, technologically speaking, then this kind of an industry is a public utility.

It is affected with the public interest. That is why we have the regulated industries in our midst today. It is a very unsatisfactory solution, I might add, and I am very happy that the technological considerations are such in the industries of which we are speaking here this afternoon that it is not necessary, technically speaking, to have firms of such size that they supply persistently over half of the market.

Senator BUSH. I would just like to comment on this.

You have emphasized the importance of competition.

Mr. LANZILLOTTI. Yes, sir.

Senator BUSH. I can recall as long ago as in the twenties, that the question of mergers, mergers were inhibited at that time by the Department of Justice on the basis that they wouldn't approve a merger if it resulted in giving the larger company or the merged company more than 50 percent of the market.

That was a rule of thumb that was good at that time, I believe, and it stopped many mergers from taking place.

In other words, if Procter & Gamble wanted to buy a smaller soap company, but it had enough business to put it up over the estimated 50 percent of the market the Department simply wouldn't approve of it.

Now, I think that is all right and as far as I know that is still their policy.

Do you gentlemen know that?

Mr. LANZILLOTTI. Well, I am very glad, Senator Bush, that you brought this up. I know some of the other members of the panel—

Senator BUSH. Let me finish my point.

Let's assume it is still their policy and I think it is a sound policy, generally speaking, but once you have got a merger, and let's say you come up to 47 percent through a merger which may be a desirable merger because of any reason, let's say, let's say it is a good reason, I don't think you ought to set up any limit that would inhibit the growth of that merged company to where it might go on to get 54 percent or even 56 or 57 percent.

One of the things we want to stimulate is growth in this country, in industry.

Mr. LANZILLOTTI. Within a competitive framework.

Senator BUSH. Yes. That is right. But it seems to me that if a company is going to increase its position, let's say, from 47 to 55 percent, it is doing it competitively and somebody else is losing the business while they are getting it in a competitive market.

Senator PROXMIRE. I see Mr. Kahn and Mr. Adams are very anxious to get into this on growth.

Mr. Kahn, do you want to go ahead?

Senator BUSH. Everybody wants to get into it.

Mr. KAHN. Yes.

I, probably of the four people around this table, have been more concerned about the danger that you have raised about having the antitrust laws so set up that they will condemn a firm merely because of its share of the market, and it has seemed to me that this might inhibit competitive effort, in just the way that you are mentioning.

Senator BUSH. And growth?

Mr. KAHN. Yes, sir; precisely.

Not wanting to overstep the 50-percent boundary, I say that as a preface to establish the cleanness of my credentials.

Senator BUSH. Yes.

Mr. KAHN. Because it seems to me there is really an important off-setting consideration.

The people at General Motors themselves claim that they are constantly inhibited today in competing strenuously by their fear that they will get and maintain more than 50 percent of the market, and that, therefore, they will become targets of an antitrust attack.

Now, it seems to me that the answer to that contention is that General Motors really would be better off and the cause of really intensive competition would be served if the constituent companies of General Motors would be broken up.

There would be no hesitation in saying to Chevrolet, the Chevrolet Division of the company, "go out and compete as strenuously as you can; you only have 25 percent of the market; don't turn around and say to me, 'I am terribly embarrassed by my high-profit margins'."

This is just what the General Motors people say, "It really pains me terribly to charge so high a price, I could charge a lower price but the nasty old Department of Justice will get on my tail if I cut prices."

It seems to me the only way to free these companies to compete effectively is to cut them down so they don't fall afoul of this prohibition.

Now, the case of United States Steel is a perfect one.

Senator BUSH. So they can't cut prices?

Mr. KAHN. It is exactly what I want General Motors to do and they are not doing it. The tendency is when you have a very small number of firms dominating an industry and particularly if you have one firm with 50 percent, as you well know, to hold an umbrella over the industry, to hold an umbrella over prices. This was, of course, the historic policy of Judge Gary in the steel industry and from his point of view it was a great success because it is what saved United States Steel in the 1920 decision.

When the U.S. Government brought a monopoly suit against United States Steel, all United States Steel's competitors came in and said, "They are not hurting us, we love United States Steel."

Why did they love them? Because United States Steel held a high price umbrella under which the more efficient firms could enjoy fat profit margins and could grow more rapidly. It was the consumer who suffered.

That is why I think that the primary emphasis must be on market power.

Do we have the conditions for effective competition?

The technological consideration should be a way of rebutting, this is precisely what Mr. Lanzillotti has said, a way of rebutting the presumption.

The same thing about a merger. I would certainly say I can't think of a case by which a company could, by a merger, rise from 40 to 50 percent of the market and give me a convincing explanation that would be justified.

If it is so efficient let it grow and build plants but let it grow the easy way by exchanging its stock with another company.

Mr. LANZILLOTTI. Please note in the other case you have new investments rather than mere transfer of ownership.

Senator PROXMIRE. I would like to ask you gentlemen, the myth and the reality here in this country is we believe in competition.

In Europe they follow a cartelized monopolistic approach. We have at least one distinguished U.S. Senator, a very, very able man, who has argued we have been too vigorous in the enforcement of our antitrust laws, and far more vigorous than Europe has been and this is one of the reasons why Europe is moving ahead, expanding, growing more rapidly, the standard of living growing, increasing more rapidly than ours.

I don't happen to agree with that, but I think that this does seem to be the case that they have not had a Sherman Act or a Clayton Act or antitrust policy generally as we have had it, and yet they have had a very remarkable growth, particularly in the last 10 years.

What is the answer?

Mr. Adams, I think you were talking about our position vis-a-vis Europe.

How about that?

Mr. ADAMS. I am always the leadoff man, and these gentlemen have more time to think.

Mr. LANZILLOTTI. We are just good counterpunchers. [Laughter.]

Mr. ADAMS. Well, I would point out that until about 10 years ago, the United States was unique as a country in basing its national policy on the antitrust philosophy.

We were the only country in the world that consciously tried to promote competition. It was 10 years ago that the Europeans decided that the cartel philosophy was the thing that held them back, and I think many souls over there have been saved by the productivity teams that came to the United States under the auspices of the Marshall plan and saw precisely the growth element implied in competition.

Senator PROXMIRE. Do you have any studies that indicate the degree of concentration in European countries as compared with this country in industry?

Mr. ADAMS. No. But you see, Senator, the mere creation of the Common Market has broadened the area within which competition

takes place, and this has automatically weakened the power of cartels and monopolies which were dominant in individual nations but which could not dominate the broader Common Market. If I may tie this to something that Professor Kahn said just a moment ago, the danger of concentration is that you get industrial statesmanship.

Corporate managers look over their shoulder. They try to act responsibly in the interest of their stockholders, their laborers, and the consumers.

I don't want them to do that. I want them to go out in search of profit. I want them to compete.

If we think back, I think it is fair to say that Adam Smith looked upon competition not so much as a technique for allocating resources, but rather as a technique for stimulating economic growth.

He felt that the concentrated mercantilist system stifled growth in Europe. By introducing a competitive regime, by dispersing and decentralizing the centers of initiative, Smith hoped to liberate the creativeness and the growth energies that reside in the entrepreneur, and thereby achieve national economic growth.

Of course, the experienced Europe in the early 19th century proved the wisdom of that policy orientation.

In the latter 19th century, Europe suffered a relapse and returned to the cartel system that stifled growth. Today I think the Europeans have again recognized the benefits of competition. They have taken a leaf out of our book and, I might say, they have done us one better. They are more competitive than we are today, to their advantage and our disadvantage.

Senator PROXMIRE. I think that has to be documented, too. There is still a heavy concentration at least in some industries in Europe, is there not?

Mr. KAHN. There is.

Senator PROXMIRE. Some industries are far heavier than it is here.

Mr. KAHN. And particularly if you take it by countries. But I do think this is terribly important, that the liberalization of trade in Europe in the last 10 years even before the Common Market agreement—you had national quotas imposed on importation of foreign goods, and under the OEEC program in 1948 you got the progressive liberalization of intra-European trade—the consequence was in real economic terms that you got a sudden massive deconcentration; in effect, a massive deconcentration of European industry.

Fiat had 95 percent of the Italian automobile market. Now Fiat has to compete like mad with Renault and Volkswagen, and it is this opening opportunity and mutual market interpenetration that has, I think, played a major role in the expansion of European industry.

May I make one other historical analogy that I think might be illuminating?

The first book I wrote was on the position of Great Britain in the period between World War I and World War II.

And I think it has particular pertinence today when Great Britain is trying to get into the Common Market countries. One major problem of Great Britain, which had been, as we have been, the leading industrial country of the world, with higher wages, higher living standards than were enjoyed by any of their major competitors, was that British businessmen had become sluggish. They had a higher

level of concentration than we have in the United States. They were conservative, they pursued policies for the most part of cost plus pricing which, of course, will sound familiar to you.

This is not a question of the fault of individuals, but a matter of historical evolution.

The U.S. manufacturers have in the same way enjoyed until fairly recently a wonderful position. They led the world in some of the most important growing industries, whether it was television or movies or automobiles, and on the basis of this headstart they fell into sluggish ways. I genuinely believe that is true. It is too sweeping a generalization but in too many industries it is true.

That is why I place so much emphasis on the President's proposal with respect to trade. Just as the salvation for England has to be found in exposing themselves to the competition and to the opportunities of the Common Market, so I think this is true of the United States in the 1960's. In many ways, there is such a parallel between our position and theirs: Our balance-of-payments problem, for example, is just like England's in the 1920's.

Senator PROXMIRE. So we open a free world trade area just like the Common Market and including the Common Market and in doing that we tend to a sort of relative deconcentration to a very considerable extent.

This is another of your proposals and, incidentally, I think it is a practical one because I think we are going to pass this bill with some changes but pass it, and this may give us an automatic antimonopoly effect, at least an automatic increase in competition.

I would like to ask you about one other aspect of this that frankly troubles me a lot because I agree very strongly with you gentlemen, except I am concerned about what actually happened to this country in the depression of the thirties when we did turn not toward greater competition but as you said, we turned toward the NRA, and toward price fixing, and I can see why we did it.

It seems to me if you get too much of this competition, I can't say too much, if you get competition of this kind, under some circumstances it can be extraordinarily deflationary, particularly if you develop a situation in which labor unions become quite weak, it can result in wage cutting and as I think Mr. Kahn, you implied in your paper, we are not so sure it could not be worse than it is now.

Mr. KAHN. Yes. I think that is quite true.

If one is talking about a general economywide deflation and decline, I don't think most economists believe that the way to get out of a recession is to let prices and wages fall.

I agree with you completely. But I think we are at a juncture now where we are not talking about a general major depression or recession in which generalized price cutting leading to wage cutting leading to price cutting will just take you down, there is no bottom so far as I know to that kind of spiral.

We are rather at a kind of a critical point where we are growing but not enough.

Senator PROXMIRE. This is a matter of balance really, isn't it?

We can't go all the way either, all the way. If we do go all the way with competition we are likely to get into a situation you can't exactly

call chaos, but very sharp cyclical movements that can be enormously destructive of human values.

Mr. ADAMS. Senator, I must dissent from this proposition.

I don't think that the NRA type of price fixing got us out of the depression of the 1930's.

The problem of depression in the 1930's was an inadequacy of purchasing power, and the way to get out of that depression was to get more purchasing power into the hands of people who would use it.

It is not by Government fiat artificially to raise prices that a country can solve the problems of depression.

The NRA was a hopeless fiasco. It was certainly not an effective antidepression device and the more of that type of rigidity that we build into our economy, the more deleterious, I think, the effect would be.

I shudder at the thought that we would promote NRA types of cartels in any of our industries at any time.

Senator PROXMIER. I am not saying we should do that. I am saying we have to recognize that if we should have this kind of vigorous, unqualified competition, which I think is most unlikely, but if we should have this kind of thing, that we might also have this kind of serious problem.

I wonder, you gentlemen are all familiar with Edward Chamberlain's book on the theory of monopolistic competition.

As I understand this book when I studied it it suggested that we have very imperfect price competition anyway, very imperfect price competition, because you don't have commodities that are precisely homogeneous with thousands of sellers selling precisely the same thing.

Under these circumstances that since almost everybody in the economy can limit their supply, whether he is the member of a labor union, a lawyer, a doctor, a big manufacturer, or a small manufacturer who moves under the umbrella of the big one you have to recognize we have this kind of an economy. Now, others in the society, to wit, farmers, if Government should step out, find themselves in a position of perfect and pure competition because what they produce is homogeneous and because there are thousands of sellers. Under these circumstances don't you have to have some protection for these people?

Without that don't you have a situation in which they are bound to be exploited, as farmers have been?

Let me just finish my statement by saying this and I would love to document if I had time how farmers have been exploited.

They work 12 hours a day in my State, they invest 40 to 50 thousand dollars per farm, they have enormously increased their efficiency three times as much as people off the farm have, they take a big risk and what do they get? Sixty cents an hour on the average, this is the average farm.

Mr. LANZILLOTTI. Senator Proxmire, I would like to comment on this statement you have made.

You touch on one thing. I would like to say I don't believe the small farmer is advantaged by the kind of farm program that is based upon high rigid price supports, as we have had in this country for quite some years.

The small farmer, I think as you well know, simply doesn't have enough production to benefit from that kind of a program. The farms that are advantaged by it are the large corporate-sized farms.

I happen to have lived in the State of Washington for 12 years where the effects of high price supports can be seen most vividly.

Senator PROXMIRE. Let me interrupt to say at this point we produce more milk than any other State in the Union. We export more than the next five States combined. I don't know a single corporate farm that produces milk in the State of Wisconsin, they are all family farms.

There are some large family farms that take four or five sons to operate them but not corporate.

Mr. LANZILLOTTI. I am speaking about the "basics." You don't have price supports in dairying that come under the basic price-support program.

Mr. ADAMS. Let's talk about the farm problem outside the dairy industry.

Mr. LANZILLOTTI. Very well. Outside of dairying. The point is this. It is not the small, family-size farms that benefit from the price-support program. The large corporate wheat farmer in the Polouse country of Washington, the Big Bend country, the Wheat Belt, for example, these are the ones who are benefiting because they have the acreage. The small farmer doesn't have either the funds or the land available to be purchased if he did have the funds. The large corporate-sized farms are the ones.

You mentioned the way in which the farmer was disadvantaged. One of the reasons why the small farmer is disadvantaged is through the impact of the concentration in the food and food-processing industries.

I made an analysis of these industries a few years ago, and you find all of the kinds of situations that we are talking about here in the food-processing industries. You have collusive pricing, you have mergers in food that are increasing more rapidly than any other industry in the United States.

You find joint ventures, and you have various types of collusive practices resulting from high concentration in these industries.

Conglomerate operations of which Professor Adams spoke, discretionary power of which Professor Kahn spoke, these are the things that are helping to put the squeeze on the small farmer.

Senator PROXMIRE. I couldn't agree with you more on food processors. There is no question they have all of the attributes of industrial operators. But I still maintain whether you are producing dairy products or hogs or beef or producing wheat, that most of our farms in this country are still family farms. There are some exceptions, and most of the production of our country is overwhelmingly in the family farming area and I have statistics up to here to establish that.

I have poured it into the Congressional Record now for 5 years. There is just no question about it. There has been a transition. There are a few areas where some of the corporations are operating in a big way, or big co-ops are. But by and large, our production is still on a family farm basis and I just want to say one more thing because I want to apologize to Senator Bush because I am off the point.

Senator BUSH. That is all right.

Senator PROXMIRE. I do want to emphasize here is one area where we have really shown the rest of the world the way and especially the Communist world.

We have family farming in this country and our productive efficiency is greater than in any other area of our production as compared with the Communist bloc. They are starving in China, they are starving in Cuba, they are tremendously disadvantaged in Russia because they have to take 50 percent of their people to produce their food.

In this country we are doing brilliantly with our farming. It is in the free, competitive, individual, independent area. This makes a strong argument for what you gentlemen are saying.

Mr. ADAMS. Precisely.

Senator PROXMIRE. But at the same time, I say pure and simple justice requires us to have some kind of a farm program which will give these people something.

If you do what the CED tells us to do and just take out the farm program entirely, as the Iowa State University, as the Department of Agriculture, as virtually everybody who has studied this has said, farm income will drop 25 percent.

Mr. ADAMS. Senator, all the panelists are suggesting, and I hope I am not being presumptuous in speaking for my colleagues, is that you save American industry from this kind of centralized, sovietized, authoritarian control which has failed in the Soviet Union in the field of agriculture.

Now, with all the strength at our command, we ought to avoid that kind of system in American industry. Certainly in agriculture we have tried to avoid that by maintaining a large number of competitors.

Let us do the same thing in industry. That is all we are saying, and I think this can be done feasibly, it can be done in accordance with the imperatives of modern technology.

Senator BUSH. Mr. Chairman, I am sorry but I have got to go at 3:30.

I just want to express my appreciation to the members of the panel for a very interesting day, indeed. I am sorry I will have to cut it off. It is very helpful and very interesting.

Senator PROXMIRE. Thank you so much, Senator Bush. I just want to ask a couple more questions. I want to thank you gentlemen, too, for being extremely responsive.

What alternative do our firms have—they are losing their export market—except to buy and build a plant abroad? I am thinking of a very fine firm in Wisconsin, Kearney Trecker, it exported in effect about 1,300 to 1,500 Milwaukee jobs over to England, built a big plant in England, took advantage of the fact their market was in Europe and wages are lower and so forth. No. 1, I am not sure necessarily this is a bad thing because this is still the free world being built up and we are building up their strength by commercial private investment instead of by impositions on the taxpayer, and No. 2, I just wondered what I would do or you would do, Mr. Adams, if you found yourself in the position of losing your export market and finding this marvelous market in Europe, with these great opportunities there, why shouldn't you invest in it?



Mr. KAHN. Since Mr. Adams raised this problem, I might say that perhaps there is a difference of opinion between us.

I certainly agree with him to the extent that this flow of capital abroad is encouraged by tax preferences, tax havens.

Mr. ADAMS. Which it is.

Senator PROXMIRE. I think that is right.

We have a proposition we are probably going to lose in the Senate a week or so when it comes up but I think that is true.

Mr. KAHN. Apart from that I don't think there is anything wrong with it.

Mr. LANZILLOTTI. I would like to inquire about that statement, Professor Kahn, whether you don't mean to recognize that these companies, by going abroad, still have a protected or captive concentrated market at home.

Now, if our own home market were free to have the encroachment from abroad in different forms, then I would have no objections to it.

But here is where they can have their cake and eat it, too. These companies need not fear the encroachment, the competition from foreign markets under protective tariffs or quotas or what have you in chemicals.

Senator PROXMIRE. We are inviting other countries to come in and develop their own industries in this country, and Japan said they would take us up on it but of course they don't have the capital.

Mr. LANZILLOTTI. I would suggest lowering our tariffs, and other trade barriers that Professor Kahn has alluded to earlier. You ask if there is anything wrong with our companies investing in plants abroad. No, I would support the notion and I would tend to support Professor Kahn provided we open our markets more to foreign competition.

Senator PROXMIRE. I would like to ask you gentlemen if any of you could tell me, if there is any substance, in your judgment, in the claim that business confidence would be badly damaged if we followed a policy of vigorous antitrust.

President Kennedy, whenever he runs across what to him is a puzzling and I must say is quite puzzling to me, criticism that he is antibusiness, says, "What do you mean, because we are enforcing the antitrust laws?"

He said that a couple of times, and I think that there may be a general feeling in the business community that if any administration enforces the antitrust laws virgorously they don't like business. Because of antitrust big firms have to be careful about growth and expansion and about building more plants and about hiring more people, and this may have an adverse effect on the economy.

How about that?

Mr. Barber?

Mr. BARBER. I think there is no question but that this is a serious problem. To my way of thinking though, it is a problem that is not limited only to this kind of question.

It seems to me there are many things which a Chief Executive or a political figure must take which are unpopular.

Senator PROXMIRE. I am not talking about the unpopularity but talking about what effect it is going to have on the economy, on employment, purchasing power and so on.

Mr. BARBER. I am getting to that.

Senator PROXMIRE. I think it would be very popular, incidentally.

Mr. BARBER. Well, here, I similarly have a question.

Senator PROXMIRE. Maybe we ought to divide it this way: If you are not a stockholder in a firm that is the target of antitrust prosecution, it probably is popular.

Mr. BARBER. That calls to mind the report that appeared in the Wall Street Journal the earlier part of this month which reported on a survey made by the Opinion Research Corp. of Princeton for 70 big—this is the Wall Street Journal saying—big corporate clients.

It was a cross-section survey of the population as a whole, and the persons interviewed were asked whether they thought one or two companies have "too much control" in the Nation's largest industries.

It seems to me the results were rather surprising: 61 percent of the people answered "Yes," and indeed 68 percent of the businessmen who were polled answered in the affirmative, a larger percentage than of the public generally.

But when you get down to more specific questions as to what you want to do, the initiation of specific cases, then the percentage of popularity of this may tend to decline.

When we consider the effect on the economic situation, first of all it strikes me that there probably would be some impact in the stock market but if we are going to ask the kind of longer run question what would be the impact ultimately upon employment, upon growth, upon income, the distribution of those incomes and such, then it seems to me there is a very strong case that greater competition would be achieved through a vigorous program and, as a consequence, you would attain a climate that would be more favorable to business.

So I think that the longrun implications of any such program would be distinctly favorable to the businessmen, to business opportunities.

From this point of view, therefore, it seems to me that the program is the kind that we should go forward with even though at the outset you would be bound to get a degree of hostility on the part of certain interest groups.

Mr. ADAMS. Senator, I don't think, with all due respect, that the issue is necessarily a genuine one. In fact, it may be an altogether phony issue.

I think we ought to be aware of the fact that there was more vigorous antitrust enforcement under the Eisenhower administration than there has been under the Kennedy administration so far, and no one, to my knowledge, has considered the Eisenhower administration anti-business for that reason.

Senator PROXMIRE. I suppose that is right; and historically isn't it true there was less vigorous enforcement under the Taft than under the Roosevelt administration?

Mr. ADAMS. Yes, sir.

Senator PROXMIRE. Because of Teddy's fierceness, and so forth, he was labeled by many, at least, as a trustbuster, and Taft quite to the contrary.

Mr. ADAMS. Of course, again, if we refer to history, I think it is safe to say that Teddy instead of speaking softly and carrying a big stick, spoke loudly and carried a twig [laughter]; besides, I don't think we should accept this argument that vigorous law enforcement

will undermine business confidence. If there is something wrong with the antitrust law, by all means take it off the statute books.

If the law is right, there is only one alternative you have, and that is to enforce it.

MR. KAHN. I think additionally it is hard to imagine the institution within a very short period of time of a major effort. It takes a long time to prepare suits; it is hard to imagine the administration suddenly breaking out in the next 2 weeks with such a rash of major suits against all the leading companies in American industry as to have any such significant effect realistically.

Senator PROXMIRE. I understand that Judge Loevinger will be here tomorrow morning. He was here yesterday, and I wish you had been here before he had been, but we will get another crack at him tomorrow on the basis of information that identical bids are being released this morning at the Department of Justice building. I do want to ask, have the CAB, FCC, and ICC been contributing to economic concentration?

By and large they regulate industries which tend to lend themselves to a degree of great size and and to some extent real monopoly.

Also particularly ICC and CAB are regulating railroads, airlines which have had an awful lot of economic difficulty and trouble, and some of which have actually failed, and they have had the alternative and it is a very tough alternative of either permitting a merger or just accepting the failure with a terrific loss of investment, loss of jobs, loss of service for the public. Would you acknowledge that under these circumstances transportation being such a very difficult trial for both the railroads and airlines, that when they have permitted mergers, they have done so more on the basis of apparent economic necessity than any philosophy that we should follow a greater monopolistic concentration?

MR. KAHN. Since I have to catch a train, may I say a sentence and leave?

Do you mind if I have the last word?

Senator PROXMIRE. You may.

MR. KAHN. May I put in a plug for Professor Adams' book, "Monopoly in America, the Government as Promoter."

That is the first thing.

Secondly—

Senator PROXMIRE. Yes; I have heard very good things about that book, and I am anxious to read it.

MR. KAHN. It is an awfully popular book, but still [laughter] the second thing is I am not so sure that the mergers are the major problem in transportation, as I argue in my statement.

The critical question is are we going to let the railroads compete or aren't we going to let them compete. To a large extent the efforts of the administrative commissions are to protect one kind of transportation as against another.

I am concerned, for example, about the effort of the coal industry to get pipelines built. I think this would be magnificent, this is a great technological advance, it is a way of cutting costs and we are running into opposition on the part of competing industries, so it seems to me in the interest of companies themselves, I think greater competition might be to their advantage.

The merger question I can see is a much more difficult one.

Senator PROXMIRE. Thank you very, very much, Mr. Kahn.

Why don't you go right ahead and we will just permit the others to answer and then we will wind up.

Mr. LANZILLOTTI. I think Professor Adams is best qualified to talk of this. Afterwards if you don't mind, I think we might come back to this question of acquisition and mergers and possible legislation.

Senator PROXMIRE. Professor Adams?

Mr. ADAMS. Well, I think that the prevailing concentration of power that you find in the American economy and certainly that you find in the regulated industries, is not something that is a God-given fact. It is not a law of nature. It isn't inevitable.

Senator PROXMIRE. To some extent it is. One of the panelists said a while ago that if an industry is going to have such a large proportion of monopoly we ought to regulate it. You ought to give them a public utility status, these have something of a public utility status, they are regulated.

Mr. ADAMS. That is fine; but most of the concentration you find, I think, is manmade, it comes of man and not of heaven.

Now, in the transportation field, I think there was some logic to regulating the railroads in the 19th century when the railroads had a monopoly. They fitted the category of natural monopoly, and regulation was set up to protect the consumer against this exploitative monopoly. Today, this situation has changed so completely, both in the passenger field and in the freight field, that the greatest single thing we could do in my opinion, as far as surface transportation is concerned, is to deregulate the whole industry. Have the ICC close shop and let the railroads and the trucks and the barges and so on fight it out within the limits of the rules set up by the antitrust laws.

Competition in this industry is perfectly feasible. It is perfectly feasible, both technologically and economically. Unfortunately, it is being artificially restrained by the Government.

As Fortune magazine put it some years ago, the Government has created a huge freight cartel, and that is precisely the situation we are in today.

Senator PROXMIRE. That is a very, very interesting suggestion. You are suggesting we just abolish the ICC and the CAB?

Mr. ADAMS. Well, no, in the case of the CAB, I think you have a few more problems.

But even on that score (laughter) if I may invite your attention to a historical fact, the progress that was made in air transportation came about largely as the result of the marginal competition that was offered by the nonscheduled airlines.

This was the stimulus for growth in that industry.

Senator PROXMIRE. Let me ask you, Is there support for your view to your knowledge in the industry?

For instance, Mr. Robert Young some time ago was an advocate of greater competition of various kinds between the railroads. Is there any figure in the railroad industry who advocates competition?

Mr. ADAMS. Senator, I think generally speaking, the people who hold a certificate—

Senator PROXMIRE. I don't mean this at all critically, but I am just wondering.

Mr. ADAMS. Those who hold any Government grant of privilege are obviously protecting a vested interest position.

Senator PROXMIRE. So many of these railroads are doing so badly, many of them are losing lots of money. We have one up in my State that claims to be losing \$1,500 a day and they are pleading with the ICC to have a chance to abandon their operation entirely.

Mr. ADAMS. I think they should be allowed to. Where a railroad operates and how it operates ought to be left to its own managerial discretion.

Senator PROXMIRE. Here is where you run into a really tough political problem because the people who use that service don't want to see it abandoned. They depend on it, they need it. They say it is the only way they can commute, many of them can't afford automobile transportation, or it is very inconvenient, and also, of course, you have literally thousands and thousands of jobs.

Now, in spite of the ICC we have lost all kinds of railroad service and railroad operation, and we are going to continue to. That makes it difficult.

Mr. ADAMS. If it is—well, if it is the judgment, the legislative judgment of the State legislature or of the Congress, that a particular type of service ought to be maintained even though it is unprofitable, then the only thing to do is to grant that kind of service an outright subsidy.

In that case you would know precisely what you are buying and how much it is costing you.

But to prevent competition in order to achieve this kind of protection, this is the most inefficient way of subsidizing an industry.

It would be analogous to saying to the carriagemakers in the 19th century, "We are not going to permit the competition of automobiles in order to protect the jobs and the investment you have made in your industry."

Senator PROXMIRE. Mr. Lanzillotti, do you want to finish off the ICC? [Laughter.]

Mr. LANZILLOTTI. I think Adams has taken care of that problem.

Senator PROXMIRE. Do you support it?

Mr. LANZILLOTTI. I support him on this; yes, sir.

Senator PROXMIRE. Well, we will have the ICC before us on Thursday at this rate. [Laughter.]

Mr. LANZILLOTTI. We face these risks rather repeatedly. You mentioned a point earlier about antitrust laws and business uncertainty. There was a very small point I wished to make on that particular problem, or dilemma.

We could reduce the uncertainty which faces the business community today in that area, and I think we should. I think it is unfortunate that we have so much delay in the decisions in this particular area of merger cases. I don't think it is good for the antitrust agencies program nor do I think it is good for the business community.

In other words, what I am saying is we need to cover more ground and cover it more rapidly in the area of mergers. The law has been on the books here now for over 10 years and while I am gratified with recent decisions, we have covered hardly no ground at all.

Business firms that wish to acquire or merge with firms find that the final decisions are not yet rendered, and I think we could adopt some amending legislation to expedite matters. For example, I would endorse the O'Mahoney bill, the one on prior notification, particularly the injunctive provision for the FTC.

I think this would be a very positive measure and it may be that we also could develop rules of thumb regarding the percentages that would be presumptively illegal if firms of, say, 20 percent or more tried to merge with some other firm, having say 10 percent, horizontally or vertically, that they would be illegal on their face, and the presumption could be rebutted with appropriate evidence.

These very suggestions would carry us into a new area—but I do think we could reduce business uncertainty about how the merger law is going to affect them if we did amend it along the lines that I have just indicated.

Senator PROXMIRE. Mr. Barber, do you want to comment?

Mr. BARBER. There is a great deal of merit to the kind of suggestions that Professor Lanzillotti has made, and which, among others, Professors Kaysen and Turner have developed in their books, "Anti-trust Policy," which would set out guidelines and indicate in a given situation that firms proposing to merge or firms in a certain position shall be treated in a specified manner. I feel this would simplify the administration of the law and would go a considerable distance to help in achieving lower levels of concentration.

I recognize we can prolong this for a great period. But let me only suggest again that what strikes me is that while we have talked today about a great many aspects of this problem and about antitrust laws and possible changes in them, I fear that we may leave with nothing more than a long discussion.

I think what we do need are some specific considerations, proposals, and I can't help but think that if we are sincerely interested in this problem, that if we really think it is significant enough to devote even a day's hearings to, we should look at it a lot more closely and reach some determinations. Otherwise we have wasted a lot of time.

I think we have got to make up our mind at some point whether we mean it when we say we want to help small business, when we want to enforce antitrust policies, when we want to have free competitive markets and so forth, and that if we don't mean it then I think it would be well to use the resources we spend in this way on something more constructive, like the construction of fallout shelters or something. [Laughter.]

This brings me back to one point that you raised, Senator. I know you have done a great deal in the procurement area and have worked very aggressively and sincerely and have tried to improve the situation. But I do not share the conclusion that you came to earlier that it seems virtually impossible to do anything about it. I think things can be done about this. I think they should be done. But I agree it is going to take some very close hard prodding at middle-run military officials, not the top rung.

Senator PROXMIRE. Thank you very much.

As a middle-run Senator we are going to have Judge Loevinger tomorrow who is below the President.

At least, in that sense he is kind of a middle-rung operator. But seriously, we are going to press him hard on these things. I think the suggestions you gentlemen have made have been extremely useful, many of them very provocative, and I think I would like to add to what Senator Bush said this has been a very instructive, enlightening, entertaining, and useful day, thanks to you.

Thanks a lot, and we will adjourn until tomorrow morning at 10 o'clock when Judge Loevinger will appear.

(By order of the chairman, the following statement is included in the record of the hearings, inasmuch as Professor Clark was not able to testify in person :)

STATEMENT OF JOHN M. CLARK ON THE RELATION OF INDUSTRIAL CONCENTRATION  
TO THE PURPOSES OF THE EMPLOYMENT ACT

Concentration may be defined as a condition in which a large fraction of the capacity and output of an industry in any given market area—possibly a majority, but not necessarily so—is produced by a small number of large firms. There may or may not be also numerous small firms, which may or may not be important factors, in the aggregate, in the behavior of the market. For a careful analysis, most of these terms would need further defining. It may be assumed at the start that concentration is not carried to the lengths of monopoly, this being a distinct problem and one for the antitrust laws. As to the effects of concentration on high and stable employment, it seems clearly impossible to make overall general statements that would be either accurate or useful. Some aspects of its effects are favorable, some unfavorable, all subject to modification by the setting of public controls and private policies, including responsibilities voluntarily accepted, in which industry operates. Thus the only useful diagnosis must take the shape of a discriminating analysis. This may begin with the conditions necessary or favorable to high and stable employment.

First and most basically important is a total volume of effective demand for goods and services, big enough to absorb our total productive power, with unemployment of labor limited to voluntary nonemployment plus a small percentage incidental to normal job shifting. Since productive power is continually growing, this means that effective demand must grow with it; and since such growth involves irregularities and uncertainties, and inequalities as between different branches of production, the minimum necessary allowance for job-shifting unemployment runs into the millions, even though a small percentage of the total labor force. Such unemployment should be temporary and transitional for particular workers, though persistent in the aggregate as a feature of a growing and mobile economy.

A second major requirement is that fluctuations in the economywide rate of economic activity—production, income, investment, and consumption—should be moderate, so that cyclical maximums of unemployment do not become unmanageably great. Whatever effect industrial concentration may have on this requirement will be in connection with any public policies bearing on cyclical stabilization of industry.

Thirdly, the same requirement holds for fluctuations in particular industries or products and the personal incomes of those deriving income from them, to the extent that these fluctuations affect the total incomes of these persons, especially workers employed in these industries, and are not entirely offset by job shifting, including supplementary employment, or in other ways.

Fourthly, as already indicated, there is need for adequate and enlightened policies minimizing the amount of necessary shifting to unfamiliar jobs, employers, or family residential locations, and aiding the shifts that remain necessary. The impact of technical progress means a reduction in the proportion of purely manual labor and a corresponding increase in the proportion of more highly skilled employments involving the superintending of more elaborate and effective technical, chemical, or similar applications of applied science, together with the planning, devising, and developing of these applications of applied science, and of the science itself. This includes the devising and developing of new or modified products, and of demand for them. This means a major movement "upward" in the proportion of occupations, toward those

with less exacting physical requirements and more exacting mental and technical requirements. And workers need facilities and assistance toward finding their places in this changing assortment of occupational opportunities.

Reverting to the first and most basic requirement, as I have said elsewhere ("Competition as a Dynamic Process," Brookings Institution, 1961, pp. 83-85): " \* \* \* the main requirement is that consumers shall spend a large enough fraction of their income so that \* \* \* voluntary savings will not be more than business will want to spend for investment to carry out the accompanying total volume of production. As an approximate rule of thumb, one might assume that this requirement will be met if we continue to spend for consumption the same fraction of our growing income that has marked the trend of our growth in the recent past. But if real income per capita increases by more than 20 percent in a decade, it is obvious that consumers will not simply buy 20 percent more of everything, or 10 percent more of some familiar things and 30 percent more of others. If production were planned on such a basis, much of the output would fail to find buyers and industrial contraction would result. To avoid this kind of failure \* \* \* calls for a combination of new products and improvements or elaborations of existing ones, the test being always whether the consumer can be persuaded to pay for the new products or the elaborations. This gives the advertising industry much work to do \* \* \*. And this raises the question whether advertising might perform the function that is here in question by merely misleading the consumers into buying what industry offers, regardless of whether it gives them any net increase in service values. To this the ultimate limit comes when consumers become too disillusioned to respond, but one must regretfully admit that consumers appear capable of absorbing large amounts of misleading salesmanship before reaching the ultimate limit of no response.

"What we want, of course, is an assortment of offerings that would embody our whole increase in productive power in products and values which, in the light of informed hindsight, we would judge to be worth their cost. This cost includes the cost of research and market exploration and of the selling effort necessary \* \* \* also the inevitable false starts and failures. \* \* \* Another side of the same coin consists of the losses suffered by producers whose products are superseded. Such costs of obsolescence are inevitable features of growth; whether we should judge them wasteful depends mainly on whether the superiority of the successful products represents enduring serviceability or the vagaries of taste or mere novelty. In the latter case, successive displacements might leave no residue of enduring consumer gain.

" \* \* \* there may be a limit to the rate at which our machinery for exploring and developing such things can find them and make them marketable. If there is such a limit, and if we reach it before we reach the limit of our productive power, we face an interesting question: Is it better for us to be stimulated into spending the excess of our potential income on wasteful, futile, and frivolous consumption, or not to spend it at all?" From the single standpoint of high and stable employment, the argument is loaded in favor of the conclusion that misdirected production is better than involuntary idleness, as Keynes suggested by his illustration of the building of pyramids. But any such course would be a confession of failure in the real task of generating demand sufficient to absorb rapidly increasing power of production and well directed to serviceable ends.

An equivalent for pyramid building, coming nearer home, might be what the present writer has called product inflation as a tendency likely to occur when giant firms in an industry are too few and smaller competitors are too few and too weak. A prime example would be the elaboration of passenger car models and the coolness of the Big Three to economy models, until a smaller competitor forced the pace. This tendency to product inflation is definitely connected with an unduly small number of giant firms, each of which lacks room enough to increase its physical volume of sales by a large enough proportion to increase its total net earnings by offering the buyers, competitively, a free selection of economy models at a corresponding saving (op. cit., pp. 252-257). Other examples of a slightly different sort might include the growth of extravagant packaging, and the exorbitant prices exacted for brand-name drugs, together with the extravagant methods of promoting their sales.

Reverting to page 85 of the work already quoted: "Suffice it \* \* \* that if any considerable fraction of the effort so spent yields cumulative improvements in our level of living, this cumulative improvement outweighs whatever fraction of our resources we devote each year to bringing it about. We should like to



reduce the wastes and increase the serviceability. But most economic students would prefer an economy actively energizing its productive resources and progressing annually, with an amount of waste motion, to one with less waste motion and less employment of resources or slower economic progress. The former represents the direction in which the institutions of market research and sales promotion are energetically steering the American economy."

The question assigned to this paper is the relation of industrial concentration to this whole process of absorption of productive resources. Since, let us say, the end of the Civil War, realized productive power has increased with remarkable steadiness, while concentration has been increasing. Even if figures for recent years should show some slowing down of the rate of increase, this could not clearly be traced to concentration itself as its responsible cause. The causes are more complex, and include protective responses of organized labor to the fear that the process known as automation is bringing an unduly sudden and rapid spurt in man-hour productiveness, of a labor-displacing kind and extent. Meanwhile the expansion of demand for products has not visibly slackened, but may be moving into areas of products requiring more creative imagination, both in services themselves and in methods of financing them. This includes health services and recreation activities and the uses of that leisure for the masses which is such a recent and such a transforming feature of our present economy. These areas of product innovation may be less obvious than those of the late 19th century, and the research and exploration called for are often in the fields of public or noncommercial action. In industry's particular field of marketable products, the advantages of the giant firm count heavily in some kinds of innovation; and emphasis seems to be shifting in this direction, as against the "multitude of small undertakers" to which Alfred Marshall, in 1890, attached decisive importance ("Some Aspects of Competition, 1890," in *Memorials of Alfred Marshall*, A. C. Pigon, editor, 1925, pp. 279-281).

Firms of any size can succeed in product innovation; but the most characteristic modern kinds stand a better chance if the innovating firm has size enough to combine the advantages of numbers and independence with size enough to be able to afford a department of research, engineering, and design, or at least to secure these services from a specialized agency. The more extensive operations of the big firms have wider coverage, especially where the big firm deals in diversified products, and this affords more chance for cross-fertilization of different innovating activities; also for the dovetailing of fluctuations of different products.

As to regularization of investment outlays, which are crucial for cyclical stabilization, the big concentrated firms have developed a tendency to program such outlays on an annual schedule, thus mitigating the irregularities which can result from the fact that single enlargements of productive capacity, by a giant firm, involve very large acts of investment outlay. Of course, such advance programming is modifiable, if requirements do not come up to the expectations on the basis of which the program was laid out; but in spite of this it appears to have considerable regularizing effect.

While we are not identifying concentration with monopoly, its effects on the character of competition call for attention. Competition is, in general, held to be favorable to high and stable employment, though not sufficient by itself to bring this result about. It may be, as some hold, that if the economy were more unmitigatedly competitive than it is, business recessions would be more likely to cause business firms to slash prices in the attempt to maintain physical output in the face of weakened demand, rather than cutting output and resisting declines in prices. Unfortunately, experts disagree as to which kind of price behavior is a better way of sustaining employment. "For maintaining overall demand, economists prevailingly hold that ruthless competitive slashing of prices is less effective, as well as more disturbing, than well-judged monetary and fiscal policies" (op. cit., p. 82. What follows is based on this passage, though not quoted verbatim).

Given the latter, and more moderate sensitiveness of prices, what competition can do is to help the economy to be flexibly responsive to adequate total demand, carrying out the mobilizations that will always be needed to place resources where they are called for by expanding productive power, and minimizing the pools of unemployment that may persist in an economy where there is not enough of this adaptable mobility. Social security and other security policies need to be so handled as to avoid creating obstacles to proper mobility; such as are created when retirement rights are of a sort which a worker sacri-

fices if he changes jobs. As I have said elsewhere, the economy would respond better if freed from undue rigidities of particular prices and wages. If price policies under industrial concentration are of this unduly rigid sort, they are unfavorable to the objectives of the Employment Act; but if they remain flexible and merely avoid unmitigated competitive price-slashing, they can involve helpful cooperation with other more positive policies looking to the stabilization of employment.

To sum up certain high-spot conclusions to which this brief and inadequate analysis points, there are some features of industrial concentration that can be unfavorable to the objectives of the Employment Act, especially if the surrounding smaller firms are too negligibly weak to introduce reasonable competitive flexibility and prevent undue price rigidity. On the other hand, there are policies facilitating the really very exacting shifting of occupations that is called for, which very large firms, leaders in an industry, are in a position to promote more effectively than the members of an atomistic industry.

(Whereupon, at 3:55 p.m., the committee adjourned to reconvene at 10 a.m., Wednesday, August 22, 1962.)

# STATE OF THE ECONOMY AND POLICIES FOR FULL EMPLOYMENT

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WEDNESDAY, AUGUST 22, 1962

CONGRESS OF THE UNITED STATES,  
JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Hon. Wright Patman (chairman) presiding.

Present: Representative Patman; Senators Sparkman, Proxmire, Pell, and Javits.

Also present: William Summers Johnson, executive director, John R. Stark, clerk; Hamilton D. Gewehr, research assistant.

Chairman PATMAN. The committee will please come to order.

This is the concluding session of the committee's hearings on the state of the economy and on policies for achieving maximum employment production and purchasing power.

We have considered monetary policies, fiscal policies and policies for maintaining competition. Each of these policies is in some degree a substitute for the others. It would not be practical, it seems to me, to hope that we can solve all of our problems through improvements in any one of these policies, so the task ahead, it seems to me, is to try to achieve improvements in all three as well as in other policies and procedures of the Federal Government.

This morning we have a return visit from Mr. Loevinger, Assistant Attorney General in Charge of Antitrust.

Judge Loevinger, we had an opportunity to peruse your identical bid report yesterday afternoon and I think you are to be warmly congratulated, sir.

Previous Assistant Attorneys General in Charge of Antitrust have tried over many years to get systematic reporting of identical bids and failed.

I believe you have accomplished a very difficult task. I have been around Washington long enough to know that it takes time and experience to install a new reporting system where so many different agencies are involved and I would not expect that your first report would be perfect.

The important point is that you have made a good start and I have no doubt you will make improvements in future reports on this subject.

Judge Loevinger, you may proceed in your own way and after we have heard your comments members of the committee may wish to put questions to you. I assume you would like to discuss the identical bid report.

**STATEMENT OF HON. LEE LOEVINGER, ASSISTANT ATTORNEY GENERAL IN CHARGE OF ANTITRUST DIVISION, DEPARTMENT OF JUSTICE; ACCOMPANIED BY LEWIS MARKUS, CHIEF, ECONOMIC SECTION, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE**

Mr. LOEVINGER. Yes, sir.

Thank you very much, Mr. Chairman, for your kind comments.

You are quite correct in saying since this was a new venture, involving the handling of a mass of new data and its arrangement in a new way that we were, perhaps, a little slower than we might otherwise have been. That accounts for the delays in the issuance of the report which we had thought might have been available earlier, but for the difficulty in handling the data and insuring accuracy in the report.

It would not be fair to present this report to the committee or to the public without giving full credit to this committee and to its distinguished chairman, Congressman Patman, for the report itself.

The initial idea for the kind of reporting system upon which this identical bid report is based came from the Joint Economic Committee, which on March 14, 1961, adopted a resolution recommending that the President issue an Executive order relating to this subject matter.

Following a White House conference 2 days later the President authorized the chairman, Congressman Patman, and Senator Douglas to announce the President's intention to issue such an Executive order.

The Executive order, in fact, was issued on April 24, 1961, and the reporting system thereafter was instituted pursuant to the Executive order by the Department of Justice in cooperation with the Defense Department and the General Services Administration.

This report is the first report of its kind under this Executive order, and as I say is due, in large extent, to the interest and the stimulation of this committee and its chairman.

In presenting the report it probably should be noted also that it is not meant to say that identical bids are always necessarily illegal.

However, it is suggested that identical bids can serve as warning signs of collusion that may be violative of the antitrust laws.

We feel that the submission of identical bid reports gives the Department of Justice broader sources of information on which to base investigations of possible collusive bidding as well as indicating other areas in which there may be a lack of competition even though there is no actual collusion.

The program of reporting identical bids pursuant to the Executive order was actually initiated by the Federal agencies on July 15, 1961.

The actual reports, as is indicated in the text accompanying this report, were, of course, received later than that.

The Department has also invited purchasing officials from more than 2,000 State and local government units ranging from States to school districts to participate in this program beginning November 1, 1961.

The Executive order requires the Attorney General to consolidate the information furnished under the order in a report to the President and the Congress.

The first report is being released this morning at this time. Copies of the report have been made available to the committee, and I might mention a few of the highlights.

First, this is a preliminary look at the first 6 months of reporting by Federal agencies, and something less than 3 months of reporting by State and local governments.

Although the order has been in effect for longer than this period, the difficulties that I have mentioned have prevented the report from being issued more nearly currently with the cutoff date.

In the future we should be able to minimize this lag period.

Second, while a projection of the report's experience indicates that identical bidding affects only a relatively small percentage of total public procurement, the sample on which the projection is based is not reliable enough to establish this conclusion firmly.

Third, the report points up a number of sectors in the economy in which public procurement encounters price rigidities and these sectors are of sufficient national importance to warrant further scrutiny.

Finally, the report reveals that while identical bidding may be suspect of collusive agreement it may also be the consequence of factors unrelated to illegal activity which can be corrected by means other than antitrust enforcement.

The report suggests that identical bidding appears to be a significant public procurement problem in several broad product categories including asphalt road materials, chemicals, lumber, textiles, and compressed and liquefied gases.

In a large number of cases all bids were precisely identical as to price. In other cases identical bids were interspersed among disparity bids.

Sometimes the identical bids were the low bids creating problems of tie bid resolution for the procurement officer while in other cases the identical bids were below the low bids and were thus not in the area of competition.

The diverse factors which may be responsible for identical bidding suggest that a case approach is essential to determine the underlying causes responsible.

At one extreme identical bidding may be the result merely of unsophisticated procurement policies and procedures which tend to induce and perpetuate it.

At the other extreme identical bidding may be the result of conspiratorial agreement. Where the cause of identical bidding lies in procurement policies and procedures, remedial steps may be taken by new procedures designed to discourage the practice.

Where Federal or State laws are responsible for identical bidding action may be taken to recommend or legislate their modification.

Where collusive agreements among bidders are suspected the facts giving rise to such suspicions should be reported to Federal, State, or local law enforcement agencies which can then investigate and take appropriate action.

In markets where price competition appears to have been subordinated to other forms of competition, it is obvious that public procurement by competitive bidding tends to be frustrated and it may be necessary to introduce methods of procurement which will induce competition for public business.

The two principal objectives of the Executive order are first to publicize information with regard to identical bidding and advertised

procurement of Federal, State, and local governments in order to discourage future submission of such bids.

And second, to make more effective the enforcement of the anti-trust laws by insuring that the Department of Justice shall have information which may indicate any conspiracy in restraint of trade.

Assessment of the effectiveness of the publication of identical bids in discouraging identical bidding of future procurement must of course, await the reaction of identical bidders and procurement officials to this report.

The effect of such exposure will, of course, be measured by the reduction of the volume and the frequency of identical bidding in public procurement subsequent to the issuance of this report.

Such evaluation will, of course, be present in future reports to be issued under the Executive order. Although I do not have any sound grounds for saying that this must be so, I have a personal intuitive feeling that the relatively small percentage of identical bids reported herein is at least in part the results of the activities of this committee and of the Executive order and of the reporting system.

These activities and the issuance of the Executive order were well publicized substantially in advance of when the reports were to be gathered, therefore, there was time for a deterrent effect to be felt and this may be in part the reason for the relatively low incidence of identical bids.

It is premature to evaluate the results of the program in achieving the second objective of the Executive order. The relatively short period of time that the program has been in operation makes truly objective evaluation difficult.

However, it is well established that identical bid reports provide a stream of current market intelligence which is a valuable aid to anti-trust enforcement.

In the recent past a number of significant investigations in antitrust cases have had their genesis in identical bid reports.

Just since July 1961, identical bid reports affecting 15 product categories have shown sufficient indica of collusion after analysis to warrant further investigation.

In addition to forming the basis for leads to investigations, identical bids are used extensively as aids to investigations already underway. They are used to provide information in the preparation of cases for trial or settlement, and they are used to observe the effects of and compliance with decree provisions in litigated and negotiated judgments.

In time, it is contemplated that the vast record of price information accumulated and organized as a consequence of the operation of the Executive order, will provide an historical background against which to compare shifts in price behavior in a large number of markets ranging across the entire spectrum of the national economy.

Such information is extremely valuable for antitrust enforcement purposes at the Federal and State levels. It is further contemplated that these records will be made available to State and local governments to aid them in the prosecution of cases which may indicate violations of State laws and in correcting abuses at the local government procurement level which may restrain competition and increase the cost of government.

This is essentially all I have to say in presenting this report, Mr. Chairman.

Again I should like to emphasize the contributions that I think that this committee and its chairman have made in getting this program instituted. We recognize that this is our first attempt in the field, that it is probably incomplete, and imperfect.

However, the Department of Justice will certainly carry out its duties under the Executive order to the best of its ability, and we believe that our ability to handle this data will improve as time goes on and we will be able more efficiently to make reports in the future.

Chairman PATMAN. Senator Javits is being compelled to go to the Appropriations Committee soon and he would like to ask questions.

Senator JAVITS. Just one question.

Judge Loevinger, I am very glad to see you and I am very anxious to get from you either now or when it is convenient to you, in the form of a communication to the committee, the answer to the following question.

Is the antitrust policy of the United States, which is now being pursued in respect to American business the same as, different from, and if so, to what substantive extent, than that pursued under the previous administration.

Mr. LOEVINGER. Basically, Senator Javits, I think that the antitrust policy is the same substantively.

The enforcement of the antitrust laws is a matter of law enforcement. This is a fact that I think academic economists sometimes overlook. We are not legislating, we are not making law. We are enforcing laws that have been passed by Congress and that have been interpreted by the courts. It is our duty as lawyers to enforce those laws according to the policies established by Congress and the interpretations given by the courts and we do this. We do it more or less well, and opinions may differ as to that.

I think that in some respects we have been more efficient and more vigorous than some of our predecessors. We have reorganized the Antitrust Division simply in order to handle some of the matters more efficiently.

We are engaged in more activities than previously the Division was engaged in.

The report that is being presented this morning is an example of this. This has required the institution of whole new procedures of handling data. Basically, however, in substantive terms, we are a law enforcement agency and I do not believe that there can be great differences among honest and vigorous law enforcement officials in the substantive enforcement of the law, because we are necessarily governed by congressional policy and judicial interpretation.

Senator JAVITS. If the Chair will allow me just one other followup question, I shall then be through. I am very grateful to my chairman and my colleague, Senator Proxmire, for their graciousness.

We are hearing here and you are part of the hearings, the question of the state of the economy.

Now, would you—or perhaps you would have to go back and consult the Attorney General—have any recommendations for us as to the way in which we could constructively, helpfully, affect the economy by anything that we could do about the antitrust laws.

As you say you are a lawyer, you are bound by the law and you are bound by the cases as they have implemented the law.

As we considered various suggestions, people came here and talked about tax cuts, and various other things. What about antitrust law revision?

Do you think your Department is prepared to make any recommendation to us as we deal with the question of improving our economy, with relation to the antitrust laws?

Mr. LOEVINGER. Well, I think I can give you at least a general answer to that, Senator Javits.

We have commented during the course of the last year and a half on between 300 and 400 legislative proposals from the viewpoint of antitrust.

Those range across the entire spectrum of the antitrust law enforcement or of antitrust law policy.

Basically, I believe that we feel that the antitrust laws are sound and substantially are well adapted to secure their basic objectives.

We have made some recommendations for legislation. The one I would urge upon this committee is probably not very controversial even, the provision for a civil investigative demand which has been passed by both Houses of Congress, either has been or I believe is about to be reported out by a conference committee as to certain minor differences between the Houses, and we would very much appreciate having that expeditiously enacted.

Senator JAVITS. Civil investigative demand, meaning the right to get data—

Mr. LOEVINGER. The right to get documents from corporations in civil investigations.

Senator JAVITS. Without subpoena before a grand jury?

Mr. LOEVINGER. Yes. I believe that substantially the entire conference committee is in accord on the resolution of the minor differences between the versions of the bills before the House and the Senate, and I believe that this will be presented to the Congress very shortly.

This is one of the major enforcement tools that we believe will be useful.

Now, notice, this has no substantive effect on the law at all. It simply is a matter of enforcement.

Senator JAVITS. So you do not recommend a substantive change in the law?

Mr. LOEVINGER. We are not recommending any substantive changes at this time, with the reservation that we have commented favorably on certain proposals that are not, I believe, fundamental to the antitrust laws. They tend to be relatively peripheral.

Senator JAVITS. Thank you so much, Mr. Chairman, and thank you, Senator Proxmire.

Chairman PATMAN. Thank you, Senator Javits.

Judge Loevinger, several of the panelists we had yesterday met with the staff and they commented on your report. These were Professors Adams, Lanzillotti, and Barber. They were all highly pleased with the report and the fact you have instituted this reporting procedure. They all did express disappointment, however, in one aspect of your



report which is this: You report in table 2, where you show the details of the bids, only those bidders who submitted identical bids and you omit the names of the other bidders. They felt that the first report you prepared for us on the sample of the 193 bids, for years prior to the President's Executive order, was a great deal more informative and useful in this respect whereas your new report may conceal more than it reveals and could be misleading in some respects.

For example, at page 177 you report bids for truck and bus tires. The report indicates that there were 14 bids and 4 of them were identical. Then you list the four companies who submitted identical bids and these are the Big Four in the rubber industry.

But the fact that you show there were 14 bids and only four identical would suggest to State and local purchasing agents that perhaps they could expect a lot of bids at a variety of low prices for such truck and bus tires.

Yet I wonder how many of those 14 bidders were only local dealers for the big four rubber companies and I would assume that the local dealers would likely submit higher bids than the manufacturers.

How many rubber companies, Judge, are there who are making first line truck and bus tires, do you know?

Mr. LOEVINGER. I don't know, Congressman, I am sorry.

Chairman PATMAN. You don't know.

Do you know any reason why the name of the low bidder shouldn't be published?

Mr. LOEVINGER. No.

As a matter of fact, I think the low bid is indicated here. I should give credit to Mr. Lewis Markus, the head of the economic section—

Chairman PATMAN. Suppose you identify him for the record.

Mr. LOEVINGER (continuing). Who is here with me, Mr. Chairman. Mr. Markus has been largely responsible for actually assembling this report and doing the economic work, and supervising the detailed manipulation of data involved here.

Chairman PATMAN. It is page 117 that I am referring to.

Mr. MARKUS. Congressman Patman, if I may go back to your first question?

Chairman PATMAN. Yes, sir.

Mr. MARKUS. On the omission of the nonidentical bidders.

Chairman PATMAN. Yes, sir.

Mr. MARKUS. The impression that we had at the time we undertook this program, was that we would want to lay heavy emphasis on the identical bidders throughout the report. The feeling we had was if we identified within the framework of the report the nonidentical bidders the inference may be drawn that they were in the same category as the identical bidders and for that reason, at least, we did not include all of the details as to every bid that was submitted in response to an invitation.

Chairman PATMAN. It is being brought to your attention so that you can consider it in the future reports. We realize this is a pioneering venture and we can't expect to have everything just exactly right at the beginning.

Mr. MARKUS. Certainly.

Chairman PATMAN. This never has been done before, we realize that.

Your reports exclude all procurements of a value of \$10,000 or less, and in view of the fact that in fiscal 1961 the Defense Department bought over \$1 billion under contracts of less than \$10,000, wouldn't it be a good idea to at least sample a significant portion of contracts in this smaller size range?

Mr. LOEVINGER. I suppose this is a matter of judgment, sir.

The \$10,000 limit is established in the Executive order. My recollection is that the Attorney General has the authority to vary this limit as may appear necessary, and indicated by experience.

It might be advisable to sample some of the other bids. I think that it is a question of the degree of burden that the procuring agencies are willing to bear, of getting used to the procedures, of getting our own techniques for handling the data sufficiently well established so that we can give any assurance that if we get any additional data it can be usefully handled.

Chairman PATMAN. Judge Loevinger, I am very much interested in some of the statements you make on pages 7 and 8 of the report. You point to the fact that there are so many variables involved in determining the price at which to submit a bid that—

It is difficult to justify identical transaction prices and particularly those filed in response to invitations for sealed bids.

In view of that statement and giving attention to the highly concentrated character of many of these industries, wouldn't it be a good idea if we had legislation making identical bids *prima facie* evidence of antitrust violations?

Mr. LOEVINGER. I don't think that I can really comment on such a proposal, Congressman Patman, without giving a little more careful consideration to it and seeing the proposal.

Conceivably there might be constitutional problems depending upon how this were done.

If, for example, the filing of identical bids were made *prima facie* evidence of violation of the Sherman Act, this might involve establishing a presumption in a criminal case that could not withstand constitutional attack.

I am not saying that it would, and I am speaking off the cuff, so that I am rather unsure of myself. I think that such legislation would have to be very carefully drafted, although I think that there may well be an area in here in which some legislation might be appropriate.

Chairman PATMAN. Thank you, sir.

As I read over your report and think about some of your comments, it seems clear to me as I think it does to you, that where there has been a high incidence of identical bids a collusive situation is frequently found.

Wouldn't this suggest very strongly the wisdom of the kind of legislation I mentioned to you just a moment ago; namely, a law making the submission of identical bids, perhaps over a period of time or on a number of different occasions, *prima facie* evidence of antitrust violations?

In other words, go beyond what we were discussing a while ago, and where it is a kind of chronic or continuing situation, consider it *prima facie* evidence?

Mr. LOEVINGER. Yes.

Well, I believe that this carries out the suggestion in my prior answer, sir, that you cannot give a dogmatic response to this. It depends upon the drafting of the legislation.

There are situations in which identical bids are obviously not necessarily the result of collusion. Thus resale price maintenance laws may well account for identical bidding in certain situations; certain programs of the Agriculture Department account for identical bidding quite legitimately.

Account must be taken of these situations, and therefore any attempt to create presumptions must be rather carefully drafted.

Chairman PATMAN. Senator Proxmire, would you like to ask some questions?

Senator PROXMIRE. Yes.

Judge LOEVINGER, how extensive is identical bidding? On the basis of your examination so far, can you give us a notion whether this constitutes 5 percent, 10 percent, 2 percent of procurement?

Mr. LOEVINGER. Yes, sir.

Our answer necessarily depends on extrapolation from data which, we hasten to assure you, are incomplete and therefore not wholly reliable, and you must realize that we are extrapolating from what we really admit are not wholly adequate data.

However, the figures roughly are these: that the total amount of procurement by State and local governments in the course of a year is a little bit in excess of \$10 billion. So far as we can ascertain virtually all of this is advertised or competitive.

The total procurement by the Federal Government in the course of a year is on the order of \$31 to \$32 billion. However, because a very large part of this is by military agencies, and agencies such as the AEC, which predominantly negotiate—

Senator PROXMIRE. And that is—

Mr. LOEVINGER (continuing). Their procurement, there is only about \$4.8 or \$5 billion that is advertised.

On the other hand, our reports do not cover all State and local procurement; therefore, we have something on the order of \$10 to \$15 billion, \$15 billion being the maximum and \$10 billion being about the minimum, of procurement that is competitive or advertised that is covered by these reports.

The extrapolation indicates identical bidding affects about \$100 million worth of this, or about 1 percent in terms of total value. As we have indicated this is rather less than we expected to encounter, and may indicate that the activities, and the inquiries and the reporting system, have already had some effect.

Senator PROXMIRE. I take it from what you have said before that this is simply one method of collusion.

You talk about indicia of collusion that identical bidding may be one aspect of it.

Another aspect of it may be simply rotating a low bidder and dividing up the market that way.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. I am wondering if you have any kind—of course, you wouldn't have the kind of specific mathematical estimate with regard to these other kinds of collusion that you would have with regard to competitive bidding.

I would presume, however, that identical bidding is more common when dealing with less experienced and smaller procurement officials where the large firms involved feel they can perhaps get away with it.

I notice the example which you give out in Oregon was a case of buying county asphalt, and they came in and the procurement official had just thrown up his hands and said, "This is the same thing, boys; year after year you come in with the identical bid and year after year there is nothing we can do about it, we just accept it, and we will give firm A the business this year, D had it last year, and B the next, and so on."

Is it the conclusion—your conclusion on the basis of your observation—this identical bidding will be engaged in where the sellers feel they can get away with it because of less sophistication or knowledge on the part of procurement officials?

Before you answer I would like to say this: You give some excellent advice in your report to procurement officials who want to stop identical bidding.

You point out what they can do is give it to the firm for whom the bid is the most expensive; that is, whose mill is farthest away from the delivery point, or give it to the same firm year after year and don't let them share the market this way.

So I would think a really determined procurement official who really wants to stop identical bidding, which is repetitive, can do so.

Mr. LOEVINGER. I think a great deal can be done by procurement officials. I am not sure that we are prepared to pass judgment to the extent of saying it is most common where the procurement officials are unsophisticated or inexperienced. This gets into a kind of subjective judgment that is hard to make.

I think I can say this, however, because we have had considerable discussion with State law-enforcement officials and with State procurement officials, I believe that the State officials feel that it is very difficult for them to deal with these problems.

There is, of course, as you know, concurrent jurisdiction between Federal and State Governments, in the antitrust field. Nevertheless, State law-enforcement officials feel that the Federal Government is the only law-enforcement agency that can effectively deal with restraint of trade and particularly with large companies and particularly where it extends over large areas.

Senator PROXMIRE. So a big contribution here could be, No. 1, to inform local procurement officials of what they can do to stop identical bidding, or at least, discourage it.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. And, No. 2, that the Federal Government stands ready to act in the event that this is reported and can be one evidence, at least, of collusion, and one evidence of breaking the antitrust laws?

Mr. LOEVINGER. Yes, sir.

I believe this is true. I believe that the report itself, and the reporting system, have had a very widespread educational effect and we have received a good deal of correspondence from State procurement and law-enforcement officials saying that they felt this program was a helpful and useful one.

Senator PROXMIRE. Judge, I am going to be a little tough, and I hope you will understand I have the greatest admiration and sympathy for you.

But yesterday we had a series of papers from outstanding professors who were very critical of our antitrust policy, very critical indeed, and they documented it and I thought it was most impressive.

One of the well-documented papers was by Professor Barber of Southern Methodist University.

I want to read part of the excerpts because I think it is a mighty serious indictment.

He said:

The Antitrust Division of the Department of Justice is the principal enforcement agency in the field of antitrust, charged with the responsibility of enforcing the Sherman Act. Looking back over the last year and a half, one finds an extremely unsatisfactory performance.

The cases initiated in number are many (60 cases were commenced in the calendar year 1961; in 1960, the comparable number was 90; but of these, 39 involved the heavy electrical conspiracy).

But, in character, they reflect little enforcement imagination and seem, by and large, unlikely to have any significant impact on reducing the level of prevailing concentration.

I do not wish to imply that the work of the Division has been unimportant; certainly not. What I do suggest, however, is that the resources of this agency are not being employed to their fullest potential.

Of the 60 cases begun in 1961, 28 involved so-called per se violations (most notably price fixing, but also including allocations of territories, and bid rigging—the latter a variant of price fixing).

Most of these were hard-core, overt conspiracies in which the Government usually possessed uncontradictable evidence of law violation. In many of these cases, the defendants did not dispute the charge, pleaded guilty or nolo contendere, and were fined.

All too frequently the fines constituted little more than a slap on the wrist. The firms were chastized, held up to modest public ridicule, and told to sin no more.

The work of the Antitrust Division in suppressing corporate mergers is of much greater importance, although I think it deserves emphasis that this is essentially only preventive in nature; it does not usually reduce existing levels of concentration.

In calendar year 1961, the Department of Justice filed 19 cases, seeking to block or set aside corporation consolidations. Most of these were of importance and involved firms of substantial size, whose affiliations promised reduced competition.

Interestingly, however, two of the more important of these cases (one involving American Smelting & Refinery Co. and the other the Penn-Olin joint venture) were brought during the final days of the preceding administration.

And, actually, as the year progressed, one finds that the antimerger work of the Antitrust Division gradually slackened. This trend, of considerable importance, persists to the present time. So far during the year 1962, only a few cases involving mergers have been filed. What explains this curtailment in activity is not clear. And it is associated with, what seems to me, a growing number of trivial cases.

The list of industries involved in cases brought this year includes, for example, a variety of conspiratorial behavior in such vital product markets as venetian blinds, kosher food products in New York City, service station prices in Washington, and ice show productions.

And then there is a quotation here from Assistant Attorney General Loevinger, yourself, to Anthony Lewis. In Mr. Lewis' article you are quoted as saying:

It is probably true we are affected by business uncertainties to the point where we are holding up cases with a novel or uncertain character approach. We are sticking pretty much to the predictable, to the established lines.

Just one more observation. Mr. Barber says:

The gasoline station operators who agree upon prices at which they sell their products are speedily brought within the criminal reach of the law. The major oil companies who are able to achieve coordination in price, of the concentrated character of the industry, go free. Both should be brought within the law.

I would be very interested in your comments on this very indictment by a responsible and able scholar.

Mr. LOEVINGER. I agree that the witness is an able scholar, and have no doubt that he is responsible but I don't believe that the indictment is responsible, Senator.

It is very easy to say that you should reduce the concentration in the oil industry.

However, I should like to know precisely what this means. I have heard these criticisms before. I have seen these articles and I know that there are academic economists who have made suggestions of this sort.

As a matter of fact, I have sat down with a number of them, and have talked not for hours but for days. At one time my first assistant and I spent 3 days talking to a group of economists who included at least one of the witnesses who has appeared before this committee seeking specific ideas of the character of those that they are discussing before this committee.

If they mean that we haven't taken a list of the 50 or the 100 largest corporations in the United States and gone out and started to break each of these up into smaller pieces, of course, they are quite correct; we haven't.

I don't believe we are authorized to do this under the present law.

No prior administration has undertaken to do this, either.

Senator PROXMIRE. Well, in the criticisms that I read, I didn't talk about—they didn't talk about dissolution at this point in his paper. He was talking, as I understand it, primarily about mergers and preventing mergers, and also, of course—

Mr. LOEVINGER. We have been active in this field. We have maintained as high a level of vigor and enforcement activity as any prior administration.

As a matter of fact, the calendar year 1961 showed that we have brought very nearly twice as many cases under the Celler-Kefauver Act as any prior administration.

Senator PROXMIRE. Yes, but what is the significance of the cases you bring? In the particular fields in which he mentions here, venetian blinds, kosher food products in New York City, service station prices in Washington, and ice show productions, these are trivia. These are not the fundamental moving groups in our society, these are not the big steel, automobile, oil companies where concentration is clear, and where there seems to be a real power to maintain prices, and to hold up prices, and in the judgment of some, to retard growth and economic expansion.

Mr. LOEVINGER. Senator Javits might not agree that kosher food products in New York City is not a fundamental industry.

Senator PROXMIRE. I am sure he would not agree with some of the rest of this.

Senator Javits is very able. We disagree on antitrust policy.

Mr. LOEVINGER. However, I think that there is an interesting point here. At the time the antitrust laws were passed in the latter part of the 19th century and the earlier part of the 20th century, there were great movements toward the establishment of national monopolies—the formation of the United States Steel Corp., the formation of the Standard Oil Co., the formation of the original American Tobacco Co. Under the antitrust laws proceedings were brought to prevent or break these companies up. The suits against Standard Oil and American Tobacco were successful; the suit against United States Steel was unsuccessful.

However, there have been no comparable movements in recent years. There is no comparable movement going on today. The mergers that are being talked about today are mergers of big companies with a few little ones but there are no mergers of giant companies getting together to form national monopolies.

It is interesting to note, for example, that at the time the U.S. Supreme Court held—I think somewhat dubiously but nevertheless held—in 1920 that the United States Steel Corp. had not violated the law in forming this giant corporation, it had about 40 percent of the steel business in the United States, and today its share is down to slightly over 30 percent.

So that concentration, by that measure at least, has not increased.

Now, this business of measuring concentration is a very tricky business. We are at work on this. We have gathered all the data available to us. We are watching the very able work being done by the Kefauver subcommittee on this. We are attempting to analyze their data but you can't simply say concentration has or has not increased across the board.

You have got to look at specific markets and specific situations.

Senator PROXMIRE. In many specific ways it certainly has. There is no question in the retail trade industry it has increased in the sense that the small proprietor is disappearing and in some areas he has all but disappeared. You have the statistics that were given yesterday by Dr. Barber on page 3 of his testimony where he pointed out the percent of value of shipments accounted for by four largest companies, passenger car, 99 percent; sheet glass, 95 percent; locomotive parts, 92 percent; electric light bulbs, 90; primary aluminum, 82; cigarettes, 80; metal cans, 80; power and distributing transformers, 80; computing machines, 77; wheel tractor parts, 72; tires and tubes, 71; sheet ingots and semifinished shapes, 71.

In other words, you have some very, very important industries where only four companies clearly dominate, and where it is evident, I think, to all of us that these four companies can affect, come close to fixing prices and in some cases in some of these industries do, in fact, fix prices, establish prices.

Mr. LOEVINGER. Where we find them fixing prices we bring cases. We have brought cases on price fixing against United States Steel, Bethlehem, and certain smaller companies involved in a price-fixing arrangement.

It is perfectly true that Dr. Barber can pick out some cases involving small companies that sound as though antitrust is, in the words of Senator Monroney, watching mouse holes.

It is not true that all cases against small companies are necessarily insignificant.

For example, one case that we brought against three small banks in New Jersey, the *Hunterdon County Bank* case, involved the fixing of uniform service charges by these banks.

A consent decree was entered into in this case; there is no question about the facts in the case. They did it openly. They didn't attempt to conceal what had been done. The bringing of this case and the bringing of this consent decree were very widely publicized in banking circles and they resulted in the issuance of an order by the Comptroller of the Currency to all national banks.

That resulted in the institution of an enforcement program by the Comptroller of the Currency and I am certain if you talk to bankers that this case has had a profound effect throughout the banking world even though it was itself a small case.

On the other hand, it is not true that the predominance of our cases have been small or trivial in any sense.

In the automobile field, we have brought cases against General Motors, Ford, and Chrysler. The last administration in the automobile field, I think may have had a case against General Motors, although not involving automobiles, which our cases have; involving automobiles they brought cases against Renault, Hambro, and Volkswagen.

In the communications field we have brought a case against Columbia Broadcasting Co. and against MCA, which was accused of being—and we believe was—essentially a monopoly in the entire talent field.

As I say, in steel we have brought cases against United States Steel and against Bethlehem. You can go down the categories, and we have not neglected the big companies. We have no warrant, we have no authority, simply to go into a field and say there are three or four or five big companies, and, therefore, they must be broken up.

However, we have not avoided bringing cases against big companies, either.

Where we have found big companies engaged in activities that were anticompetitive, antitrust suits have been instituted, and certainly the big companies are watched more carefully with respect to merger activities.

We have a case against the Ford Motor Co., because of its acquisition of Autolite assets, which involves spark plugs and certain other automobile parts.

Senator PROXMIRE. I will have some more questions; my time is up.

Chairman PATMAN. Federal agencies, Judge, are required to report only in the case of procurements made at \$10,000 or more, where identical bids are found in line items valued at \$2,500 or more. How significant is this latter exclusion? It seems to me it invites splitting of a bid of, say, \$10,000 in five pieces where you expect identical bids so as to avoid reporting.

Mr. LOEVINGER. I am not able to answer altogether on this, Congressman Patman.

Chairman PATMAN. Suppose you answer, then, for the record when you look at your transcript.

Mr. LOEVINGER. I am not sure I can give a much better answer later. These things were worked out in cooperation and consultation with the procurement agencies.

We have no reason to believe that the procurement officer of Defense and GSA were anything other than highly cooperative and doing their very best to help us work out practical limits and practical criteria for securing the best possible reporting.



If experience indicates that these limits are too high, I don't think that there will be any difficulty in lowering them.

I don't believe there has been sufficient experience to indicate this now.

Chairman PATMAN. That is right.

Mr. LOEVINGER. I just don't have enough information to give you a good judgment on it.

Chairman PATMAN. As we said in the beginning, this is a pioneering venture and we will probably profit by the experience we have in the future.

If four companies selling the same products were to rotate their bids, company A making the low bid once, then the next time company B, and so forth, with no identical bid submitted on any given bid, then that wouldn't be covered in your report, would it?

Mr. LOEVINGER. No, sir.

Chairman PATMAN. It wouldn't be possible.

The Executive order does not relieve the head of Federal departments from reporting under the Armed Services Procurement Act, and the Federal Property and Administrative Services Act.

How many reports under these two laws did you receive during the reporting period?

Mr. LOEVINGER. I don't know, Congressman.

I suppose that it is obvious that the armed services and the General Services Administration will not make duplicate reports, and to the extent that the data they might otherwise report are covered in the identical bidding report, they won't make additional reports.

These statutes would impose on them the duty only to report some particular situation where there were nonidentical but apparently collusive bids so that these would quite obviously be relatively limited in number.

Chairman PATMAN. Have you had much resistance in the Federal agencies about making the kind of report you feel is necessary?

Mr. LOEVINGER. No, sir, they have been very cooperative.

Chairman PATMAN. Fine.

In the previous report you made for us, some industries appear to be habitually making identical bids. Have you compared the new report with the previous report to see whether some of the industries have changed their bidding practices since the President's Executive order was announced?

Mr. LOEVINGER. Not yet, no, sir.

Chairman PATMAN. I call your attention to page 226 of your report and several subsequent pages, about the electric companies.

It seems they are still making identical bids. You indicate, on page 226 that in the case of one item amounting to \$925, the same bid was presented by Graybar Electric of Newark, N.J.; Westinghouse Electric Supply Co. of Newark, N.J.; Wagner Electric Corp., St. Louis, Mo.; Jersey State Electric, Jersey City.

Right below it is another item of \$1,458 where General Electric, Westinghouse, and General Engineering all submitted identical bids. Then there is one on page 227 where Westinghouse, General Electric, and General Engineering, all made the same bids of \$972.

Then on page 279, there are three examples, and without objection I will just put these in the record without enumerating them.

(The information referred to follows:)



## POLICIES FOR FULL EMPLOYMENT

925

| FSC<br>COM-<br>MODITY<br>CLASS | FSC CLASS TITLE<br>AND<br>AGENCY, DESTINATION, PRODUCT<br>DESCRIPTION, INVITATION<br>NUMBER, BIDS INFORMATION                                                                                                | AMOUNTS AWARDED                    |                             | BASIS<br>OF<br>AWARD | NAME OF IDENTICAL BIDDER<br>AND<br>AWARD INFORMATION                                                                                           | EVALUATED<br>UNIT<br>PRICE<br>(dollars) | F.O.B.<br>PRICE<br>BASIS     | CASE<br>NUMBER | LINE<br>ITEM<br>NO. | BID<br>OPEN-<br>ING<br>DATE |
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|                                |                                                                                                                                                                                                              | UNIT OF<br>MEASURE AND<br>QUANTITY | TOTAL<br>VALUE<br>(dollars) |                      |                                                                                                                                                |                                         |                              |                |                     |                             |
| 6120                           | TRANSFORMERS, DISTRIBUTION<br>AND POWER STATION<br>CITY COMMISSION<br>JACKSONVILLE FLA.<br>DEST. NEPTUNE BCH. FLORIDA<br>OIL FILLED OUTDOOR TYPE<br>CURRENT TRANSFORMERS<br>99111-10<br>03 BIDS 03 IDEN BIDS | UNITS<br>3                         | 2,916                       | OTHER                | WESTINGHOUSE ELEC. CORP.<br>PITTSBURGH PA.<br>AWARD<br>GENERAL ELECTRIC CORP.<br>NEW YORK N.Y.<br>GENERAL ENGINEERING CO.<br>JACKSONVILLE FLA. | 972.00<br>972.00<br>972.00<br>972.00    | DEST<br>DEST<br>DEST<br>DEST | 50057          | 8                   | 11/61                       |
| 6145                           | WIRE AND CABLE, ELECTRICAL                                                                                                                                                                                   |                                    |                             |                      |                                                                                                                                                |                                         |                              |                |                     |                             |
|                                | NAVAL SUPPLY CENTER<br>OAKLAND CALIF.<br>DEST. FOREIGN<br>SHIELDED, SINGLE-CONDUCTOR<br>DIRECT BURIAL POWER CABLE<br>1FB-228-17669-62<br>17 BIDS 02 IDEN BIDS                                                | FT.<br>140000                      | 27,901                      | LOW                  | WESTINGHOUSE ELECTRIC<br>WESTINGHOUSE ELEC SUPP.<br>OAKLAND CALIF.<br>GRAYBAR ELECTRIC CO., INC.<br>SAN FRANCISCO CALIF.                       | 1.1999<br>2.2343<br>2.2343              | DEST<br>DEST<br>DEST         | 637            | 1                   | 11/61                       |
|                                | U.S. ARMY ENGINEER DIST.<br>NEW ORLEANS LA.<br>DEST. MULTIPLE<br>ELECTRICAL POWER CABLE<br>ENG-16-047-62-5<br>12 BIDS 02 IDEN BIDS                                                                           | FT.<br>3000                        | 2,826                       | LOW                  | ANACONDA WIRE & CABLE CO.<br>NEW YORK N.Y.<br>NU-LITE ELEC. WHOLESALERS<br>NEW ORLEANS LA.                                                     | 2.826<br>2.903<br>2.903                 | DEST<br>DEST<br>DEST         | 776            | 1A                  | 11/61                       |
|                                | CITY COMMISSION<br>JACKSONVILLE FLA.<br>DEST. JACKSONVILLE FLA.<br>UNGROUND NEUTRAL<br>NEOPRENE JACKET CABLE<br>1316<br>06 BIDS 06 IDEN BIDS                                                                 | FT.                                |                             | NO AND               | CONTINUED                                                                                                                                      |                                         |                              | 50054          | 3                   | 11/61                       |

## POLICIES FOR FULL EMPLOYMENT

| FSC<br>COM-<br>MODITY<br>CLASS | FSC CLASS TITLE<br>AND<br>AGENCY, DESTINATION, PRODUCT<br>DESCRIPTION, INSTANTANEOUS<br>NUMBER, BIDDING INFORMATION                          | AMOUNTS AWARDED                    |                             | BASIS<br>OF<br>AWARD | NAME OF IDENTICAL BIDDING<br>AND<br>AWARD INFORMATION                                | EVALUATED<br>UNIT<br>PRICE<br>(dollars) | D.O.B.<br>PRICE<br>BASIS | CASE<br>NUMBER | LINE<br>ITEM<br>NO. | STD<br>OPEN-<br>ING<br>DATE |
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|                                |                                                                                                                                              | UNIT OF<br>MEASURE AND<br>QUANTITY | TOTAL<br>VALUE<br>(dollars) |                      |                                                                                      |                                         |                          |                |                     |                             |
| 6145                           | WIRE AND CABLE, ELECTRICAL                                                                                                                   |                                    |                             |                      | ANACONDA WIRE & CABLE CO.<br>NEW YORK N.Y.                                           | 5.072                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | OKONITE CO.<br>PASSAIC N.J.                                                          | 5.072                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | PHELPS-DODGE COPPER PROD.<br>NEW YORK N.Y.                                           | 5.072                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | SIMPLEX WIRE & CABLE CO.<br>CAMBRIDGE MASS.                                          | 5.072                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | U.S. STEEL CORP.<br>JACKSONVILLE FLA.<br>TENN. COAL & IRON DIV.<br>JACKSONVILLE FLA. | 5.072                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | GENERAL CABLE CORP.<br>JACKSONVILLE FLA.                                             | 5.072                                   | DEST                     |                |                     |                             |
|                                | CITY COMMISSION<br>JACKSONVILLE FLA.<br>DEST. JACKSONVILLE FLA.<br>UNGROUND NEUTRAL<br>NEOPRENE JACKET CABLE<br>1316<br>06 BIDS 06 IDEN BIDS | N.F.T.                             | NO AWD                      |                      | ANACONDA WIRE & CABLE CO.<br>NEW YORK N.Y.                                           | 7991.00                                 | DEST                     | 50055          | 4                   | 11/61                       |
|                                |                                                                                                                                              |                                    |                             |                      | OKONITE CO.<br>PASSAIC N.J.                                                          | 7991.00                                 | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | PHELPS-DODGE COPPER PRODS.<br>NEW YORK N.Y.                                          | 7991.00                                 | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | SIMPLEX WIRE & CABLE CO.<br>CAMBRIDGE MASS.                                          | 7991.00                                 | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | U. S. STEEL CORP.<br>TENN. COAL & IRON DIV.<br>JACKSONVILLE FLA.                     | 7991.00                                 | DEST                     |                |                     |                             |
|                                |                                                                                                                                              |                                    |                             |                      | GENERAL CABLE CORP.<br>JACKSONVILLE FLA.                                             | 7991.00                                 | DEST                     |                |                     |                             |
|                                | CITY OF LUBBOCK<br>LUBBOCK TEXAS<br>DPT. LUBBOCK TEXAS<br>BARE WIRE OF STRENGTH OF<br>4280 LBS.<br>6379<br>05 BIDS 05 IDEN BIDS              | CWT5.<br>200                       | LOTTERY<br>6.702            |                      | GRAYBAR ELECTRIC CO.<br>AMARILLO TEXAS                                               | 33.51                                   | DEST                     | 50151          | 1                   | 12/61                       |
|                                |                                                                                                                                              |                                    |                             |                      | CONTINUED                                                                            | 33.51                                   | DEST                     |                |                     |                             |

| FSC<br>COM-<br>MODITY<br>CLASS | FSC CLASS TITLE<br>AND<br>AGENCY, DESTINATION, PRODUCT<br>DESCRIPTION, INVITATION<br>NUMBER, BIDDER INFORMATION                   | AMOUNTS AWARDED                    |                             | BASIS<br>OF<br>AWARD | NAME OF IDENTICAL BIDDER<br>AND<br>AWARD INDICATION                                           | EVALUATED<br>UNIT<br>PRICE<br>(\$/unit) | F.O.B.<br>PRICE<br>BASIS | CASE<br>NUMBER | LINK<br>ITEM<br>NO. | BID<br>OPEN-<br>ING<br>DATE |
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|                                |                                                                                                                                   | UNIT OF<br>MEASURE AND<br>QUANTITY | TOTAL<br>VALUE<br>(\$/unit) |                      |                                                                                               |                                         |                          |                |                     |                             |
| 6145                           | WIRE AND CABLE, ELECTRICAL                                                                                                        |                                    |                             |                      | GENERAL ELECTRIC SUPPLY<br>LUBBOCK TEXAS<br>AWARD                                             | 33.51                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | WESTINGHOUSE ELECT. SUPP.<br>LUBBOCK TEXAS                                                    | 33.51                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | SOUTHWESTERN ELEC. SUPPLY<br>LUBBOCK TEXAS                                                    | 33.51                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | C.B. ANDERSON CO.<br>AMARILLA TEXAS                                                           | 33.51                                   | DEST                     |                |                     |                             |
|                                | ELECT. & WATER UTILITIES<br>JACKSONVILLE FLA.<br>DEST. JACKSONVILLE FLA.<br>NEOPRENE JACKET CABLE<br>1316<br>06 BIDS 06 10EN BIDS | FEET<br>7171                       | 36,471                      | OTHER                | ANACONDA WIRE & CABLE CO.<br>NEW YORK N.Y.<br>AWARD                                           | 5.086                                   | DEST                     | 50240          | 3                   | 12/61                       |
|                                |                                                                                                                                   |                                    |                             |                      | THE OKONITE CO.<br>PASSAIC N.J.<br>AWARD                                                      | 5.086                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | PHILIPS DODGE COPPER PRODS<br>NEW YORK N.Y.<br>AWARD                                          | 5.086                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | SIMPLEX WIRE & CABLE CO.<br>CAMBRIDGE MASS.<br>AWARD                                          | 5.086                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | U.S. STEEL CORP.<br>JACKSONVILLE FLA.<br>TENN. COAL & IRON DIV.<br>JACKSONVILLE FLA.<br>AWARD | 5.086                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | GENERAL CABLE CORP.<br>JACKSONVILLE FLA. AWARD                                                | 5.086                                   | DEST                     |                |                     |                             |
|                                | ELECT. & WATER UTILITIES<br>JACKSONVILLE FLA.<br>DEST. JACKSONVILLE FLA.<br>NEOPRENE JACKET CABLE<br>1316<br>06 BIDS 06 10EN BIDS | FEET<br>2928                       | 23,453                      | OTHER                | ANACONDA WIRE & CABLE CO.<br>NEW YORK N.Y.<br>AWARD                                           | 8.01                                    | DEST                     | 50241          | 4                   | 12/61                       |
|                                |                                                                                                                                   |                                    |                             |                      | THE OKONITE CO.<br>PASSAIC N.J.<br>AWARD                                                      | 8.01                                    | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | PHILIPS DODGE COPPER PRODS<br>NEW YORK N.Y.<br>AWARD                                          | 8.01                                    | DEST                     |                |                     |                             |
|                                |                                                                                                                                   |                                    |                             |                      | CONTINUED                                                                                     |                                         |                          |                |                     |                             |

| FIC<br>COM-<br>MODITY<br>CLASS | FIC CLASS TITLE<br>AND<br>AGENCY DESCRIPTION, PRODUCT<br>DESCRIPTION, INITIATION<br>NUMBER, BIDS, INFORMATION                               | AMOUNT AWARDED                     |                             | BASIS<br>OF<br>AWARD | NAME OF IDENTICAL BIDDER<br>AND<br>AWARD INDICATION                                           | EVALUATED<br>UNIT<br>PRICE<br>(\$/unit) | F.O.B.<br>PRICE<br>BASIS | CASE<br>NUMBER | LINE<br>ITEM<br>NO. | BID<br>OPEN-<br>ING<br>DATE |
|--------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|-----------------------------|----------------------|-----------------------------------------------------------------------------------------------|-----------------------------------------|--------------------------|----------------|---------------------|-----------------------------|
|                                |                                                                                                                                             | UNIT OF<br>MEASURE AND<br>QUANTITY | TOTAL<br>VALUE<br>(\$/unit) |                      |                                                                                               |                                         |                          |                |                     |                             |
| 6145                           | WIRE AND CABLE, ELECTRICAL                                                                                                                  |                                    |                             |                      | SIMPLEX WIRE & CABLE CO.<br>CAMBRIDGE MASS.<br>AWARD                                          | 8.01                                    | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | U.S. STEEL CORP.<br>JACKSONVILLE FLA.<br>TENN. COAL & IRON DIV.<br>JACKSONVILLE FLA.<br>AWARD | 8.01                                    | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | GENERAL CABLE CORP.<br>JACKSONVILLE FLA. AWARD                                                | 8.01                                    | DEST                     |                |                     |                             |
|                                | LIGHT, GAS & WATER DIV.<br>MEMPHIS TENN.<br>DEST. MEMPHIS TENN.<br>ELECTRICAL POWER CABLE<br>MOVE<br>06 BIDS 04 IDEN BIDS                   | FT.<br>3000                        | 2.722                       | OTHER                |                                                                                               |                                         |                          | 90290          | 1                   | 12/61                       |
|                                |                                                                                                                                             |                                    |                             |                      | PHELPS DODGE COPPER PROD.<br>NEW YORK N.Y.                                                    | .9074                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | ANACONDA WIRE & CABLE CO.<br>TULSA OKLA.                                                      | .9074                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | SIMPLEX WIRE & CABLE CO.<br>CAMBRIDGE MASS.                                                   | .9074                                   | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | GENERAL CABLE CORP.<br>MEMPHIS TENN.<br>AWARD                                                 | .9074                                   | DEST                     |                |                     |                             |
| 6210                           | INDOOR AND OUTDOOR<br>ELECTRIC LIGHTING<br>FIXTURES                                                                                         |                                    |                             |                      |                                                                                               |                                         |                          |                |                     |                             |
|                                | CHICAGO TRANSIT AUTHORITY<br>CHICAGO ILL.<br>DEST. CHICAGO ILLINOIS<br>NARROW BEAM MERCURY FLOOD<br>LIGHT<br>P-5857<br>04 BIDS 04 IDEN BIDS | UNITS<br>9                         | 1.597                       | OTHER                |                                                                                               |                                         |                          | 90018          | 1                   | 11/61                       |
|                                |                                                                                                                                             |                                    |                             |                      | ELECTRIC SUPPLY CORP.<br>CHICAGO ILL.                                                         | 177.48                                  | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | HYLAND ELECTRICAL SUPPLY<br>CHICAGO ILL.                                                      | 177.48                                  | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | GRAYBAR ELECTRIC CO.<br>CHICAGO ILL.                                                          | 177.48                                  | DEST                     |                |                     |                             |
|                                |                                                                                                                                             |                                    |                             |                      | EPENEGEE ELECTRIC SUPPLY<br>CHICAGO ILL.<br>AWARD                                             | 177.48                                  | DEST                     |                |                     |                             |

Chairman PATMAN. On page 230 there are two examples and on page 231 there is one example.

Is there anything you can do about cases like General Electric, which has been convicted, and is paying terrific damages for admitted collusion, and yet, they still go ahead and submit these identical bids?

Is there anything being done about that, Judge Loevinger?

Mr. LOEVINGER. Well, I am sure that the electrical companies would say that these were largely shelf items which were bid out of catalogs on standard prices, and that this accounts for the identity rather than any collusion.

So far as what we can do is concerned, the situation is this: the defendants in the *Philadelphia Electrical* case indictments are also defendants in civil cases in which we are seeking injunctive orders against continuation of the practices and having certain specific provisions designed to discourage these practices.

A large number of these civil cases have either resulted in or are very close to resulting in agreements on judgments to be entered.

Some of the more important ones are still under negotiation.

One of the reasons that they are under negotiation, incidentally, is that I am seeking somewhat broader and more effective provisions in the decrease than were originally demanded at the time the suits were instituted and the time negotiations were started in December of 1960.

But until these civil cases have been disposed of, and the decrees entered, we are not in a position, of course, to effect enforcement.

Once the decrees have been entered then we will observe what effect they have and we will examine future instances of this to see whether or not they are in compliance with the decrees.

Chairman PATMAN. There are quite a few identical bids by the big steel companies on a delivered price basis shown in this new report of yours.

Have you had an opportunity to look at the Federal Trade Commission's order to the steel companies concerning the use of the basing point system, Judge?

Mr. LOEVINGER. I am familiar with it generally. I have not examined it specifically with relationship to this report, no, sir.

Chairman PATMAN. Is there any doubt in your mind that the steel companies are still quoting prices on the basing point system?

Mr. LOEVINGER. Well, I don't think that the question of my subjective feelings with the steel companies is particularly important. I have considerable doubt that there is any evidence that the order is being violated.

At least I assume that the Federal Trade Commission is examining this matter and following up on compliance with its own order.

Chairman PATMAN. Is there much evidence that it is being observed?

Mr. LOEVINGER. I don't really know, Congressman.

Chairman PATMAN. Throughout your report there are instances where four or five companies bid identically on a particular item, but the low bidder's name is not shown, then on the next bid for the same item, there will be four or five identical bidders with the name of one of the previous bidders missing.

It seems to me also that if you published all of the bids where two or more of the bids are identical, State and local purchasing agents

could draw some conclusions about those companies that are rotating the low bid, and perhaps avoid stepping into a trap.

Incidentally, the bill I introduced and which the House has passed, and which is still pending before the Senate Committee on Government Operations, would require you to report all of the bids wherever two or more of the bids are identical.

This bill incidentally was not drafted just off the cuff, but it was drafted after careful consultation with a large number of experts who spent many years on identical bid rigging matters, both the economics and the law on the subject.

So, I hope that in your future reports you will report all of the bidders. It seems to me you could do that in table 2.

Another thing, Judge Loevinger: Of the 737 Federal cases of identical bidding reports that you reviewed, 118 were excluded on the ground they required "special treatment."

That is a pretty high percentage. Most of these, I gather, came from the Agriculture Department.

Would you comment on this, and are you and the Justice Department convinced that these identical bids submitted to Agriculture for purchases for the school lunch program are not the result of collusion? Have you investigated this situation thoroughly, Judge?

Mr. LOEVINGER. I suppose a candid answer is "No," we have not investigated the situation thoroughly, and we do not mean to suggest, either, that the cases excluded are not the result of collusion or that the cases included are the result of collusion.

We have had to adopt certain fairly arbitrary criteria for getting the report up, and the criteria do not involve completeness of each case, of the kind that we give an antitrust case, nor a judgment as to whether or not there has been a law violation.

I think it must be clearly understood that these are cases reported on the basis of fairly arbitrary criteria and that additional analysis and investigation must be made in order to reach a judgment as to the significance of the cases.

Chairman PATMAN. Judge, your summary table on page 16 shows that you received 1,259 reports of identical bids and that your report covers less than half of these. You included in the report 599 and threw out 660.

One of the reasons you threw some out of that 123, according to the table, was that they "required separate treatment." Could you give us some information about the nature of the problem in the case of these 123?

Then you threw out 186 because you say the data are incomplete. Are you doing anything about checking missing data, particularly from the Federal agencies?

Mr. LOEVINGER. Perhaps Mr. Markus can answer that.

Chairman PATMAN. All right, Mr. Markus.

Mr. MARKUS. As to the incomplete reports, we have underway a canvass and a recanvass of the agencies that did not complete the reports in accordance with the instructions.

Chairman PATMAN. I see.

Mr. MARKUS. Eventually, these reports will be included in subsequent analyses that will be made in future reports.

Chairman PATMAN. Fine; that is all right.



Thank you.

Mr. MARKUS. As to the reports that required separate treatment some of those are included in the chapter in which we discuss Agriculture Department procurement, and others will probably be treated in supplemental reports that we will issue from time to time. But they were problem types of reports. They were either very large in the number of items involved and the number of bidders and required very special treatment.

Chairman PATMAN. Yes, sir.

Then you threw out the 129 which you say you found to be not identical after evaluation. And 115 of these came from Federal agencies. It seems to me a little puzzling that you would have so many which the procurement agency thought were identical but after review, your staff found not to be identical.

I wonder if you could give us a memorandum for our records showing a breakdown of these as to the reason why they appeared to be identical but were not judged identical.

Could you prepare that for the record when you submit your transcript back?

Mr. LOEVINGER. Yes, sir.

(The material referred to appears in the appendix at p. 952.)

Chairman PATMAN. Thank you.

Judge, in table 2 where you show the basis of the award indicating that it is sometimes made on the basis of low bid, sometimes by lottery, and sometimes you show that no award was made. But a very large percentage of the awards are shown to have been made on other bases. I wonder if in future reports we couldn't have a better specification as to how the awards were made rather than having so many shown to have been made on an unspecified basis.

Mr. LOEVINGER. Yes, I think that could be done.

Chairman PATMAN. Fine; thank you, sir.

Senator PELL?

Senator PELL. I have no questions.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Yes, I would like to go back to what I was asking about.

Professor Barber says that so far during the year 1962 only a few cases involving mergers have been filed in spite of the fact that some trivial, as he describes it—and I think they are relatively trivial—cases have been brought with regard to relatively small industries.

What explains this curtailment in activity?

Mr. LOEVINGER. There has been no curtailment in activity, Senator Proxmire. We bring cases as the facts come to our attention and as they arise.

My prediction is that with the Supreme Court decision in the *Brown Shoe* case which in a speech to the American Bar Association I have described as judicial ratification of the Celler-Kefauver Act, there may very well be fewer merger cases.

The explanation, I think, is quite simple. The explanation is that as the legal standards become known, and become clearer, there is greater voluntary compliance. Lawyers advise clients not to undertake mergers. Mergers are submitted to the Antitrust Division for clearance

in advance, and we advise companies that they should not merge, the situation simply does not arise.

Senator PROXMIRE. See if I understand then what you are saying is there has been no curtailment, but there have not been as many cases involving mergers brought simply because there are fewer mergers that would be in violation of the law.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. Well, yet there is an increasing concentration in American industry, it seems to me. The statistics that I gave the other day in the retail area which alarm me and concern me very deeply, the fact that in New York City with a growing population, tremendous increase in sales, the number of individual proprietors is less than one-half what it was 10 years ago.

Now, the number of retail firms which sell more than \$100 million has tremendously increased. It is awfully hard for me to believe that there isn't under these circumstances some concentrations in some areas that involve a degree of monopoly of one kind or another.

Mr. LOEVINGER. I am sure that there are concentrations that require further antitrust analysis. The difficulty with this approach is that it involves jumping from one base and one time to another and comparing disparate things.

For example, the figures on concentration are meaningless unless they are relatively long range.

The most recent figures that are available, as far as I know, are those recently issued by the Kefauver subcommittee that are based, I believe, on the 1958 data.

Now, to talk about concentration in terms of a 1948-58 trend, and then say since January of 1962 up to the end of July 1962 you haven't brought as many merger cases simply doesn't mesh at all. You may have wholly different trends in 1962 than you did in 1957. I don't know whether you do or not. But the figures—

Senator PROXMIRE. You think there is some evidence that maybe the concentration trend has been arrested and reversed and there is less concentration now and they are moving in the other direction?

Mr. LOEVINGER. Our analysis of the concentration ratio figure, Senator, says that these are very difficult things to work with in overall terms.

I think that there are periods when mergers apparently tend to take place, and in other periods when they tend not to take place and these things have more to do with the expansion or contraction of the market and tax considerations than they do with tendencies toward concentration as such in most cases.

I think, for example, that the figures with respect to the retail stores in New York probably have very little to do with mergers. I would suspect that most of the small proprietors who went out of business did not engage in mergers of a character that would ever come to the attention of any of the law enforcement agencies or be reflected in any statistics if indeed there was anything that could be called a merger.

Mostly, they probably involved small proprietors going out of business and going out and getting jobs as employees.

Senator PROXMIRE. Could you identify the steel items for which you have brought price-fixing charges against United States Steel and Bethlehem?

Mr. LOEVINGER. Steel forgings.

Senator PROXMIRE. Only steel forgings?

Mr. LOEVINGER. Steel forges.

Senator PROXMIRE. These are not the volume items such as sheets, bars, and so forth, where the power of the big steel companies over price really counts; are they?

Mr. LOEVINGER. I think the power of big steel companies over price really counts in these. These go into very important commodities including battleships.

They count more in other areas because the other areas involve greater volume; yes, sir. We have investigations going on in the other areas and what may develop I am not in position to say.

Senator PROXMIRE. There is no question but that the pattern has been, when one steel company, often United States Steel, sometimes another, raises prices, the others usually do precisely the same to the penny within 24 or 48 hours; isn't that correct?

Mr. LOEVINGER. There certainly has been price leadership; yes, sir.

Senator PROXMIRE. Is there nothing the Antitrust Division can do under the law?

Mr. LOEVINGER. We don't know. We are looking at it.

Senator PROXMIRE. Well, how did—I hope you look awfully hard.

How about the situation with regard to oil? Here is the most profitable industry in America, and certainly the most tax privileged industry in America.

Here is an industry which restricts production, operates 8 days a month, 7 days a month, almost always less than 10 days a month down in Texas, gets high profitable prices, is able to persuade the Congress to restrain imports.

Now, I am just wondering whether or not there is some kind of action that can be brought with regard to the concentration in the oil industry that would prevent them from restricting production or is this something that the State, particularly the State of Texas preempted and there is nothing that can be done about it.

Mr. LOEVINGER. The restriction of production is pursuant to State action and as you have noted, the restriction of imports is due to congressional action.

I don't believe it is within our jurisdiction to sue either the States or Congress. I am being facetious, of course.

The action taken by legislative bodies, whether State or Federal, is not within the scope of the antitrust laws, Senator Proxmire, and there are influences of this sort that are basically anticompetitive, I am sure, that are taken by legislative action on the basis of legislative judgment presumably that this is appropriate.

Despite its anticompetitive implications when such action is taken by either State or Federal legislative action, the antitrust laws simply don't apply. There is no question about it.

On the other hand, in the oil industry we are constantly watching the large companies, and we do, in fact, bring suits when it appears that there is any tendency toward lessening competition substantially or toward monopoly.

We have, for example, a case pending against Standard Oil of Indiana and certain other oil companies, another oil company or com-

panies, I have forgotten the number of defendants, involving the acquisition of the assets of the Honolulu Oil Co.

There are a great many people who criticized us for bringing this case, saying that this is an attempt to extend the Celler-Kefauver Act too far.

I think the case is justified, and we intend to pursue it. But actually in the kind of statistical analysis that you have mentioned previously, the oil industry is, of course, not a highly concentrated industry.

There are a great many companies in the oil industry, a great many competitors.

Senator PROXMIRE. Looking at it from a national basis, I suppose you could say that. But there are certain phases and aspects of the oil industry in which there is a degree of economic power and certainly the power to get together and limit production as a result establish a profit margin and a price, and so forth.

You say the academicians, I understood you to say, have not come up with the kind of constructive ideas which their criticism would suggest they might on how to reorganize the highly concentrated industries.

Have not people like Professor Bain, discussed antitrust policy with the Division economists and worked up reports on steel and other industries, hasn't there been some of this going on?

Haven't they made constructive suggestions?

Mr. LOEVINGER. I don't know of a report by Professor Bain on steel, Senator Proxmire.

Senator PROXMIRE. I don't mean necessarily on steel, but on the concentrated industries, other concentrated industries, perhaps?

Mr. LOEVINGER. We have a great many economic analyses of concentration, both generally and in specific industries.

Senator PROXMIRE. You wouldn't say that academicians have not made a constructive contribution to alternative ways of organizing these concentrated industries?

Mr. LOEVINGER. Yes, sir; I would.

Senator PROXMIRE. You would?

Mr. LOEVINGER. In this sense that the academicians have given us a lot of analyses, a lot of statistics as to what they claim concentration to be, but I have had no practical suggestions as to what, under the antitrust laws should be done about situations, nor, indeed, have any of them, so far as I know, suggested any objective criteria by which we can determine when concentration has reached an impermissible level either from the legal or the economic viewpoint.

Senator PROXMIRE. Well now, I understood you to say along that same line you have no warrant, no authority to deal with concentrations as such, and by dissolution and divestiture, and yet the Sherman Act, I understand has been interpreted to reach oligopoly situations where there has been price identity.

Is this a lack of warrant because the matter isn't important in your view to achieve competition; that is, the concentration is not sufficiently great in steel and in automobiles and other industries so that this does interfere with competition or is it your feeling that the interpretation of the law is not as clear as I stated?

Mr. LOEVINGER. No. I say this, Senator. That merely because four companies may have, say, 60 or 80 percent or whatever percent-

age it is, of the production in an industry, this in and of itself does not warrant antitrust action.

Now, if these four companies in fact, act in combination or concert in setting prices, then this certainly does warrant antitrust action.

If any one company or any group of companies act to monopolize, to exclude competitors, to engross the entire area of a field, then this warrants antitrust action.

But the raw concentration figures do not in and of themselves provide a basis for antitrust action.

I think the problem arises because there are some who feel that antitrust being essentially a principle for the defense of liberalism in a classical sense, for the organization of power on a pluralistic basis in the economic realm, for the establishment of a foundation, as the Supreme Court has said, of social conditions that permit democracy to flourish, they feel that because it is of this character that it can be used to remake the economic structure of society into an image closer to some Utopian goal.

Senator PROXMIRE. No. Let me say I feel very strongly the men who appeared before us yesterday were not thinking in Utopian terms.

They were appearing before this Joint Economic Committee and they were not appearing before us for the purpose of suggesting a political Utopia. They argued that because we have this degree of concentration, because we have administered pricing, because we have this friction in competition, we are unable to get the kind of growth that we ought to have, we are unable to get the kind of expansion of markets that we ought to have, unable to get the price flexibility we ought to have that would open up markets and they say this is one of the reasons why we have to follow a fiscal policy of increasing our budget deficits even though the economy is expanding in order to do something about a serious unemployment problem and lack of full utilization of our industrial capacity.

This was a real economic analysis. The only gentleman who appeared yesterday who wasn't an economist was Professor Barber, but I do think that his testimony is primarily economic testimony related, as I understood him at least, to the economic situation and not to the notion that somehow we want to be more pluralistic and somehow we want to avoid the evils of political and economic power combined.

In other words, it was a very real and genuine effort to try to do something about the economy which is the responsibility of this committee.

Mr. LOEVINGER. I agree with much of what has been said, Senator.

I think as I indicated in my testimony on Monday, that a flexible economy, a competitive economy, an economy in which there is a pluralistic organization of power, if you like, is indispensable to the achievement of efficiency, full productivity, and prosperity.

I think it is indispensable to the effectuation of monetary and fiscal and other policies.

Senator PROXMIRE. Let me just interrupt to say, wouldn't you agree also at the present time the reason why we have this continuous nagging high level of unemployment and underutilization of our facilities in spite of the fact we have been in a period of economic expansion for a year and a half is because of monopolistic concentration, because of administered prices?

Mr. LOEVINGER. No, I wouldn't say that is true.

Senator PROXMIRE. I just want to interrupt also—I hesitate to interrupt twice in a row—but I want to say I was wrong about Professor Barber. He has two degrees in economics and two degrees in law so I think he qualifies as both an economist and a lawyer. [Laughter.]

Mr. LOEVINGER. I think that the economists fall into the fallacy of oversimplification when they suggest that merely having greater competition is going to solve all of the problems of cyclical economics.

I think that——

Senator PROXMIRE. I would agree with that.

Mr. LOEVINGER. I think that antitrust, as I said before, is a necessary but not a sufficient condition for full productivity and prosperity.

I believe that antitrust establishes conditions that permit the effectuation of monetary, fiscal, tax, trade, and many other policies.

Senator PROXMIRE. We all agree with that. You see——

Mr. LOEVINGER. But it doesn't replace them.

Senator PROXMIRE. Certainly.

And we have had hearings on fiscal policy, monetary policy, experts in those fields.

Now, we are hearing the expert in the field of competition and monopoly. We recognize this is only one part of our economic policy, but an important part, and here they feel we failed as we failed perhaps in the other areas, too.

Part of the reason why we haven't been able to expand and grow and move is because we have not had the kind of vigorous competition that we should have and because we have had an increasingly concentrated economic situation in this country, in which prices have been very sticky, in which, in spite of the fact as was brought out by Professors Lanzillotti, Kahn, and Adams yesterday, even though we have a decline in demand and move into a recession, steel prices continue either steady or move up, and this isn't only true of steel, it tends to be true of automobiles, it tends to be true of these other industries.

We want to do something about this, and you said to Senator Javits earlier, that by and large you agree with the antitrust philosophy that has guided this country over the past several years, and that you aren't recommending any substantial legislation, at least at the present time.

It looks as if we are just going to accept greater and greater concentration and these frictions in our economy that are going to give us great economic difficulties.

Mr. LOEVINGER. Concentration has not, I think, been increasing in the steel industry.

It has been increasing somewhat in the automobile industry. I think that there is some difficulty in simply lumping these things all together.

I suppose the point at which I disagree with the economists is this, in thinking that the antitrust laws have not, on the whole, been pretty effective. I think that the antitrust laws have not been a failure. I think the antitrust policy has been fairly effective.

If you say it should be carried out more efficiently and better I won't quarrel with you for a minute. I am sure there is much room

for improvement. When we get to the point where we don't think we can improve, then somebody really ought to do something about us, but I don't think we have failed. I think we have been doing an efficient and an effective job, and to the degree that the economy needs further stimulation, I believe that it will come from other policies than simply going out and swinging an antitrust club.

I think the continued efficient, effective, vigorous enforcement of antitrust is necessary to permit these other policies to be effective, and we are moving—we are moving in some new fields.

We are moving in the field of banking which I think is an important field, where similar suits had not previously been brought, for example.

Senator PROXMIRE. I just have a couple of more questions.

Let me say that in the area of banking we certainly have had a tremendous increase in mergers, in concentration, in enormous expansion of the assets by a few huge banks and so forth.

But I would like to ask you if you don't feel that since administered pricing has this very great economic significance, and you would agree, I think, that it does have economic significance.

Mr. LOEVINGER. Yes, sir.

Senator PROXMIRE. Why can't we begin suits against major industries which do engage in administered pricing?

If it would take new legislation, I think many of us would sympathetically consider, in fact, enthusiastically support, that kind of legislation.

Mr. LOEVINGER. Administered pricing is an economic concept. I don't believe it has yet been reduced to sufficient precision to be used as the foundation for legal action.

If it has been, and if there is a definition that can effectively be used for legal action, we certainly would be glad to consider it.

I believe it has been referred to in our report, which I suppose you are looking at, as indicating essentially inflexible pricing which presumably results from relatively oligopolistic market structure.

But this is not the kind of concept that in any way that I am able to project, can be used for legal standards by itself.

It seems to me it requires some refinement.

Senator PROXMIRE. Well, my final question is a technical question that reverts back to your estimate that about 1 percent of the bidding was identical, and on that particular point, I understand that you have thrown out more than half of the 1,200 cases here, and it is my understanding that in doing that you have changed the numerator, denominator is still 10 billion, and since you have thrown out about half that you ought to at least modify your denominator accordingly and you come up not with 1 percent, but 2 percent, or more than 2 percent.

Mr. LOEVINGER. I prefaced my statement by saying our data are not complete and sufficiently extensive to justify any accurate extrapolation.

This is a very rough estimate. It may be one-half of 1 percent, it may be 2 percent. I am sure that there is this degree of what the statisticians call probable error.

Senator PROXMIRE. Let me just make these other further qualifications and see if you can agree: (1) Only selective cities were invited

to report; (2) the cities and States reported on a voluntary basis, there is no assurance of complete reporting; (3) the Federal procurement of less than \$10,000 and State procurements of less than \$1,000 are excluded; and (4) more than one-half of the reports received were excluded from your tabulations for various reasons.

Is that correct?

Mr. LOEVINGER. Yes, sir; those are all correct. I think it should be said that the cities and States that were included were those that encompassed the overwhelming preponderance of State and local procurement, however. That the units that were included were selected in such fashion that the exclusions were relatively small in both number and volume.

Senator PROXMIRE. Thank you, Mr. Chairman. Thank you so much, and I apologize for taking so long, but this has been extremely helpful.

Chairman PATMAN. Interesting and helpful, Senator Proxmire, we appreciate your doing so.

Senator Sparkman?

Senator SPARKMAN. Thank you, Mr. Chairman.

Judge, it is good to see you here again and hear you.

This is a very interesting report that is on our desk. I have been looking over the news release that goes with it, and I don't intend to be critical, but I was somewhat surprised by the note of optimism throughout the news release.

As a matter of fact, I had been led to believe, purely from newspaper reports back over the last year or two, that this identical bidding for Government contracts had developed into quite a serious matter and was rather extensive. In fact, our committee, the Joint Economic Committee, just about a year ago, August 1961, put out our own publication, I am sure you have seen it.

Mr. LOEVINGER. Yes, sir.

Senator SPARKMAN. It reported 93 cases involving identical bids. The material was obtained, I recall when we instructed the staff to get in touch with the Antitrust Division and to get the information, and to make it available.

Now, are we to understand that after exploring the matter quite fully you have come up with the conclusion that perhaps it is not as extensive as you thought it was?

Mr. LOEVINGER. This is our conclusion, Senator; yes.

Now, why it is not as extensive we aren't prepared to say yet. Some of the reasons suggested by Senator Proxmire may affect the statistics.

I suggested earlier that it is conceivable, and I have an intuitive feeling that there is some influence exercised merely by the interest of this committee, the Executive order, the program of reporting, and the publicity given to all of these things.

This report encompasses reports, the first of which was not filed until about August of last year.

This was some 5 months after this committee had indicated an interest in it, and at least 4 months after the Executive order.

Furthermore, the reports, the mass of reports are sometime after that so that there was plenty of time for the publicity to have had some effect.



Senator SPARKMAN. Well, I may say that my thought regarding this, perhaps, was stimulated by the recent acceptance by the General Electric Co. of an agreement that had been worked out.

Mr. LOEVINGER. Yes, sir.

In the civil damage cases?

Senator SPARKMAN. Yes; in the civil damage cases.

Mr. LOEVINGER. That was not——

Senator SPARKMAN. That was not handled by your division, was it?

Mr. LOEVINGER. Yes, sir; it was.

Senator SPARKMAN. Was it handled by your division?

Mr. LOEVINGER. Yes, sir; I personally handled the negotiation of the final agreement.

Senator SPARKMAN. Oh, yes, the first settlements were with the Federal Government.

Mr. LOEVINGER. Yes, sir.

Senator SPARKMAN. And then I believe they turned to certain cities to whom they had sold equipment and either settled with them, or are in the process of settling with them.

Mr. LOEVINGER. The second announced agreement was with the New York State Power Authority.

Senator SPARKMAN. Oh, yes. I think I have seen in the press they were extending that out generally to all of the agencies and individuals, I suppose, with whom they had done business.

It seems to me that the bigness of that coverage was such as to emphasize to the ordinary person that it was quite widespread.

I hope that your work on this has had some good effect. Certainly it should have.

I notice in the news release that some successful methods to discourage identical bids are suggested by the report.

I am wondering if most of those bids were not negotiated bids in the beginning or invited in such a way that there was not the feeling that there was really the competition that ordinarily comes with bidding.

And I wonder if some invitations to bid go to only a selected group or if they were thrown open so that everybody including small business was invited to come in to bid.

The Senate Small Business Committee, which was set up in 1950, has filed a report every year since then, starting in 1951, and I believe in every single report we have come out with the suggestion that if all of the Government bidding was on a competitive basis small business would have no complaint, because it knew it could come out all right in the field of free, open, competitive bidding.

And I wonder if, after all, that is not the best method of discouraging identical bids: open, competitive bidding where small business and big business can all bid alike, but with the understanding that the contract will go to the successful low bidder.

Mr. LOEVINGER. I think there is no question that this is a desirable, and in most cases the most desirable, method of procurement, Senator.

I am sure that we favor this, that we advocate it. We have worked for it in many respects.

I believe that what we are talking about as bidding situations here, are so-called advertised bids where everyone is permitted to bid.

I am aware that there are a number of cases where those who are considered as potential contractors or suppliers are limited in one way or another.

Attention has been given to these in other activities but not in this report.

I am sure that there is no inconsistency between the findings and the recommendations of the Small Business Committee and this report.

You see, this report purports to cover only a relatively small percentage of Federal Government procurement. The total amount of Federal Government procurement that is covered by this report is only in the neighborhood of 16 percent of the total Federal Government procurement.

And it may be less than that actually. This is an approximate figure.

Senator SPARKMAN. I don't have the figures in mind now with reference to the percentage of our procurement that is done on a competitive bid basis as against that that is done on either a negotiated basis or a limited bid basis where just a few suppliers are invited to come in and participate. But I do know that it has been a continuing fight with us to try to get the procurement agencies of the Government to use open competitive bidding, and I rather feel that it may be the best cure for these identical bids.

Thank you, Mr. Chairman.

Chairman PATMAN. May I add one thing to what Senator Sparkman said.

Suppose you have identical bids from a half dozen companies, of which one was a real big one and the other one smaller and so forth. Suppose you had the policy of giving it to the smallest company making the identical bid, wouldn't that have a tendency to break this up, Judge Loevinger?

Mr. LOEVINGER. The wisdom of this policy is subject to debate, certainly, but this is a suggestion that has been made, and it seems to me that there is much to recommend it, this may very well be an appropriate suggestion.

Again, it depends somewhat on the fields, the character of commodity you are talking about, but I think there is much to commend such a suggestion.

Chairman PATMAN. I think it would break them up overnight, Judge; I hope you try it.

Senator PELL, did you have anything?

Senator PELL. No.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Judge Loevinger, I came back because I had done what I could do at the Appropriations Committee and I wanted to take a little issue with you, if I may, with respect to the contribution that could be made by a revision of the antitrust laws to our economic situation.

I cannot agree there is no place in an improved economy for a revised concept of the antitrust laws and so I would like your judgement upon these two points: One, we have run into a situation which would indicate that if you really are going to compete with state trading on the part of Communists, you unquestionably have to find some

way of getting American concerns to be able to act in concert, if the Government wishes them to.

Now, that is particularly pertinent to the oil situation. Is there any way right now that if the Government desired a group of American oil companies to cooperate with it in meeting the Russian challenge in the oil field which is very important in Europe, if they could do so?

Mr. LOEVINGER. Senator Javits, I think your real quarrel is with Senator Proxmire; he was attacking me during your absence because we weren't more vigorously seeking to induce greater competition in the oil industry.

Now, regardless of what the various political or economic theories may be, I submit we cannot be at once more and less competitive.

We have got to seek either one or the other solution.

There is, of course, the Webb-Pomerene Act which permits independent enterprises to establish common associations with exemption from antitrust rules for export trade.

I don't know that this has been tried. I think that the question is a difficult one to answer in abstract terms. The oil industry is an extraordinarily complex industry. There are many aspects of it that are already subject to Government control, and to limitations of competition by various governmental measures.

There are a number of provisions under existing law that permit combinations to be undertaken with protection against charges of antitrust violation.

We have had, as a matter of fact, some months ago, extensive conferences with representatives of the Defense Department and the Interior Department, and established an Oil Industry Committee which has been approved by the Attorney General under the Defense Production Act, I believe that is the statutory authority, and which does, in fact, meet and engage in certain activities related to our national defense.

Senator JAVITS. Well, now, may I interrupt you to say that the authority for that has expired?

That statute—that is, the section of the law has been repealed and the committee is now functioning under the authority which you did once have. There is no longer any such authority.

Mr. LOEVINGER. My impression was that the act had been extended for a year.

Senator JAVITS. No.

The authority of the Attorney General to approve a combination of the act; that is, the general authority, has been repealed. It's now subject to approval only for a specific group of procurement contractors, and as a matter of fact, I am waging a little campaign to get the authority restored, but the committee you speak of is functioning under your permissive authority which you had and gave them at the time so if they broke up and you had to have a new one, you could no longer give them any such immunity.

Mr. LOEVINGER. Well, the act—I believe you are correct. There has been the expiration of one of the provisions in the Defense Production Act.

Actually, what has taken place recently is not the formation of a new committee or a new agreement, but a modification of the prior agreement.

You are correct in that, Senator.

Senator JAVITS. Now, Senator Proxmire and I have no differences on this; we may have on other things because I am not talking about general competition.

I only asked you the specific question, If the Government wants a group of American companies to combine for the purpose of doing a job the Government wants done, that is a very different thing from general competition. Does the Government have such authority?

That is the question I ask.

Mr. LOEVINGER. I don't believe I can answer that, Senator. I think that it is too general. There is no general authority on the part of any agency to authorize combinations in a sort of *carte blanche* fashion; there are a number of specific authorities.

Senator JAVITS. Is there authority to cause the oil companies to combine to cooperate with the Federal Government, existing authority today, in order to meet the Russian challenge to the oil supplies of Europe?

Mr. LOEVINGER. There is no authority to force them.

Senator JAVITS. Is that specific?

Mr. LOEVINGER. Or to cause them to combine.

Senator JAVITS. Is there any authority to give them immunity from the antitrust laws at the Government request?

Mr. LOEVINGER. It depends on what they want to do.

Senator JAVITS. I think my question is very specific, Judge.

Can you give the oil companies, who at the Government's request will combine with it to act in respect of Russian supplies of oil to Europe, freedom from antitrust prosecution by law?

Mr. LOEVINGER. To act now, to do what?

Senator JAVITS. To buy together, to sell together, to run their tankers together, to do any act which would be a violation of the antitrust laws, unless they did have some protection.

And this is at the Government's request, the U.S. Government's request; can you do it?

Mr. LOEVINGER. I guess I am just not prepared to give you an answer because no agency has ever requested this of us.

Senator JAVITS. All right.

In other words, you cannot give us the answer now. Will you supply it for the record?

Mr. LOEVINGER. All right.

(The information referred to appears in the appendix at p. 952.)

Senator JAVITS. I might tell you, Judge, I am not trying to lead you into any controversies, but I do think we are very materially lacking with equipment to deal with this situation and the antitrust laws which are the set of laws which are materially in the way of really getting American business to do its part in what I think needs to be done, that is the only point of my question.

I have just one other question, and I am grateful to the Chair for giving me this other opportunity.

Now, in respect of our small business problems—

Senator PROXMIRE. If the Senator would just yield at this point on a particular question, which is very interesting. It is my understanding we do have a consortium of American oil companies operating to-

gether in the Near East. We have discussed it a number of times on the floor.

What I would like to have very much, if these consortia are permitted in the future, that the public be allowed to know about them in full so we know who is involved and what authority is given and so forth, and if not, why this is not good public policy to make this a public record.

MR. LOEVINGER. This, of course, is the problem with sanctioning such things. It becomes almost impossible to follow them to know what is going on, and, therefore, in general, the Government policy has been throughout the years to be very cautious about either through legislative or administrative action sanctioning anticompetitive combinations of business.

Senator PROXMIRE. I understand; the staff informs me there have been times in the past where the identities and authorities and so forth have not been made public, and there are—there is some feeling this should be made public, or if not, we should be told exactly why not.

MR. LOEVINGER. I don't know. There is still pending a case in the Antitrust Division involving the biggest oil companies in the country, and an alleged cartel or restraint of trade arrangement in the Near East.

Senator PROXMIRE. Thank you, Senator.

Senator JAVITS. I might just say to my colleague that there are certainly techniques for supervision.

For example, I have myself suggested one. I just don't think that the Department of Justice, whether under this Attorney General or the preceding or any other Attorney General, has been inventive enough.

For example, you can appoint a special master in a court proceeding to supervise any agreement and get yourself completely informed at all times, even with the power of investigation and subpoena. I deeply feel that our antitrust laws are not at all abreast of our international world situation but are just operating in a vacuum which extends from 1888 until today.

And I think it is high time we get to it and find out what to do in our national interest.

I would like to ask you just one question about the domestic field. During the war it was possible for small contractors to combine under the York plan in order to jointly bid on Government procurement and get business accordingly.

Is any such thing possible now in respect of export trade, in which small business hardly participates?

MR. LOEVINGER. Yes.

Small business can form Webb-Pomerene export associations just as well as big business.

Senator JAVITS. As a practical matter from your experience in the Department, is the Webb-Pomerene law effective and efficient enough for that purpose, because I have heard it said that it is not. It is not congenial to that kind of operation.

MR. LOEVINGER. It isn't widely used. I don't know the reason. I suspect the reason is partially because the big companies don't really need it, and the small companies are relatively uninformed and unsophisticated about this kind of thing.

Senator JAVITS. So you feel we have adequate machinery as we are going to consider the trade bill; and it is a very important question, only 5 percent of American companies engage in export trade.

Do you feel we have the legal machinery then which is necessary to enable small business to cooperate for that purpose in the export field, but it hasn't used it?

Would that be your answer?

Mr. LOEVINGER. I wouldn't want to go so far as to say the machinery is wholly adequate, Senator Javits. I have not studied the Webb-Pomerene Act to see whether or not it can't be improved or changes made in it without saying this is so; it may be so. We would have to examine it to say that.

Senator JAVITS. Would you be good enough to do that. I don't want to tax you too much, but it is important, as you can see, because we are going to pass, I hope, a new trade bill tremendously expanding, we hope, American trade.

(The material referred to appears in the appendix at p. 952.)

Yet we know that only 5 percent of American companies actually participate in export trade, and certainly if we can give a legal help to expanding it, and broadening the participation, this is very good.

Now, the Export-Import Bank under Harold Linder is doing a magnificent job in making financing and credit guarantees available. If we have any hesitations on the legal side, let us at least know what they are; and if Congress looks to act, our Small Business Committee or even this committee might very well be induced to make some recommendations to the subject.

Mr. LOEVINGER. Let me say this, Senator, basically what is needed, in my judgment, is not less but more competition.

The Webb-Pomerene Act, whether in its present or in a revised form, is a means for establishing what the Europeans call export cartels.

Now, there is some feeling in Europe that we should be moving away from rather than toward the encouragement of export or import cartels.

As you are undoubtedly aware, within the last 10 years there has been a tremendous movement within the European community itself in the direction of our form of competitive economy, rather than toward the 19th century European cartel economy.

It seems to me that this is an inappropriate time for the United States to start leading the way back toward the cartel economy of 19th century Europe. Europe is now moving toward the competitive economy of 20th century America. And I think we should encourage this and lead the movement in that direction.

I think that a movement toward restriction or limitation, toward more cartels, toward more combination is a backward movement.

Senator JAVITS. Judge Loevinger, you will forgive me if I disagree with you 100 percent for this reason. You are truly living in the past. Ninety-five percent of American small business is excluded from the export trade. The cartel is in the 5 percent which is included. We have got to find techniques to let the small fellow get into it. That is real competition.

You are not restraining competition today, you are allowing a monopoly because you are not allowing the small fellow to have some of

the advantages of bigness which he might get by cooperation under complete supervision, and I have had the opinion that the Antitrust Division is living in the past, and you prove it to me, because if you think that we are going to a cartel system, if we try to find ways in which we are going to get 95 percent of American business firms to participate in the field from which they are excluded, you and I differ 100 percent.

Chairman PATMAN. Have you finished?

Senator JAVITS. I am finished.

Chairman PATMAN. May I invite the attention of the gentlemen of the committee—and I am not doing this to lobby with you, although I don't think I would violate any law if I did; but you would probably construe it as lobbying by a House Member with the Senators—that this is a great anniversary. August 22, 1961, the House of Representatives—1 year ago today—passed H.R. 8603, the identical bidding bill, and it is now in the Senate and has been for a year before the Government Operations Committee and the Appropriations Committee, and no action has been taken on it, and I just want to ask these gentlemen here who are members of this committee and who initiated this matter, to do something about the passage of this bill, and I suggest that under your rules, you can do most anything that is germane; you could consider an amendment providing that, in the event of identical bids, the policy be adopted of giving the award to the smallest concern making the identical bid. And then I think you would break up this identical bidding.

Senator PROXMIRE. I think that is an excellent suggestion. I can't see anything really wrong with it although maybe there is. But I think you would break up identical bidding in a hurry.

Chairman PATMAN. You gentlemen, I hope, won't overlook the fact this bill number is H.R. 8603. It was passed a year ago. [Laughter.]

And I hope you do get action on it.

Senator JAVITS. He is lobbying.

Chairman PATMAN. Yes, I am lobbying.

Any other questions before we conclude?

This brings to a close the committee's hearings on the state of the economy and on policies for achieving full employment. We have a number of charts, tables, and notes which have been prepared by the committee staff, which were circulated to the members of the committee for their use.

I believe most of these have been admitted to the record at appropriate places. However, many of these have not been put into the record and I would like them to appear and without objection they will be placed in the record as an appendix.

I believe that the committee's hearings have been most informative and most useful.

We are indebted to the large number of witnesses who devoted their time and energies to preparing statements for us and who have come here to testify.

I particularly want to thank those members of the committee who have given their time to these hearings; several members have attended all or almost all of the sessions and raised very penetrating questions and the chairman feels indebted to them.

The committee will stand adjourned.

(Whereupon, at 12 noon, the committee stood adjourned.)





## APPENDIX

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AUGUST 22, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,*  
*House of Representatives, Washington, D.C.*

DEAR MR. PATMAN: I have been highly gratified and indeed flattered by the many comments, both favorable and critical, which have followed the proposal for the issuance of gold certificates against foreign-held dollars which I had the privilege of outlining before the Joint Congressional Economic Committee on August 13. This interest in turn has induced me to give some further thought to the problem.

It appears to me that many of the objections which have been raised against the plan could be met by *restricting the issuance of the certificates to foreign central banks*. In this way the volume of the certificates outstanding at any moment would not be affected, directly or indirectly, by private speculation. The certificates would offer no shelter to floating funds or to "hot money." They would function simply as an additional instrument of cooperation between central banks, alongside with the other measures which have been evolved with such a striking measure of success during the past few years.

In this sense the issuance of gold certificates against dollars, and perhaps also other currencies, could represent a practical step in the direction of some of the broader arrangements which have been suggested by many distinguished authorities, such as Dr. Rueff, Dr. Triffin, Mr. Bernstein, and Mr. Zolotas, in order to expand the mechanism of the International Monetary Fund. I would like to stress, however, that in my opinion the greatest merit of the gold certificate plan lies in the fact that such a device would strengthen beyond any possible doubt the power of the American monetary authorities to shape freely their policies, and that by the same token it would reemphasize the unique position of the dollar as the major key currency in the world.

It seems to me—and I daresay this view is widely shared among many people in Europe—that the difficulties which at present continue to beset the dollar, despite the encouraging improvement which has occurred in the basic components of the U.S. balance of payments, are to be viewed not only within the narrow context of gold reserves and gold flows but against the background of the enormous strength of the American economy. An economy that can boast an annual national product in excess of \$550 billion can take care of temporary balance-of-payment problems by its own efforts and strength. Surely, the support which the dollar is receiving through the concerted and enlightened action of the central banks of the free world is an outstanding example of what the West can accomplish when it stands united. At the same time, it is in the interest of all of us that the United States may continue to lead the free world from a position of strength in all respects. In my opinion, the issuance of gold certificates against dollar balances held by foreign banks, far from being an admission of weakness, would restore the ability of the U.S. Government to regain complete freedom in the conduct of its monetary affairs and to reassert the U.S. control over the price of gold which has existed for almost 30 years and which has served the world well. It would further reduce the role played over the gold market by private operators, and buttress rather than impair the functioning of the international gold exchange standard.

Altogether, monetary cooperation between the United States, Britain, and continental Western Europe has led to an increasing pooling of their gold and other convertible assets. Unless I am mistaken, the system would operate with greater safety if it would involve also the availability of a type of asset the value of which is stable under any and all conceivable conditions. Among other things it would at this stage relieve the management of Europe's central banks from the agonizing task of reappraising continuously its duties and responsibilities in terms of both national interest and international cooperation. So long

as the claims of the two sets of interests can be conflicting in a major degree, the choice is bound to be most difficult and tortured. Once the potential area of conflict between those claims is removed, it becomes once more practicable for each monetary authority to pursue wholeheartedly the path of international cooperation.

Domestic considerations should and will continue to play a major role in shaping national monetary policies, within the framework of freely accepted limitations and safeguards, such as those which are embodied in the articles of incorporation of the International Monetary Fund. The availability of gold certificates would be helpful on both counts. It would not involve a pledge impinging upon the unfettered freedom of decision of the U.S. Government on a subject which is so closely related to the exercise of sovereignty as the choice of the gold parity of the currency. It would simply insulate the dollar holdings of foreign central banks against the effects deriving from the use of that freedom, thereby discouraging gold movements which stem from the "precautionary motive" of central banks which after all are entrusted with the safeguard of their nations' basic assets.

In my appearance before the joint committee I emphasized the fact that the gold certificate plan was to be conceived largely as a temporary device, which was by no means a substitute for more fundamental methods of redress of the balance-of-payments position. I still hold that opinion, and would not wish to overrate unduly the longrun remedial effects of any such plan. At the same time, further reflection has led me to think that the availability of such instrumentality to central banks would be likely to strengthen also two major features of an effective international gold exchange standard. The link between the dollar, i.e., the key currency of the international system, on the one hand, and gold on the other, would become emphasized, while avoiding the rigidities which would affect unfavorably international liquidity. The special position of the dollar as the center of gravity of the system would become strengthened. The various nations of the free world would be enabled to hold each other's currencies in almost unlimited amounts, thereby pooling to the greatest practical extent their gold and convertible assets. And while this state of affairs would provide an additional cushion against the vagaries of "hot money" and the adverse impact of psychological factors, it would give no incentive to monetary irresponsibility, since it would put, so to say, a price tag upon the freedom to devalue. Although it might add up to a significant advance in the process of constant adaptation which is being evolved in cooperation between governments, central banks, and the International Monetary Fund, in response to the ever-changing stresses and pulls of the world economic configuration.

I am attaching herewith, for such use as the committee may wish to make of it, a fuller elaboration of my proposal on this subject, giving also my views on several other proposals which have been advanced for improving the gold and international liquidity situation.

Deepest regards and thanks for the consideration given.

ETTORE LOLLI.

#### THE DOLLAR AND GOLD

#### SOME CLARIFICATIONS ON THE PROPOSAL OF THE ISSUANCE OF GOLD CERTIFICATES AGAINST DOLLARS HELD ABROAD

\* \* \* \* \*

The problem of gold and of international liquidity is not new, and many solutions have been proposed by economists and financiers from remote to present times.

The proposal submitted to the Joint Economic Committee of the Congress of the United States in the hearings of August 13, 1962, is, however, different from the general plans for the solution of the problem of international liquidity; and it is also essentially different from the mere "exchange guarantee" or "gold clause" for international debts.

In order better to evaluate the particular characteristics of the proposal, it is advisable to review briefly the principal "plans" presented recently. This review is contained in a short appendix attached to this memorandum.

It is clear that the proposal for issuance of gold certificates made before the Joint Committee of the U.S. Congress is not an international plan, since it concerns only one country, the United States. Furthermore, it is not a normal exchange guarantee offered on dollar balances held abroad, because it is not auto-

matically extended to all these balances but only, if at all, to those dollar balances for which conversion into gold is requested (therefore only through the central banks). Finally, it differs from the Stamp proposal which considers the issuance by the Fund of gold certificates, since the latter create new international liquidity, whereas the gold certificates originating from the gold certificate proposal would leave the total liquidity unchanged. *This proposal has the only scope of taking away the psychological pressure from the dollar.* It does not alter in any way the existing situation and does not cause any of the inconveniences claimed in the first hasty criticisms against it. It is an expedient to permit what is practically equivalent to a conversion into gold of dollar balances held abroad, even for amounts in excess of the gold available.

The essential characteristics of the gold certificates issued according to the proposal are the following:

(a) The certificates do not bear interest and are, namely, in all respects comparable to gold ingots;

(b) The issuance of the certificates sterilizes an equal amount of dollars. This is an essential condition like the first one. The dollars collected against the gold certificates should not remain at the disposal of the U.S. Treasury, but should be put out of circulation.

In order to better exemplify our idea, we report below in its essential parts the wording that should appear on the certificates:

"The Treasury of the United States, at its option, will pay at sight to the bearer of this certificate 1,000 ounces of gold or its equivalent in dollars at the time of its presentation."

The certificate represents a quantity of gold, but it is payable *either in gold or else in its dollar equivalent*. It is true that the gold represented by the certificate may not exist in the deposits of Fort Knox but, for practical purposes, this has no importance. Nobody in fact takes materially away the gold from Fort Knox. At the moment when a country should need to make use of its gold reserves, and therefore request from the United States the payment of its gold certificates, it would be exactly the same to obtain gold or dollars at the rate current at that time.

Provided that the dollars against which the gold certificates are issued, are immediately put out of circulation, such a practice would not change anything in quality or in quantity compared to the present international monetary system; it would have instead the beneficial effect of eliminating once and for all and in a definite way any doubt about the dollar as a reserve currency. And, once this doubt is eliminated, any pressure on the dollar would automatically disappear, along with all the motives or pretexts which now lead some people to sustain the necessity of its devaluation. This would naturally not prevent the U.S. Government from continuing with its present policy meant to reequilibrate its balance of payments.

The criticisms made against the proposal appear to a great extent inconsistent. The criticisms by Mr. Dillon and Mr. Hayes can be briefly summarized in the following points:

(a) The step is not necessary since the Government is determined not to devalue the dollar;

(b) One would create the impression that the United States does not desire to reequilibrate its balance of payments;

(c) An incentive would be given to the flight of American dollars abroad in search of the guarantee;

(d) The international monetary market would be upset because the holders of other currencies would be inclined to change them into dollars.

It is appropriate, first of all, to clarify that the proposal is *not an exchange guarantee extended* to the dollar holdings of all foreigners, but rather the conversion of dollars into gold certificates, on demand, probably limited to those coming from central banks. Nothing more, namely, than what is being done at the present time when the dollars of the foreign central banks are converted into gold; with the only difference that, with the introduction of the clause "the U.S. Government will pay \* \* \* gold or the current equivalent in dollars," the issuance of the certificates does not automatically cause a reduction of the American gold stocks.

Having stated the above, the criticisms can be examined separately.

(a) It is said that the step is not necessary because the U.S. Government has no intention of devaluing. Actually it is the very assumption that one wants to maintain unchanged the parity of the dollar which makes this step all the more

useful. In fact, if the parity of the dollar is not changed the step does not, and will never, result in any harmful consequence or cost for the United States. And, at the same time, by eliminating every psychological pressure on the dollar, it will make it easier to maintain the determination to avoid devaluation.

(b) The intention of the Government of the United States to reequilibrate its balance of payments in no way depends on the possibility offered to the central banks to change into gold a larger part of their dollar reserves. The step does not prevent in any way the U.S. Government from continuing its policy, whichever it is. Due to the increasing expansion of international commerce a parallel expansion of the international reserves is necessary; and since there is not sufficient gold, it is inevitable that one turns more and more to the foreign currency reserves, and the dollar is undoubtedly the main one. The proposed step has the only scope of making its functions as a reserve currency stronger and to stabilize the huge mass of dollars held for this purpose by the central banks of other countries.

(c) If the certificates were to be granted only in favor of the central banks, private speculators would have no possibility to interfere.

(d) It seems to us that the criticism that the international monetary market would be upset is the only criticism that may have some ground. Undoubtedly the possibility of converting dollars into gold certificates could lead the central banks to prefer the dollar to other reserve currencies, and especially the pound sterling. One should not forget, however, that the dollars changed into gold certificates become noninterest bearing, the same as the gold itself, whereas the currency holdings yield a not negligible interest. Therefore, the problem would arise only in the case of fear for the devaluation of other currencies—exactly as it happens in the present system.

In any case, nothing would prevent also Great Britain, and perhaps the other nations whose currencies function as international reserves, from issuing similar gold certificates, provided the sterilization of the sums collected against such certificates is strictly followed. As a matter of fact, we may say that the generalization of the custom of issuing such gold certificates could represent an alternative plan, even more simple than the many presented, efficiently to stabilize the international monetary situation. In effect, in view of the fact that balances held in a nonguaranteed currency yield interests, whereas their conversion into gold certificates makes them nonyielding, the various central banks would naturally be inclined to hold these balances in a foreign currency, in order to earn interests, till no suspicion of a devaluation arises. An intensification of the conversion of foreign currency holdings into gold certificates would point to the beginning of such suspicion and would sound as an alarm for the countries concerned, which would be led to take the necessary steps of economic policy with the object of correcting the situation. But, in the meantime, the possibility of converting the currency holdings into gold certificates would avoid a crisis of mistrust which is one of the main factors in the international monetary situation.

#### APPENDIX

##### BRIEF REVIEW OF PRINCIPAL RECENT PLANS ON GOLD AND INTERNATIONAL LIQUIDITY

1. It should be noted first of all that by "gold standard" a monetary system is intended in which paper currency is positively and at any time convertible into gold; and by "gold exchange standard," on the other hand, one intends the present system based on predetermined gold parities without, however, the possibility of actually converting the paper currency into gold (except for a few imperfect exceptions, the most important of which is undoubtedly the convertibility of the dollar in respect of central banks, a convertibility which is precisely the subject of the present discussion since it is imperiled by the scarcity of gold reserves as compared to the aggregate of convertible balances).

2. *The Rueff proposal.*—This outstanding economist is of the opinion that the present international monetary instability derives principally from the "monetary duplication" of an inflationary nature, which is a consequence of the function of international monetary reserves attributed to certain currencies (dollars, pounds sterling, etc.), which in their turn are issued against gold. In other words, Rueff supports the return to the pure gold standard. The difficulty, however, is that the solution would not solve the problem, but would instead aggravate it, because it would restrict the already limited existing liquidity.

Rueff's proposals are supported also by Heilperin, a Swiss professor, who has been handling this problem for many years.

3. *The Triffin plan.*—This plan which has raised many sharp polemics, takes up again Keynes' idea to create a World Central Bank, having a nominal currency of its own (the "bancor"). Triffin, however, does not entirely abolish the function of gold, but he *links* it to a new form of international reserve consisting of deposits with IMF with a *guaranteed rate of exchange and interest bearing*. These deposits would be made up by compulsory payment of a fraction (20 percent is suggested) of the reserves of each country, as well as by other voluntary payment. The part of the deposits which exceed 20 percent of the total national reserves could, however, be withdrawn in gold at any moment. The countries with a surplus in their balance of payment would go on with the compulsory payment of 20 percent of the increase in their reserves, whereas the countries with a deficit could utilize for their needs that part of their initial payment which has become excessive in respect of their compulsory deposit. The availability of the Fund, and therefore its credit capacity, would in this way be automatically increased in proportion with the increase of the world reserves.

The Triffin plan has undergone many criticisms, some of which are justified (especially, for example, the one by Angell). It has also met opposition, almost preconceived, which reflects, in our opinion, above all the difficulties of the "psychological adjustments" necessary to face problems of such wide dimensions.

4. *The Zolotas plan.*—According to Professor Zolotas, governor of the Bank of Greece, it is not necessary to change the present "gold exchange standard" system, but it is sufficient to strengthen it with some supplementary agreements.

In the first place the IMF should conclude "standby" agreements with the treasury departments and the central banks of the various participating countries, for the purpose of automatically obtaining supplementary credits from countries with a surplus balance of payment. These credits would be used by the Fund for the purpose of granting loans to those countries having a deficit.

Furthermore, Zolotas proposes that the United States and Great Britain, whose currencies are used as international reserves, should accumulate large amounts of other currencies convertible between them, to be used for operations on the open market to counteract short-term speculative operations.

Finally, all countries having a convertible currency should guarantee the gold exchange on the amounts of their currencies held by central banks of other countries. This, together with the payment of preferential interest rates to official foreign deposits, would encourage the various countries to maintain their reserves in foreign currency and not request their conversion into gold.

5. *The Stamp plan.*—This plan, which is very simple, contemplates the possibility that IMF issues a limited amount of certificates (a figure of \$3 billion for 12 months is suggested) with a value expressed in gold, but not automatically convertible into gold. The members of the Fund should commit themselves to accept these certificates, in exchange for national currency, from the Fund itself or from other central banks. The proceeds of these certificates would be used to grant aid to underdeveloped countries.

The Stamp plan also considers, alternatively, the possibility that the Fund obtain substantial "standby" credits from the various countries in a mechanism which has a similarity to that of the Triffin plan and which also includes the gold guarantee for credits toward the Fund.

6. *The Bernstein plan.*—Bernstein, like Zolotas, belongs to the group of those who support the validity in substance of the present system with only a few necessary marginal modifications. Bernstein proposes, like Zolotas, the concession by members of the Fund of substantial "standby credits" from which the Fund could draw whenever it becomes necessary.

Besides, Bernstein also proposes to create, side by side with the Fund, a new collateral "stabilizing" organization in which all the members of the IMF should take part. Against these new contributions by the members, the stabilizing Fund would issue interest-bearing certificates with a given maturity, in the currency of the lending country and with *exchange guarantee*. The quotas subscribed by the various countries would be paid in only when such countries showed surpluses in their balance of payment.

It is to be noted that also in the Bernstein proposal, one finds again some of the essential points of the Triffin plan even though in a more simple mechanism.

DEPARTMENT OF JUSTICE,  
Washington, September 18, 1962.

HON. WRIGHT PATMAN,  
Chairman, Joint Economic Committee,  
House of Representatives,  
Washington, D.C.

DEAR CONGRESSMAN PATMAN: In the course of my testimony before the Joint Economic Committee on August 20 and 22, 1962, a number of questions were asked of me. It was suggested that I undertake to answer as many of them as I could when I received a copy of the transcript. The following answers are responsive to each of the questions which I feel qualified to answer.

At page 1385 you asked whether I would attribute some of our balance of payments problems to the large volume of imports of automobiles and steel in recent years. It seems to me that one of the sources of our balance of payments difficulties has been the fact that there has been a substantial increase in imports and decrease in exports of automobiles and steel and that this expansion of net imports may have been due in large part, as you suggest, to the failure of the domestic manufacturers of automobiles to be competitive in design and of steel to be competitive in price with foreign producers.

At pages 1392 and 1393 you propounded several questions relating to the activities of tax-free foundations. You asked more specifically whether I saw anything contrary to the spirit and objectives of the antitrust laws a situation where funds accumulated by tax-free corporations are used to finance the acquisition of other corporations. The fact that tax-free foundations may be nominally nonprofit organizations does not suggest that they cannot violate the antitrust laws. If such foundations are in fact engaged in competition with other business enterprise in fields where the amount of capital available is an important factor then their tax exemption may confer a competitive advantage upon them. We have received some complaints alleging such a situation to exist. If these practices are widespread, the competitive advantages of tax-free foundations may raise questions of national policy which Congress should explore.

At page 1393 you asked whether we are following a mild program of antitrust enforcement which leaves untouched firms dominant in their industries so long as they do not become involved in collusive arrangements; and at page 1394 you asked what program we have for dealing with giant firms dominant in major domestic industries. Contrary to the impression that some seem to have, the fact and degree of economic dominance are not ordinarily self-evident phenomena. The Antitrust Division does not have the resources for a complete and continuing survey of the national economy and does not seek to make such a survey. However, the Antitrust Division does collect and analyze the available data from other sources that are relevant to economic concentration, and does make its own investigations in specific fields where it appears that there may be activity inconsistent with the antitrust laws. We have already instituted some suits based upon alleged illegal aggregation of economic power and we will institute such additional suits of this kind as the evidence we are able to secure may warrant. Our program in this field is to enforce the mandates of the antitrust laws as those laws are construed by the courts. There are, of course, those who believe that the antitrust laws do not go far enough in forbidding economic concentration of power. Obviously our mandate is simply to enforce existing law and our program is to do that—fairly, vigorously, and effectively.

With respect to the "Attorney General's Report on Identical Bidding in Public Procurement," you urged at pages 1618 and 1619 of the transcript that further reports include in table II the details of all bids filed when identical bids are reported. We gave serious study to the listing of all bids, identical and disparate, relating to each item of procurement in preparing the reports and concluded that in the interest of achieving one of the major objectives of

Executive order, the publicizing of the identical bids, it would be more to limit the published details of the bidding to identical bidders. We had included the names of all bidders, table II would have required 15 pages instead of the 278 pages in the present report. However, we your desire to make the identical bid reports as complete as possible reconsider the matter in setting up the format of the next report.

At page 1620 of the transcript you asked for "some indication of the contents of 23" identical bid cases which were excluded from the report because they required separate treatment. Of the 118 Federal cases requiring separate treatment 15 were cases submitted by the Department of Agriculture, most of which are discussed in chapter VI of the report beginning on page 24. Thus, while most cases of identical bidding affecting the procurement of agricultural commodities by the Department of Agriculture for the school lunch program and support programs are discussed in chapter VI, the bidding details are not reported into tables I through III and for that reason they are listed as "other" cases in table D, page 16.

The three remaining Federal cases of identical bidding excluded from the report are cases submitted by the Military Petroleum Supply Agency covering procurement of estimated petroleum and petroleum products requirements for a 12-month period for all service installations. The complex character of the procurement arising out of the large number of both bidders and line items of procurement necessitated the development of special processing techniques to accommodate these reports to our machine processing operations. Consequently, these reports were not assimilated for machine processing in time to meet the deadline for publication of the report. They will, however, be incorporated into the next report to be published.

Five identical bid cases reported by State and local agencies were listed in table D as having been excluded from the report because they required separate treatment. These cases involved the procurement of several types of services which necessitated the development of a method of presentation which was not completed in time for publication. These cases will be included in the next report.

You asked, at page 1621 of the transcript, for a memorandum showing a breakdown of the 115 Federal cases listed in table D as having been excluded from the report because the bids were not identical after evaluation. You also indicated that you were puzzled by the fact that so many bids which the procurement agency thought were identical were found by my staff not to be identical. The explanation for the rejection of these cases can be found in the definition of an identical bid in paragraph 1 of Executive Order 10936 which requires the reporting of bid proceedings to the Attorney General:

1. Whenever, in connection with a procurement of property or services exceeding \$10,000 in total amount and made pursuant to an advertisement or other public invitation for bids, a department, agency, or instrumentality of the Government shall hereafter receive two or more bids—

(a) Which are identical as to unit price or total amount, or

(b) Which, after giving effect to discounts and all other relevant factors, the department, agency, or instrumentality shall consider to be identical as to unit price or total amount.

Thus the Executive order requires the submission of reports when there is identical bidding either in the gross or the net amount of the bids. It was determined, however, that as a matter of policy we would publish only those bids which were found to be identical in price after evaluation. Consequently, those cases which were reported under the Executive order because they were identical as to the gross price bid were excluded from the published report if the bids were found to be nonidentical after evaluation by the agency.

Senator Javits also requested our recommendations as to whether the Webb-Pomeroy Act should be amended. We still have this matter under consideration and will communicate with you as soon as it is resolved.

Sincerely yours,

LEE LOEVINGER,  
Assistant Attorney General, Antitrust Division.

CONGRESS OF THE UNITED STATES, JOINT ECONOMIC COMMITTEE

Letter from Representative Wright Patman, chairman, Joint Economic Committee, to Hon. William McChesney Martin, Jr., chairman, Board of Governors of the Federal Reserve System, requesting that condensation of the minutes of meetings of the Federal Open Market Committee in 1960 be made public

AUGUST 14, 1962.

HON. WILLIAM MCCHESENEY MARTIN, JR.,  
*Chairman, Board of Governors, Federal Reserve System,*  
*Washington, D.C.*

DEAR CHAIRMAN MARTIN: During the committee's hearings on June 1 and 2, 1961, on the annual report of the Board of Governors of the Federal Reserve System for the calendar year 1960, it quickly became apparent that neither members of the general public nor experts on monetary policy matters could adequately determine what policy decisions had been reached by the Federal Open Market Committee during the year 1960, nor ascertain the reasons for such decisions on the basis of the brief and vague summaries of that Committee's meetings which were published in the Board's annual report.

Accordingly, on June 2, 1961, while you were testifying before the committee, I requested that you submit to the committee for its information and use copies of the full minutes of the meetings of the Federal Open Market Committee which that Committee is required by law to keep.

Further, at your suggestion I wrote you a letter on June 14, 1961, renewing my request that you submit copies of those minutes for the year 1960, along with certain other materials specified in that letter.

In neither of my requests, nor at any time, was there any suggestion or understanding that the committee would treat as confidential these minutes. However, when these minutes of the meetings were delivered to my office they were accompanied by a letter from you which contains a statement that: "The Open Market Committee is prepared to make these minutes of its meetings held in 1960 available to the Joint Economic Committee on the understanding that they will be treated as confidential." In other words, it appears that in complying with my request for copies of the minutes you sought to impose a restriction upon the committee's use of these minutes.

While I do not acknowledge that you are privileged to restrict the committee in its use of the requested materials, I adopted a procedure for making the essence of the Open Market Committee's proceedings public, while at the same time avoiding making revelations of the kind which you indicated in your letter might be objectionable. Specifically, this was to have two competent and disinterested scholars in the field of monetary operations prepare a condensed report giving in their own words descriptions of the issues discussed at each of the meetings and the conclusions reached at each meeting. This report, prepared by Dr. John G. Gurley, professor of economics, Stanford University, and Dr. Asher Achinstein, senior specialist, Legislative Reference Service, Library of Congress, is also prepared in a manner which minimizes identification of particular participants in the Open Market Committee meetings, and minimizes the possibility that policy positions taken can be attributed to particular participants.

Last week I distributed, on a confidential basis, a copy of the Gurley-Achinstein report to each member of the Joint Economic Committee, indicating that after the committee's present series of hearings is completed I intended to take up with the committee the question of making this report public. However, it is apparent that a copy of the Gurley-Achinstein report has fallen into the hands of a newspaperman, as extracts from the report appeared in news items in the New York Times yesterday and again today, and possibly others will appear in the days to come. This premature disclosure of the contents of the report in the press has raised the question of immediate release of the report to the press generally.



Accordingly, the committee met this morning and adopted by majority the following resolution:

"That the presently confidential joint committee print entitled "How Policies of the Federal Reserve System Are Determined" be submitted in a letter by the chairman to the Chairman of the Board of Governors of the Federal Reserve System, with the request that he allow us to make it public because, in our view, the material in it is in the public interest and in the public interest it ought to be made public; that this be done promptly; and that until a resolution of the matter is had, the Joint Economic Committee print be kept confidential."

In addition, it was also agreed that I would inform you that Senator Bush does not concur in the view that it would be in the public interest to make the Gurley-Achinstein report public; while Senator Javits and Mr. Curtis reserve judgment on this question until they learn your reasons for objecting to making it public, if you do object.

A copy of the Gurley-Achinstein report is enclosed. An early answer to the committee's question will be appreciated.

I am,

Sincerely yours,

WRIGHT PATMAN.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
OFFICE OF THE CHAIRMAN,  
Washington, August 16, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.*

DEAR MR. CHAIRMAN: This will acknowledge receipt of your letter of August 14 enclosing a copy of the Gurley-Achinstein report and requesting concurrence of the Federal Open Market Committee to its publication by the Joint Economic Committee in the public interest.

We are having a meeting of the Federal Open Market Committee on August 21, and this matter will be placed on the agenda for that meeting so that we can give you as prompt a reply as possible.

Sincerely yours,

WM. MCC. MARTIN, Jr.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,  
Washington, August 21, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.*

DEAR MR. CHAIRMAN: This refers to your letter of August 14, 1962, transmitting a copy of a proposed joint committee print entitled "How Policies of the Federal Reserve System Are Determined" and quoting a resolution adopted by your committee to the effect that this print be submitted to the Chairman of the Board of Governors of the Federal Reserve System with the request that your committee be allowed to make it public.

In my letter of July 21, 1961, transmitting to your committee the minutes of the Federal Open Market Committee for 1960, there were set forth in some detail the reasons for which the Open Market Committee is convinced that the public interest would not be served by publication in whole or in part of detailed minutes of meetings of the Committee. The question whether it would be in the public interest to publish the joint committee print which purports to contain an analysis and condensation of those minutes obviously involves considerations that require careful study by the members of the Open Market Committee.

Upon receipt of your letter, I immediately had the copy of the document transmitted by you reproduced and distributed by airmail to each member of the Open

Market Committee. However, the members of the Committee did not have copies of the report in time for more than cursory reading before the meeting of the Open Market Committee today (August 21, 1962).

Moreover, the last paragraph of chapter I of the report appears to indicate that a last chapter of the report has the purpose of highlighting "the points brought out by the minutes with respect to the actions of the committee in 1960," and of briefly discussing "them from the point of view of the development of a more effective monetary policy." Yet, the joint committee in the form enclosed with your letter does not include such a final chapter. It is your committee's plan to include such a chapter in the proposed print, which would be helpful to the members of the Open Market Committee also to have an opportunity to review the galley proof of that chapter.

For the reasons here indicated, the Open Market Committee at its meeting today concluded that it would be desirable to carry over until its next meeting to be held on September 11, the question raised in your letter concerning publication of the proposed Joint Economic Committee print. Promptly following that meeting, you will be advised of the committee's views.

Sincerely yours,

WM. MCC. MARTIN, JR.

#### MEMORANDUM

To: Hon. Wright Patman.

From: Wm. Summers Johnson.

Attached are notes and tables which may be helpful in interrogating witnesses.

#### INDEX

Tables relating to alternative methods of reducing taxes by Roy Moor:

Unemployment rate, GNP, and Federal surpluses and deficits in terms of two budgets, 1950-61.

How a given reduction in taxes would be distributed among various income classes under alternative methods.

Percentage increase in taxable incomes, after taxes, of the different income classes under various methods of making a \$6 billion reduction in individual income taxes.

Average tax savings per individual under various methods of making a \$6 billion reduction in individual income taxes.

Rules of thumb on revenue losses under various tax cuts.

Monetary and international statistics by William Moore:

Comparative yields on long-term Government bonds in 1962.

Changes in cost of living in selected countries, 1953-62.

Restrictions upon international capital transfers in selected countries.

Analysis of cash flow to corporations by James Knowles:

Summary.

Corporate profits in historical perspective.

The share of corporate business in the gross national product, 1929-61.

Measures of corporate cash flow as a share of national output and incomes, 1929-61.

#### *Unemployment rate, GNP, and Federal surpluses and deficits in terms of 2 budgets, 1950-61*

[Dollars in billions]

| Calendar year | Unemployment rate (percent) | Gross national product | Administrative budget | National income and product budget |
|---------------|-----------------------------|------------------------|-----------------------|------------------------------------|
| 1950.....     | 5.3                         | 284.6                  | -0.4                  | 9.2                                |
| 1951.....     | 3.3                         | 329.0                  | -3.4                  | 6.4                                |
| 1952.....     | 3.1                         | 347.0                  | -5.8                  | -3.9                               |
| 1953.....     | 2.9                         | 365.4                  | -9.2                  | -7.4                               |
| 1954.....     | 5.6                         | 363.1                  | -3.7                  | -5.8                               |
| 1955.....     | 4.4                         | 397.5                  | -2.8                  | 3.8                                |
| 1956.....     | 4.2                         | 419.2                  | 3.8                   | 5.7                                |
| 1957.....     | 4.3                         | 442.8                  | .6                    | 2.0                                |
| 1958.....     | 6.8                         | 444.5                  | -7.1                  | -9.4                               |
| 1959.....     | 5.5                         | 482.7                  | -7.0                  | -1.8                               |
| 1960.....     | 5.6                         | 503.4                  | 2.0                   | 3.3                                |
| 1961.....     | 6.7                         | 518.7                  | -6.3                  | -3.8                               |

*How a given reduction in taxes would be distributed among various income classes under alternative methods*

[In cumulative percentages]

| Income class              | Number of taxable returns | Cut in new 1st bracket <sup>1</sup> | Increased exemption | Cut in present 1st bracket | Cut in all brackets <sup>2</sup> | Increased corporate dividends <sup>3</sup> |
|---------------------------|---------------------------|-------------------------------------|---------------------|----------------------------|----------------------------------|--------------------------------------------|
| Under—                    |                           |                                     |                     |                            |                                  |                                            |
| \$5,000.....              | 39                        | 25                                  | 25                  | 20                         | 13                               | 8                                          |
| \$5,000 to \$10,000.....  | 88                        | 85                                  | 81                  | 82                         | 60                               | 22                                         |
| \$10,000 to \$20,000..... | 98                        | 97                                  | 95                  | 97                         | 84                               | 42                                         |
| \$20,000 to \$50,000..... | 99                        | 99                                  | 99                  | 99                         | 94                               | 67                                         |
| Over \$50,000.....        | 100                       | 100                                 | 100                 | 100                        | 100                              | 100                                        |

<sup>1</sup> Assumes new 1st bracket would be from \$0 to \$1,000.

<sup>2</sup> Assumes equal percentage point cut in all brackets.

<sup>3</sup> Assumes that a cut in corporate income taxes or an increase in capital consumption allowances would result in some increase in dividends.

*Percentage increase in taxable incomes, after taxes, of the different income classes under various methods of making a \$6,000,000,000 reduction in individual income taxes<sup>1</sup>*

| Adjusted gross income classes      | Reduce rate in half 1st bracket 7.5 percentage points | Increase personal exemption \$200 | Reduce 1st bracket rate 4.6 percentage points | Reduce each individual rate 3 percentage points |
|------------------------------------|-------------------------------------------------------|-----------------------------------|-----------------------------------------------|-------------------------------------------------|
|                                    | <i>Percent</i>                                        | <i>Percent</i>                    | <i>Percent</i>                                | <i>Percent</i>                                  |
| \$0 to \$5,000.....                | 3.0                                                   | 2.8                               | 2.3                                           | 1.5                                             |
| \$5,000 to \$10,000.....           | 2.2                                                   | 2.2                               | 2.3                                           | 1.8                                             |
| \$10,000 to \$20,000.....          | 1.5                                                   | 1.4                               | 1.4                                           | 2.4                                             |
| \$20,000 to \$50,000.....          | .8                                                    | 1.2                               | .9                                            | 3.0                                             |
| Over \$50,000.....                 | .1                                                    | .6                                | .5                                            | 3.3                                             |
| Total revenue loss (billions)..... | \$6                                                   | \$6                               | \$6                                           | \$6                                             |

<sup>1</sup> Estimated for 1962 on basis of 1960 data of Internal Revenue Service.

*Average tax savings per individual under various methods of making a \$6,000,000,000 reduction in individual income taxes<sup>1</sup>*

| Adjusted gross income classes      | Reduce rate in half 1st bracket 7.5 percentage points | Increase personal exemption \$200 | Reduce 1st bracket rate 4.6 percentage points | Reduce each individual rate 3 percentage points |
|------------------------------------|-------------------------------------------------------|-----------------------------------|-----------------------------------------------|-------------------------------------------------|
|                                    |                                                       |                                   |                                               |                                                 |
| \$0 to \$5,000.....                | \$75                                                  | \$76                              | \$60                                          | \$42                                            |
| \$5,000 to \$10,000.....           | 142                                                   | 132                               | 148                                           | 114                                             |
| \$10,000 to \$20,000.....          | 142                                                   | 168                               | 175                                           | 288                                             |
| \$20,000 to \$50,000.....          | 150                                                   | 300                               | 185                                           | 762                                             |
| Over \$50,000.....                 | 112                                                   | 300                               | 138                                           | 1,680                                           |
| Total revenue loss (billions)..... | 6                                                     | 6                                 | 6                                             | 6                                               |

<sup>1</sup> Estimated for 1962 on basis of 1960 data of Internal Revenue Service.

## RULES OF THUMB ON REVENUE LOSSES UNDER VARIOUS TAX CUTS

## TAX LOSS

|                                                             |                                                                                                                                                                                                                                                                      |
|-------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Change in exemption level-----                              | For each increase of \$100 from the present per capita exemption level of \$600, the aggregate revenue loss is approximately \$3 billion per year.                                                                                                                   |
| Reduce individual income tax rates across the board.        | Each 1 percentage point reduction in the individual income tax rates involves an aggregate revenue loss of approximately \$2,000,000,000 per year.                                                                                                                   |
| Reduce present 1st bracket rate-----                        | Each 1 point reduction in the 1st bracket rate, presently 20 percent, involves an aggregate revenue loss of approximately \$1,300,000,000 per year.                                                                                                                  |
| Splitting 1st bracket and reducing rate in new 1st bracket. | If a new 1st bracket were created equal to one-half the present 1st bracket range, the aggregate revenue loss for each 1 point reduction from the 20-percent rate in the new 1st bracket involves an aggregate revenue loss of approximately \$800,000,000 per year. |
| Reduction in corporate rate-----                            | Each 1 percentage point reduction in the present 52-percent corporate rate involves a revenue loss of approximately \$500,000,000 per year.                                                                                                                          |

## COMPARATIVE YIELD ON SELECTED LONG-TERM GOVERNMENT BONDS INCLUDING RECENTLY OFFERED 4½ PERCENT, AUGUST 15, 1987-92

In its financing in the last week of July, the Treasury offered a long-term bond callable August 15, 1987, and maturing August 15, 1992, bearing a coupon of 4½ percent, offered at 101 to yield 4.19 percent. In the announcement the Treasury indicated an outside limit of \$750 million of these bonds. Subscriptions for them came to \$316 million and they were allotted in full.

There is no outstanding bond against which the comparative yield of this issue may be measured directly, but the accompanying table shows yields on four other issues of long-term bonds. Of these four, perhaps the best comparison would be with the 3½ percent due February 15, 1990, since the maturity on this issue lies between the call date and the due date on the new issue. On July 30 it was quoted at 4.14-percent yield.

Direct comparison of yields must take account of the fact that each of the four previously outstanding issues are selling below par, which to certain investors, has an added attraction since the bonds are redeemable at par if the proceeds are used for the payment of Federal estate taxes.

### Prices and yields of selected long-term Government bonds

[Price decimals are 32ds]

| Date         | 3¼ percent, May 15, 1985 |       |         | 3½ percent, Feb. 15, 1990 |       |         | 3 percent, Feb. 15, 1995 |       |         | 3½ percent, Nov. 15, 1998 |       |         | 4¼ percent, Aug. 15, 1987-92 |       |         |
|--------------|--------------------------|-------|---------|---------------------------|-------|---------|--------------------------|-------|---------|---------------------------|-------|---------|------------------------------|-------|---------|
|              | Price                    | Yield | Percent | Price                     | Yield | Percent | Price                    | Yield | Percent | Price                     | Yield | Percent | Price                        | Yield | Percent |
| Weekly:      |                          |       |         |                           |       |         |                          |       |         |                           |       |         |                              |       |         |
| May 4.....   | 90.16                    | 3.88  | 92.24   | 3.93                      | 87.10 | 3.68    | 91.16                    | 3.04  | 91.28   | 3.04                      |       |         |                              |       |         |
| May 11.....  | 91.10                    | 3.82  | 93.62   | 3.92                      | 87.24 | 3.65    | 91.28                    | 3.02  | 91.28   | 3.02                      |       |         |                              |       |         |
| May 18.....  | 90.22                    | 3.86  | 93.62   | 3.92                      | 86.20 | 3.65    | 90.22                    | 3.09  | 90.22   | 3.09                      |       |         |                              |       |         |
| May 25.....  | 90.25                    | 3.85  | 91.30   | 3.98                      | 86.20 | 3.72    | 90.22                    | 3.09  | 90.22   | 3.09                      |       |         |                              |       |         |
| June 1.....  | 91.05                    | 3.83  | 92.04   | 3.98                      | 86.22 | 3.71    | 90.28                    | 3.08  | 90.28   | 3.08                      |       |         |                              |       |         |
| June 8.....  | 91.12                    | 3.82  | 92.12   | 3.96                      | 86.22 | 3.70    | 91.04                    | 3.06  | 91.04   | 3.06                      |       |         |                              |       |         |
| June 15..... | 91.10                    | 3.82  | 92.08   | 3.96                      | 86.22 | 3.70    | 91.02                    | 3.07  | 91.02   | 3.07                      |       |         |                              |       |         |
| June 22..... | 90.28                    | 3.85  | 92.06   | 3.97                      | 86.20 | 3.71    | 90.28                    | 3.08  | 90.28   | 3.08                      |       |         |                              |       |         |
| June 29..... | 89.30                    | 3.92  | 89.28   | 4.07                      | 83.00 | 3.81    | 89.10                    | 4.07  | 89.10   | 4.07                      |       |         |                              |       |         |
| July 6.....  | 89.04                    | 3.98  | 89.28   | 4.12                      | 83.14 | 3.84    | 88.20                    | 4.11  | 88.20   | 4.11                      |       |         |                              |       |         |
| July 13..... | 88.28                    | 4.00  | 90.06   | 4.10                      | 83.00 | 3.81    | 89.00                    | 4.08  | 89.00   | 4.08                      |       |         |                              |       |         |
| July 20..... | 88.28                    | 4.00  | 90.02   | 4.11                      | 85.06 | 3.80    | 88.28                    | 4.09  | 88.28   | 4.09                      |       |         |                              |       |         |
| Daily:       |                          |       |         |                           |       |         |                          |       |         |                           |       |         |                              |       |         |
| July 23..... | 88.28                    | 4.00  | 90.04   | 4.10                      | 85.08 | 3.79    | 88.30                    | 4.09  | 88.30   | 4.09                      |       |         |                              |       |         |
| July 24..... | 88.24                    | 4.01  | 90.00   | 4.11                      | 85.05 | 3.80    | 88.27                    | 4.09  | 88.27   | 4.09                      |       |         |                              |       |         |
| July 25..... | 88.24                    | 4.01  | 89.30   | 4.11                      | 85.04 | 3.80    | 88.24                    | 4.10  | 88.24   | 4.10                      |       |         |                              |       |         |
| July 26..... | 88.26                    | 4.00  | 90.02   | 4.11                      | 85.06 | 3.80    | 88.26                    | 4.09  | 88.26   | 4.09                      |       |         |                              |       |         |
| July 27..... | 88.24                    | 4.01  | 89.24   | 4.13                      | 84.30 | 3.81    | 88.18                    | 4.11  | 88.18   | 4.11                      |       |         |                              |       |         |
| July 30..... | 88.22                    | 4.01  | 89.18   | 4.14                      | 84.24 | 3.82    | 88.10                    | 4.12  | 88.10   | 4.12                      |       |         |                              |       |         |
| July 31..... | 88.22                    | 4.01  | 89.16   | 4.14                      | 84.24 | 3.82    | 88.08                    | 4.13  | 88.08   | 4.13                      |       |         |                              |       |         |
| Aug. 1.....  | 88.24                    | 4.01  | 89.22   | 4.13                      | 84.30 | 3.81    | 88.14                    | 4.12  | 88.14   | 4.12                      |       |         |                              |       |         |
| Aug. 2.....  | 89.02                    | 3.99  | 90.08   | 4.09                      | 85.10 | 3.79    | 89.00                    | 4.08  | 89.00   | 4.08                      |       |         |                              |       |         |
| Aug. 3.....  | 89.00                    | 3.99  | 90.06   | 4.10                      | 85.00 | 3.79    | 88.30                    | 4.09  | 88.30   | 4.09                      |       |         |                              |       |         |
| Aug. 6.....  | 89.02                    | 3.99  | 90.04   | 4.10                      | 85.10 | 3.79    | 88.26                    | 4.09  | 88.26   | 4.09                      |       |         |                              |       |         |

On bid bases as reported to the Treasury by the Federal Reserve Bank of New York.

<sup>2</sup> Offered price and yield.

<sup>3</sup> When issued.

*Changes in cost of living selected countries, 1953=100*

|               | Germany | Italy | Nether-<br>lands | United<br>Kingdom | France | Japan | United<br>States |
|---------------|---------|-------|------------------|-------------------|--------|-------|------------------|
| 1953.....     | 100     | 100   | 100              | 100               | 100    | 100   | 100              |
| 1954.....     | 100     | 103   | 104              | 102               | 100    | 106   | 100              |
| 1955.....     | 102     | 105   | 106              | 106               | 101    | 104   | 100              |
| 1956.....     | 104     | 109   | 108              | 112               | 103    | 105   | 102              |
| 1957.....     | 107     | 110   | 115              | 115               | 106    | 108   | 105              |
| 1958.....     | 109     | 113   | 117              | 119               | 121    | 109   | 108              |
| 1959.....     | 110     | 113   | 118              | 120               | 129    | 110   | 109              |
| 1960.....     | 111     | 115   | 121              | 121               | 134    | 115   | 111              |
| 1961:         |         |       |                  |                   |        |       |                  |
| I.....        | 113     | 117   | 122              | 123               | 136    | 118   | 111              |
| II.....       | 114     | 117   | 122              | 124               | 136    | 119   | 111              |
| III.....      | 115     | 118   | 123              | 126               | 137    | 123   | 112              |
| IV.....       | 115     | 119   | 124              | 127               | 140    | 125   | 112              |
| 1962:         |         |       |                  |                   |        |       |                  |
| January.....  | 117     | 120   | 125              | 128               | 142    | 126   |                  |
| February..... | 117     | 121   | 125              | 128               | 142    | 126   | 112              |
| March.....    | 118     | 122   | 126              | 129               | 142    | 127   | 113              |
| April.....    | 119     | 122   | 127              | 130               | 143    | 128   | 113              |
| May.....      |         |       |                  |                   |        | 130   |                  |

Source: International Financial Statistics, July 1962.

**RESTRICTIONS UPON INTERNATIONAL CAPITAL TRANSFERS IN SELECTED COUNTRIES**

Incoming and outgoing capital payments by residents and nonresidents are subject to a wide variety of controls, licensing, and restrictions in various countries. The following comment covers only selected European countries, Japan, the United States, and Canada. It is not necessarily representative of the range or complexity of such regulations.

In the case of the United States and Canada there are no restrictions (except the more or less academic one of the United States requiring licenses for transfers to or from the mainland of China and North Korea).

In Switzerland transfers of capital may be made freely except with respect to a "controlled area" involving Bulgaria, Czechoslovakia, Rumania, etc., in which case licenses are required. It is sometimes said, however, that, because of the type of banking system which prevails in Switzerland, "moral suasion" may on occasion be actively employed as an effective instrument of national policy.

In Germany there are virtually no restrictions except for the important one that nonresidents may not own domestic treasury bills without an individual license.

In general, the United Kingdom and Sweden require approval of transfers but such approval is normally granted subject to stated regulations.

The significant thing about countries which, unlike Canada and the United States, do have systems of controls is the more or less elaborate specifications which tend to make it difficult to tell without exhaustive analysis just how much the restrictions really restrict and how much of possible transfers fall into an exempt category. Illustrative of the complexity of controls which may or may not be restrictive but challenge analysis are the cases of France and Japan.

Descriptions given in the reports of the International Monetary Fund on the capital controls in this selected group of countries as of the end of the first quarter of 1962 follow.

*France*

Most outward transfers of capital by residents require approval. Transfers in respect of legacies, dowries, and, subject to certain time limitations, emigration of foreign nationals, are permitted freely without special authorization. Capital assets abroad belonging to or acquired by residents are not subject to repatriation or surrender. Residents of foreign nationality may dispose freely of their assets abroad. Residents of French nationality are permitted to re-invest such assets either in quoted securities in accordance with a general authorization or in other investments under individual license. Subscriptions to new issues may be made only by using the proceeds from sales of securities already owned by residents of French nationality. Exchange proceeds from sales of foreign securities expressed in foreign currencies and owned by resi-

dents of French nationality (so-called *devises-titres*) may be sold at a free market rate to other residents of French nationality, who in turn may use the exchange only to purchase securities quoted in foreign markets.<sup>1</sup>

The following operations and transactions related to nonresident investments may be made freely, provided that the investment is financed in accordance with the prescription of currency regulations applicable to the country of residence of the foreign investor: (1) spot and forward purchases on stock exchanges in France of specified French securities<sup>2</sup> officially quoted on those stock exchanges; (2) subscriptions to an increase in the capital of a French company, provided that its shares are officially quoted on a stock exchange in France; (3) subscriptions, at the time of issuance, to short-term or long-term securities and bonds issued by a French public service organization or by a private enterprise having its head office in France, provided that the securities issued by a private enterprise are officially quoted on a stock exchange in France; (4) acquisition on a spot basis through the intermediary of a notary public of immovable property or rights to such property located in France; and (5) loans to residents in accordance with certain prescribed conditions (the exchange of letters between a lender and a borrower must explicitly stipulate that repayment will be made directly by the borrower to the authorized bank whose services were used in financing the operation, in order that the transfer of funds may be made in accordance with the regulations). The liquidation of these investments and the transfer of proceeds accruing from their liquidation may be made freely.

The import of French and foreign securities on behalf of residents or nonresidents is free, provided that it is carried out through the intermediary of an authorized bank. The export of French securities held in France is permitted if they are at the free disposal of a resident of the area of convertibility. The export of foreign securities on behalf of residents of foreign nationality is permitted only when such securities were held by them prior to September 10, 1939, or were acquired with a permit after that date. Immovable property and French securities in France belonging to nonresidents may be transferred between residents of all countries in the area of convertibility or between residents of the same bilateral country. Foreign securities held in France by nonresidents may be transferred between nonresidents irrespective of their country of residence.

### Japan

Foreign investments in Japan are generally subject to approval, mainly in accordance with the Foreign Investment Law (Law No. 163 of May 10, 1950). All acquisitions of stocks, debentures, beneficiary certificates, and claims in the form of loans by foreign investors are subject to individual license if a guarantee for remittance of income or principal is desired. However, acquisitions of stocks in the securities market are generally approved up to 15 percent of the stock of any corporation not classified as a restricted industry and up to 10 percent of the stock of any corporation classified as a restricted industry.<sup>3</sup> All these acquisitions must be made against the yen proceeds from the sale of foreign exchange or its equivalent. Stocks in the form of stock dividends on earned surplus or revaluation of assets may be acquired freely, but application for remittance rights must be made within three months from the date of acquisition. The following are deemed to be the same as the yen proceeds from the sale of foreign exchange, if they are reinvested in Japan: proceeds from the redemption after maturity of debentures, beneficiary certificates, or claims in the form of loans; dividends on stocks; interest on debentures or on claims in the form of loans; distributed profits of beneficiary certificates; receipts from technological assistance contracts; and proceeds from sales of stocks, debentures, and beneficiary certificates.

In the event of expropriation or compulsory sale of a foreign investment, the amount paid on account of expropriation may be repatriated freely.

For the purpose of facilitating new foreign investment, the following two formulas have been established: (1) Since July 21, 1959, applicants have been able to obtain "conditional approval" under the Foreign Investment Law for a foreign investment in Japan. For investments so approved, the remittance of principal and earnings is guaranteed, subject to the condition that the Government can temporarily defer the remittance if Japan's balance-of-payments

<sup>1</sup> The system of *devises-titres* was abolished with effect from April 1, 1962.

<sup>2</sup> Securities expressed in foreign currencies and issued by French companies or organizations are considered as foreign securities.

<sup>3</sup> Restricted industries include waterworks, railways and other transportation, electric and gas utilities, and banks.

situation so requires. (2) A "prior designation" procedure under the Foreign Exchange and Foreign Trade Control Law has also been operative since July 21, 1959. For a foreign investment so designated by the authorities at the time the investor acquires an equity investment (stocks, debentures, and beneficiary certificates) or concludes a technological assistance contract, the remittance of earnings and principal will be automatically approved, subject to the condition that the remittance can be deferred temporarily if Japan's balance-of-payments situation so requires.

Proceeds of liquidated stocks, debentures, and beneficiary certificates may be remitted after two years from the date of acquisition. Proceeds from sales of stocks, debentures, and beneficiary certificates sold within two years from the date of acquisition are deposited in Nonresident Yen Deposit Accounts, balances on which can be transferred to another nonresident in return for foreign currency. Rights to the allotment of newly issued stocks may be sold if the issuing company gives its consent, or the value of the rights can be realized by selling the stocks with rights and purchasing the same stocks without rights or purchasing other stocks. (This constitutes a preferential treatment of foreign investors since, under the Japanese commercial code, the right to the allotment of newly issued stocks may not be sold.)

Investors who obtain a license or approval to acquire an equity investment with yen from a Nonresident Yen Deposit Account may have the income remitted and the principal credited to a Nonresident Yen Deposit Account.

All other capital transactions and transfers having an exchange control aspect are subject to individual license, although in practice, for most transactions, an exchange license is not required for foreign investment in Japan if the investor desires neither remittance of income or principal nor credit to a Nonresident Yen Deposit Account.

Transfers of capital abroad and investments abroad by residents are subject to approval.

Securities acquired with approval under the Foreign Investment Law may be imported and exported freely.

#### *Belgium-Luxembourg*

All capital transactions may be carried out freely through the free market or by settlement in Belgian or Luxembourg francs through the Financial Account of a nonresident. In addition, incoming capital may be received in convertible currencies through the official market or in Belgian or Luxembourg francs to the debit of a Convertible Account. The exchange control authorities may guarantee the repatriation of approved foreign investments made in Belgium-Luxembourg. In that case, capital brought in through the official market may be repatriated through that market. All transactions in securities by residents or nonresidents are free, but the financial settlement of such transactions must conform to the general regulations.

#### *United Kingdom*

Transfers of resident capital to countries outside the Sterling Area require approval, which normally is granted for commercial investment that promises to produce clear and commensurate benefits to U.K. export earnings and thus to the balance of payments in the short term. Permission may be obtained to invest foreign currency capital receipts in marketable securities expressed in foreign currency, but any such receipts in a specified currency (see footnote 2) which have not been invested within six months must be sold to an authorized bank.

Repayments abroad due to a nonresident in respect of matured capital obligations are permitted freely; otherwise, repayments non-resident-owned capital may be credited only to Blocked Accounts (see section on Nonresident Accounts, above). However, residents of Denmark, Norway, and Sweden may transfer their funds freely to their respective countries. Persons resident outside the Sterling Area who make direct investments in the United Kingdom must provide one of the specified currencies or sterling from an External Account. Capital directly invested by a nonresident after January 1, 1950, in projects approved by the exchange control authorities may be repatriated at any time, together with profits thereon.

Nonresidents may buy sterling securities on a recognized stock exchange in the United Kingdom against payment from an External Account; or, if the securities cannot be redeemed under any contractual provision within five years from the date of purchase and are not optionally payable in dollars or, in respect of securities issued on or after June 23, 1961, are not optionally payable in any other for-



foreign currency, they may be purchased with sterling from a Blocked Account. Nonresidents may sell sterling securities in the United Kingdom, provided that the proceeds are credited to a Blocked Account or reinvested in a Sterling Area security having at least five years to maturity (special facilities apply to residents of Denmark, Norway, and Sweden). Interest, dividends, etc., from such securities and the proceeds at maturity of any that are redeemable may be remitted to the country of residence of the owner or credited to any External Account.

Nonresidents may purchase officially quoted nonsterling securities with sterling from an External Account. Such securities may not be resold on a stock exchange in the United Kingdom, but may be exported.

Residents may sell outside the Sterling Area a security expressed in foreign currency and reinvest the proceeds in other marketable securities expressed in foreign currency; however, if the security sold is a U.S. or Canadian dollar security, the securities purchased must be U.S. or Canadian dollar marketable securities. Residents of the United Kingdom are required to obtain permission to acquire foreign currency securities from residents of other parts of the Sterling Area.

#### *Sweden*

Investments in Sweden by nonresidents are subject to approval. Such approval is normally granted where direct investments are concerned. Transfers from Sweden on account of dividends and other earnings on investments, interest on loans, and contractual amortization of bonds and debentures are permitted freely. Inheritances due to nonresidents may also be transferred. The repatriation of other non-resident-owned capital is subject to approval, which is, however, usually granted. Emigrants may transfer abroad up to the equivalent of Skr100,000 for each person, on special application.

Requests by residents to transfer capital abroad for direct investment are considered on their merits and are in most cases approved. Residents may, on special application, transfer capital abroad for the purchase for recreational purposes of real estate of a maximum value of Skr50,000. Transfers of capital abroad for portfolio investment are permitted only exceptionally.

Securities may be imported into Sweden through the intermediary of an authorized bank; however, their disposal is subject to approval. The export of securities is, in principle, also subject to approval.

Residents of Sweden who own foreign securities—other than those representing a direct investment—are permitted to use within six months the proceeds from the sale of these securities abroad to invest in other foreign securities denominated in a currency of the convertible area or in Swedish kronor; these proceeds may not, however, be transferred to another resident (other than an authorized bank). Residents are permitted to buy from and sell to other residents such foreign securities held in Sweden.

#### *Canada*

No exchange control obligations are imposed on capital receipts or payments by either residents or nonresidents.

#### *Germany*

There are virtually no restrictions on imports or exports of capital by residents or nonresidents, and such transactions may be carried out freely without an individual license. However, domestic money-market paper (Treasury bills, etc.) and domestic fixed-interest-bearing securities—if in the later case the contracts contain an obligation to reacquire the securities later at a definitely fixed price—may not be sold to nonresidents without an individual license. All capital movements to or from foreign countries exceeding DM500 or the equivalent in foreign currency must be reported when a maturity of 12 months or more has been fixed at the time of concluding the contract. Securities of all types may be imported or exported freely.

#### *Switzerland*

Transfers of capital from countries in the sector of controlled payments require licenses if they are made through the sector of controlled payments; transfers of capital to such countries do not require licenses. Transfers of capital to and from other countries may be made freely, except that certain outgoing transfers of capital exceeding Sw F 10 million each require permission.

Nonresident accounts related to the sector of controlled payments may be grouped as follows: (1) accounts related to Bulgaria, Czechoslovakia, Greece, Hungary, Poland, Rumania, Turkey, and Yugoslavia, which are centralized with the Swiss National Bank, and (2) the "decentralized" group, comprising accounts that may be held with the Swiss National Bank and with authorized banks in Switzerland. The accounts of the second group are of two kinds: the accounts of Eastern Germany and Iran, which are transferable only to other accounts of the same nationality, and the accounts of the United Arab Republic, which are subject to special treatment.

#### *Denmark*

Residents have an obligation to repatriate proceeds realized from assets abroad. Transfers abroad may be made by residents to pay interest on, to redeem, or to repurchase the transferor's own bonds, to lend amounts not exceeding DKr 200,000 to subsidiary companies, etc., or to a member of the resident's family, and to buy foreign securities that do not represent direct investments in foreign commercial or industrial enterprises, provided that the securities are acquired on the basis of a subscription right to shares or the like owned by the resident concerned or the resident furnishes proof that he has repatriated a corresponding amount within the last 12 months from the sale of foreign securities to a nonresident. Permission from the National Bank is required for most other transfers abroad of a capital nature by residents.

Danish emigrants are granted an exchange allowance of up to DKr 40,000 a year for each person during the first three years after emigration. Funds exceeding this amount must be credited to a Capital Account in the name of the owner and may be transferred abroad after three years.

Direct investment in Denmark by nonresidents may be made without any special license if the transaction concerns industry, commerce, handicrafts, hotel business, or transportation, and if the investment does not increase total direct foreign investment in the enterprise concerned by more than DKr 40,000 in each calendar year. Other direct investment by nonresidents requires permission, which is granted liberally. The purchase by a nonresident of real property in Denmark usually requires a special license from the Ministry of Justice. A nonresident who is or has been a Danish national may freely purchase or subscribe to securities expressed solely in Danish kroner which do not represent direct investment. Other nonresidents may purchase or subscribe to bonds that are quoted daily and are expressed solely in Danish kroner, when the funds have been obtained from the liquidation of investments in Denmark. They may purchase or subscribe to shares that are quoted daily and are expressed solely in Danish kroner, when the funds have been obtained from the liquidation of Danish shares or when the acquisition is made on the basis of subscription rights to shares. Nonresidents may grant credits within certain limits to residents to finance purchases of commodities abroad and to finance the granting of credits for exports. They may, further, grant loans up to DKr 200,000 per borrower in a calendar year to commercial and industrial enterprises connected with the lender as subsidiary companies, branches, etc., or to members of their families.

Transfers of proceeds from the sale or liquidation of all sorts of investments and other funds in Denmark owned by nonresidents other than newly emigrated Danish nationals are permitted freely, irrespective of when and how the original investment was acquired. Interest and repayment of principal on authorized loans, credits, and deposits received from persons and firms who were nonresidents at the time of receipt may be paid freely.

Inheritances may be transferred freely to any country without limitation. Individual payments as gifts to persons who are not relatives of the donor may not exceed DKr 2,000.

Imports and exports of securities require permission from the National Bank. Bona fide imports of Danish securities payable only in Danish kroner are permitted. Exports of Danish and foreign securities owned by nonresidents are normally permitted also. Danish securities held in Denmark and belonging to nonresidents may be sold freely to residents. Foreign securities held in Denmark and belonging to nonresidents may be sold to residents only with the National Bank's permission.

*Italy*

In accordance with the provisions of Law No. 43 of February 7, 1956, the repatriation of capital invested in the establishment or expansion of productive enterprises and the transfer of income thereon are not restricted. For other registered investments, the original capital may be repatriated after a minimum period of two years. All other foreign capital may be repatriated freely through Capital Accounts (see section on Nonresident Accounts, above).

Italian companies may freely take up participations in foreign companies and purchase foreign shares, provided that such investments are in their lines of business and are intended to facilitate the expansion of the firms' activities abroad. Residents may make other investments in countries of the European Economic Community in accordance with the Community's program of liberalization of capital movements (direct investments and their liquidation, movements of personal capital, short-term and medium-term commercial credits, etc.). In addition, specified financial institutions may buy and sell stocks and bonds issued and payable abroad; and all residents, without distinction, may buy and sell bonds issued by international financial organizations in which Italy participates as a member country. Other investments abroad by residents are subject to approval, which is granted only when such investments are considered economically advantageous.

The export of securities is not permitted, except of those which are owned by nonresidents and have been purchased against U.S. dollars, Canadian dollars, or externally convertible European currencies, or against funds on a Foreign Account or Capital Account.

*Netherlands*

Inward and outward capital transfers and the shifting of foreign-owned capital within the Netherlands from one asset to another are subject to control, but general licenses have been granted for most types of capital transaction.

New capital investments in the Netherlands by nonresidents are in general permitted only if made in convertible currencies. All authorized capital transactions, other than transactions in securities, take place at the official exchange market rates. All payments in respect of transactions in securities are channeled through a free market, where payments and receipts must be either in guilders through K Accounts or in convertible currencies through "reinvestment" accounts (see below). In addition, nonresidents may debit their Convertible Guilder Accounts to pay residents for transactions in securities.

Residents may buy foreign securities from, or sell them to, other residents. Residents may sell securities abroad against any foreign currency. The exchange so acquired must be deposited with an authorized bank or securities broker in the Netherlands and may be sold or retained. If convertible currencies are acquired, a "reinvestment" account may be credited. "Reinvestment" accounts may be used to buy securities officially quoted either in the Netherlands or abroad.

Nonresidents may have their securities, Netherlands or foreign, exported to them, except securities held in W-deposits.

Emigrants may avail themselves of the same facilities as travelers (see section on Payments for Invisibles, above), i.e., export up to f. 14,250 for each person. Emigrants acquire the status of nonresidents upon leaving the Netherlands, provided that they have declared their intention to settle abroad for more than three years; they may then have remitted to them the total of their assets in the Netherlands.

## CORPORATE PROFITS

## SUMMARY

The so-called profit squeeze is not found to exist.

In the first place the significant measure of profitability is not profits alone but total after tax income—including depreciation. In other words, the significant income measure is not profits but the total income to capital.

Second, as has been previously pointed out, income to capital is a function of the rate at which capital is used. At low rates of capacity utilization, corporate incomes are low; and at high rates of capacity utilization, corporate incomes are high. Furthermore, the income to capital varies much more widely than does volume of production.

The attached memorandum finds that the income to capital has not been squeezed in recent years, but rather, the converse. Since 1956, the total income

to capital has been substantially higher than would be expected from the average relationship between corporate incomes and capacity utilization which has prevailed over the span of years 1929-50. Moreover, the attached analysis does not take into account the shortened depreciation guidelines announced by the Treasury last month. The effect of these new guidelines will be substantially to increase income to capital, although, most probably, to reduce corporate profits, since relatively less of the cash flow to corporations will be counted as profits and relatively more will be counted as depreciation.

One minor refinement in the formula which has been derived for the average relationship between corporate incomes and capacity utilization might be noted: Historically, it is found that corporate incomes are determined not solely by the rate at which capacity is used, but, also, to a lesser extent, by the rate at which output is increasing. In other words, corporate incomes tend to be higher when output is increasing very rapidly than when capacity is used to the same degree, but there have been no recent increases in output.

#### CORPORATE PROFITS IN HISTORICAL PERSPECTIVE

One of the most widely discussed aspects of the state of the economy is the so-called profits squeeze. In using this phrase, observers commonly have referred to a decline in corporate profits, after taxes, as a percentage of the gross national product—from about 8 percent in 1950 to about 4.5 percent in 1961. The reduction in this ratio is then used as an explanation of the reduced level of investment, which, in turn, is then used as an explanation for the lack of vigor in the economy in recent years. From the initial premise that corporate profits have been squeezed, there has developed a whole complex of arguments for changing the income shares in favor of corporate profits, as a means of encouraging increased investment.

It is the purpose of this brief analysis to develop a consistent procedure for measuring the magnitude of corporate cash flow after taxes of corporations, and then to use this procedure to test whether corporate cash flows are indeed lower in relation to economic conditions than would be consistent with past relationships existing prior to 1950.

At the very outset, it must be pointed out that the usual procedures of dividing corporate profits, after taxes, by the GNP, is not a valid measure of whether the corporate income share is too high or too low, or is rising or falling. There are four reasons for this:

(1) Corporate profits, after taxes, are net of depreciation while the GNP is, on the other hand, as the name indicates, gross of depreciation;

(2) Corporations account in good years for about half the GNP, and significantly less than this in recession years, so that dividing profits by GNP means that much economic activity is included in the denominator of the fraction which does not relate directly to the profits in the numerator of the fraction;

(3) A corporation can pay dividends or make investments in its business out of its total cash flow regardless of whether or not this appears on its books in the form of profits, after taxes, or in the form of tax free charges for depreciation on capital. From the standpoint of investment analysis it is this cash flow to the business that counts, not the form in which it is received; and

(4) The cash flow of a corporation is influenced not merely by the level of the GNP in a particular year, but also by the difference between the GNP and what it would be at high levels of employment—which we call potential GNP—and by the speed with which economic activity is changing; i.e., is the economy growing rapidly, slowly or falling.

An inspection of the ratios of profits and corporate cash flows to actual and potential GNP, which are shown on the accompanying chart, reveal two points:

(1) Profits fluctuate very much more widely than does GNP;

(2) There appears to be a modest downward trend in the ratio of corporate profits to the GNP over the period from 1929 to date; but

(3) There is little evidence of a decline in the cash flow ratio, except for comparison with 1929, which seems out of line with all the following years.

Not quite so obvious from the chart, but which can be detected if one examines the data carefully by statistical means, is the fact that the various corporate profits ratios tend to be highest (and tend to rise the most over the

preceding year) in those years when the GNP itself is rising most rapidly. The reverse becomes true when the GNP is falling. In fact, when GNP is either stationary or rising only moderately, corporate profits tend to fall as a ratio to GNP. In brief, the record suggests that corporate profits are particularly sensitive to the speed with which the economy is moving and to the degree to which the economy's productive resources of labor and capital are currently being utilized. High employment and a rapid rate of growth is accompanied by high profits, and contrariwise, widespread idle labor and capital and a low rate of growth mean low profits. A test was made by standard least squares statistical procedures as to the relationship between the corporate cash flow and actual and potential gross national product. The data were fitted for the years 1929-41, and the years 1947, 1948, and 1949 inclusive, giving a total of 16 years in all. (Periods of price controls and the excess profits tax are omitted.) From this procedure was derived a formula as follows:

Calculated corporate cash flow equals \$1 billion, plus .0945 (potential GNP), plus .22 (actual GNP minus potential), plus .09 (GNP of the current year minus GNP of the previous year).

Using this formula, corporate cash flows were calculated for each of the years 1929 through 1961. This calculated corporate cash flow was then divided by the actual GNP for each year. The resulting ratios are plotted with a dashed line in the lower panel of the chart. It will be noted that the calculated and actual ratios of cash flow to GNP follow each other very closely for most of the years up through 1955, except for the years of World War II and the Korean rearmament when excess profit taxes were in force for corporations and various restrictions existed on prices, production, etc., which would limit the corporate cash flow to less than usual levels.

Toward the end of the period, after the tax code changes of 1954 began to be effective, the actual corporate cash flow tends to run somewhat above the computed level year after year. The fact that this gap is consistent rather than a random alternating pattern of pluses and minuses is significant. It tends to indicate that some new and consistent factor has entered into the situation, such as occurred during World War II and the Korean period. One factor that might account for this consistent excess of the actual over the computed corporate cash flow is the accelerated amortization procedures authorized for private businesses, including corporations, under the tax revisions of 1954.

The gap in recent years has amounted to about 0.9 percent of gross national product, or in dollars to about \$4 billion at prevailing prices of these years. How much of this \$4 billion, approximately, can be accounted for by the accelerated amortization procedures authorized in 1954? The Secretary of the Treasury has recently stated that the Treasury believes these provisions to have added about \$2.5 billion to business charges for depreciation over and beyond what would have been taken under the code prevailing prior to 1954. Apparently this does not include depreciation for corporations which reported losses and it does include depreciation for both corporate and noncorporate business.

It may be estimated, therefore, that probably about \$2 billion in additional depreciation charges have been claimed by corporate businesses as a result of the 1954 changes in the tax code. This would amount to about one-half of the \$4 billion gap between actual and computed corporate cash flow for the last 3 years revealed by this analysis.

It may well be that the Treasury's estimates are too conservative and that more of the \$4 billion is due to accelerated depreciation. It may also be that the formula is producing too low an estimate of the calculated cash flow and, hence, too large a gap between actual and computed. However, an inspection of the performance of the formula over the entire period casts severe doubts on this possibility—in fact, one might well have a suspicion that a formula of this type fitted over this particular span would tend to have an upward bias and would tend in recent years to overestimate rather than underestimate the calculated corporate cash flow. The formula tends to underestimate in 1929, then to overestimate slightly at the cyclical peak in 1937, in 1941, 1946, 1947, and again in 1954-55. In a word, it appears that, if anything, the formula seems to have a slight upward tilt.

Another possible explanation of part of this \$4 billion gap would be that some industries have, under the pressure of competition and reduced business volume of recent years, managed to reduce their costs relative to their prices and hence to have improved modestly their profit margins. In any case, it will

be noted that the unexplained gap is a very small sum indeed compared to a total cash flow of about \$50 billion a year.

On the basis of this analysis, the corporate cash flow in recent years has been, if anything, high by historical standards, rather than low as many have suggested. Furthermore, at least part of the excess in recent years can be accounted for by the change in depreciation schedules in 1954. It also suggests that the ratio of corporate cash flow to GNP would be higher if the economy were growing vigorously and resources were being used more nearly in line with optimum conditions such as are measured by the potential GNP.

This analysis does not take into account any impact on corporate cash flows from the newly announced revision in Bulletin F which provides new guidelines for business deductions for depreciation under the tax code. These provisions would apparently have a potential at present levels of investment and GNP of adding perhaps as much as \$3.5 billion to corporate depreciation charges. This would add between \$1.5 and \$2 billion to the total corporate cash flow, allowing for the effects on corporate profits and tax liabilities. On this basis, the gap of \$4 billion between actual and calculated, that has appeared in recent years, would be enlarged by about one-half, and a 7-percent investment credit, if enacted, would further expand this excess.

Analysis of total corporate cash flow, therefore, provides little basis for attributing low investment in recent years to reduced profit margins, or to a "profits squeeze" in other words. What seems to have happened has been a lower volume of operations and a lower cash flow, but with the same or even higher profit margin, if, by "profit margin" we mean what is ordinarily meant—the margin that would be realized at a standard or optimum volume of operations.

*The share of corporate business in gross national product, 1929-61*

[Ratios derived from data measured in current prices]

| Year      | Ratio of national income<br>originating in corpora-<br>tions to— |                  | Ratio of national income<br>originating in corpora-<br>tions plus their capital<br>consumption allowances<br>to— |                  |
|-----------|------------------------------------------------------------------|------------------|------------------------------------------------------------------------------------------------------------------|------------------|
|           | Actual<br>GNP                                                    | Potential<br>GNP | Actual<br>GNP                                                                                                    | Potential<br>GNP |
| 1929..... | 0.433                                                            | 0.441            | 0.475                                                                                                            | 0.483            |
| 1930..... | .423                                                             | .366             | .471                                                                                                             | .407             |
| 1931..... | .371                                                             | .295             | .427                                                                                                             | .340             |
| 1932..... | .315                                                             | .213             | .383                                                                                                             | .259             |
| 1933..... | .309                                                             | .203             | .377                                                                                                             | .247             |
| 1934..... | .360                                                             | .256             | .415                                                                                                             | .295             |
| 1935..... | .372                                                             | .285             | .423                                                                                                             | .325             |
| 1936..... | .391                                                             | .391             | .435                                                                                                             | .370             |
| 1937..... | .414                                                             | .362             | .456                                                                                                             | .399             |
| 1938..... | .379                                                             | .307             | .424                                                                                                             | .343             |
| 1939..... | .397                                                             | .338             | .440                                                                                                             | .374             |
| 1940..... | .421                                                             | .379             | .461                                                                                                             | .415             |
| 1941..... | .448                                                             | .452             | .484                                                                                                             | .488             |
| 1942..... | .458                                                             | .497             | .490                                                                                                             | .532             |
| 1943..... | .458                                                             | .528             | .486                                                                                                             | .561             |
| 1944..... | .426                                                             | .504             | .456                                                                                                             | .536             |
| 1945..... | .386                                                             | .437             | .417                                                                                                             | .473             |
| 1946..... | .410                                                             | .414             | .434                                                                                                             | .439             |
| 1947..... | .447                                                             | .444             | .474                                                                                                             | .470             |
| 1948..... | .464                                                             | .468             | .494                                                                                                             | .498             |
| 1949..... | .447                                                             | .432             | .480                                                                                                             | .464             |
| 1950..... | .465                                                             | .471             | .498                                                                                                             | .504             |
| 1951..... | .466                                                             | .488             | .499                                                                                                             | .523             |
| 1952..... | .457                                                             | .475             | .492                                                                                                             | .511             |
| 1953..... | .463                                                             | .481             | .501                                                                                                             | .522             |
| 1954..... | .450                                                             | .442             | .493                                                                                                             | .485             |
| 1955..... | .463                                                             | .471             | .510                                                                                                             | .518             |
| 1956..... | .466                                                             | .461             | .513                                                                                                             | .509             |
| 1957..... | .458                                                             | .442             | .507                                                                                                             | .490             |
| 1958..... | .440                                                             | .404             | .492                                                                                                             | .451             |
| 1959..... | .457                                                             | .430             | .508                                                                                                             | .477             |
| 1960..... | .452                                                             | .421             | .503                                                                                                             | .468             |
| 1961..... | .444                                                             | .407             | .497                                                                                                             | .455             |

Source: U.S. Department of Commerce, and staff of the Joint Economic Committee.

*Measures of corporate cash flow as a share of national output and incomes, 1929-61*

[Ratios derived from data measured in current prices]

| Year      | Ratio of corporate profits after tax to— |               |                                             | Ratio of corporate cash flow <sup>1</sup> to— |               |                                                       | Ratio of calculated <sup>2</sup> corporate cash flow <sup>1</sup> to— |               |                                                       |
|-----------|------------------------------------------|---------------|---------------------------------------------|-----------------------------------------------|---------------|-------------------------------------------------------|-----------------------------------------------------------------------|---------------|-------------------------------------------------------|
|           | Actual GNP                               | Potential GNP | National income originating in corporations | Actual GNP                                    | Potential GNP | Gross income originating in corporations <sup>3</sup> | Actual GNP                                                            | Potential GNP | Gross income originating in corporations <sup>3</sup> |
| 1930..... | 0.080                                    | 0.081         | 0.184                                       | 0.122                                         | 0.124         | 0.256                                                 | 0.111                                                                 | 0.113         | 0.234                                                 |
| 1931..... | .027                                     | .024          | .065                                        | .076                                          | .066          | .161                                                  | .072                                                                  | .063          | .153                                                  |
| 1932..... | -.017                                    | -.014         | -.046                                       | .039                                          | .031          | .092                                                  | .058                                                                  | .046          | .135                                                  |
| 1933..... | -.058                                    | -.039         | -.185                                       | .010                                          | .007          | .027                                                  | .024                                                                  | .016          | .063                                                  |
| 1934..... | -.007                                    | -.005         | -.023                                       | .060                                          | .040          | .161                                                  | .043                                                                  | .028          | .114                                                  |
| 1935..... | .015                                     | .011          | .043                                        | .071                                          | .050          | .170                                                  | .074                                                                  | .052          | .178                                                  |
| 1936..... | .030                                     | .023          | .081                                        | .081                                          | .062          | .192                                                  | .080                                                                  | .061          | .189                                                  |
| 1937..... | .052                                     | .044          | .133                                        | .097                                          | .082          | .222                                                  | .096                                                                  | .081          | .219                                                  |
| 1938..... | .027                                     | .022          | .071                                        | .072                                          | .058          | .169                                                  | .070                                                                  | .057          | .166                                                  |
| 1939..... | .055                                     | .047          | .138                                        | .098                                          | .083          | .222                                                  | .089                                                                  | .076          | .202                                                  |
| 1940..... | .065                                     | .058          | .153                                        | .104                                          | .094          | .226                                                  | .098                                                                  | .088          | .213                                                  |
| 1941..... | .075                                     | .075          | .167                                        | .110                                          | .111          | .228                                                  | .122                                                                  | .123          | .251                                                  |
| 1942..... | .060                                     | .065          | .130                                        | .092                                          | .100          | .187                                                  | .129                                                                  | .141          | .264                                                  |
| 1943..... | .055                                     | .063          | .119                                        | .083                                          | .096          | .171                                                  | .132                                                                  | .152          | .271                                                  |
| 1944..... | .049                                     | .058          | .115                                        | .079                                          | .093          | .173                                                  | .127                                                                  | .150          | .278                                                  |
| 1945..... | .039                                     | .044          | .101                                        | .070                                          | .080          | .168                                                  | .115                                                                  | .130          | .275                                                  |
| 1946..... | .064                                     | .064          | .155                                        | .088                                          | .089          | .203                                                  | .099                                                                  | .100          | .228                                                  |
| 1947..... | .078                                     | .077          | .174                                        | .105                                          | .104          | .221                                                  | .107                                                                  | .106          | .226                                                  |
| 1948..... | .079                                     | .080          | .170                                        | .109                                          | .110          | .220                                                  | .108                                                                  | .109          | .219                                                  |
| 1949..... | .062                                     | .060          | .139                                        | .095                                          | .092          | .198                                                  | .093                                                                  | .091          | .195                                                  |
| 1950..... | .080                                     | .081          | .172                                        | .113                                          | .115          | .227                                                  | .108                                                                  | .110          | .217                                                  |
| 1951..... | .060                                     | .063          | .129                                        | .093                                          | .098          | .187                                                  | .115                                                                  | .121          | .231                                                  |
| 1952..... | .050                                     | .051          | .109                                        | .085                                          | .088          | .173                                                  | .107                                                                  | .111          | .217                                                  |
| 1953..... | .050                                     | .052          | .107                                        | .088                                          | .092          | .176                                                  | .107                                                                  | .111          | .213                                                  |
| 1954..... | .046                                     | .045          | .103                                        | .090                                          | .088          | .182                                                  | .094                                                                  | .093          | .192                                                  |
| 1955..... | .058                                     | .059          | .125                                        | .104                                          | .106          | .204                                                  | .107                                                                  | .109          | .210                                                  |
| 1956..... | .056                                     | .056          | .120                                        | .104                                          | .103          | .202                                                  | .100                                                                  | .100          | .196                                                  |
| 1957..... | .050                                     | .049          | .110                                        | .100                                          | .096          | .196                                                  | .097                                                                  | .094          | .191                                                  |
| 1958..... | .042                                     | .039          | .096                                        | .093                                          | .086          | .190                                                  | .086                                                                  | .079          | .174                                                  |
| 1959..... | .051                                     | .048          | .111                                        | .101                                          | .095          | .199                                                  | .096                                                                  | .090          | .188                                                  |
| 1960..... | .046                                     | .043          | .101                                        | .097                                          | .090          | .193                                                  | .091                                                                  | .085          | .180                                                  |
| 1961..... | .045                                     | .041          | .101                                        | .098                                          | .090          | .197                                                  | .088                                                                  | .080          | .177                                                  |

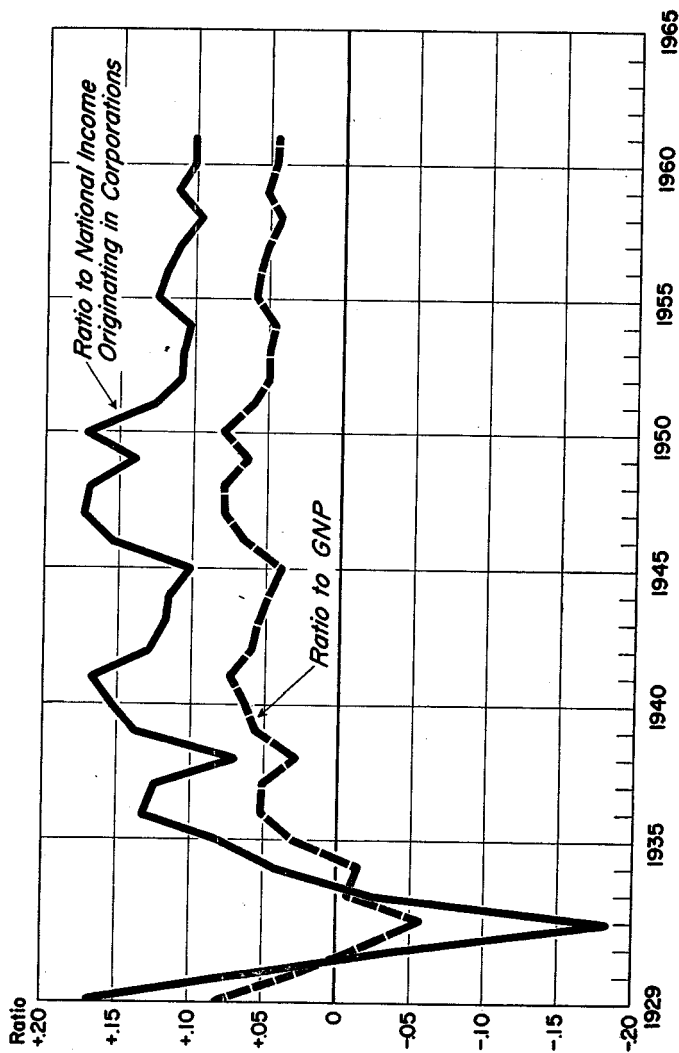
<sup>1</sup> Corporate cash flow consists of corporate profits after tax plus corporate capital consumption allowances.

<sup>2</sup> Gross income originating in corporations consists of national income originating in corporations plus corporate capital consumption allowances.

<sup>3</sup> Calculated corporate cash flow is derived from formula given in text on p. 3.

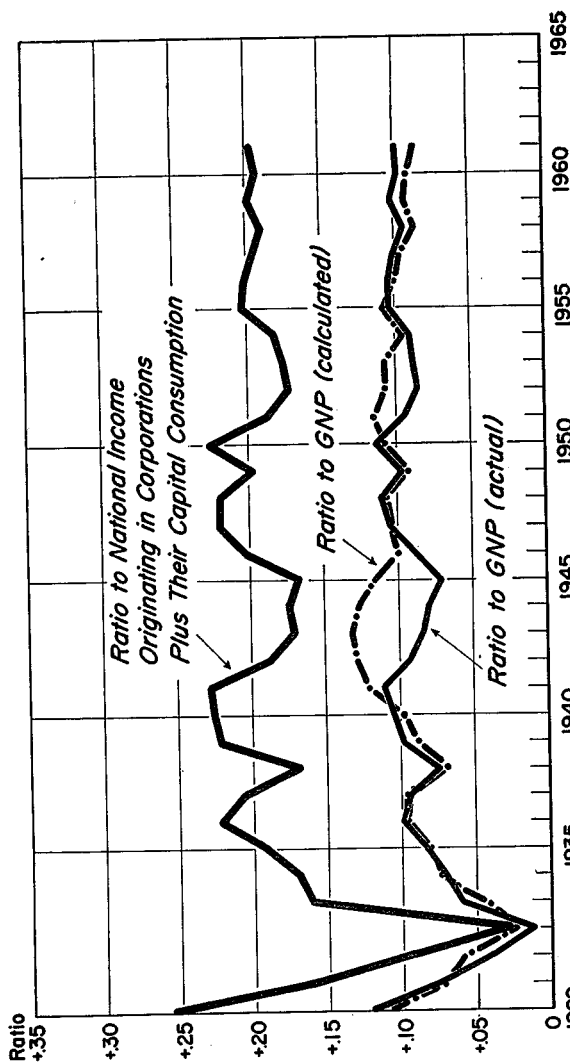
Source: U.S. Department of Commerce and staff of the Joint Economic Committee.

# Ratio of Corporate Profits after Tax to Gross National Product and to National Income Originating in Corporations





# Ratio of Corporate Profits after Tax plus Corporate Capital Consumption to Gross National Product and to National Income Originating in Corporations plus Their Capital Consumption



Source: U.S. Department of Commerce and Staff, Joint Economic Committee

BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM,  
Washington, D.C., August 9, 1962.

HON. WRIGHT PATMAN,  
*Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.*

DEAR MR. PATMAN: In reply to your letter of August 3, I am sending you tables on System transactions in U.S. Government securities by maturity System exchanges in Treasury refundings, and dealer sales and purchases U.S. Government securities. The data on System transactions, shown in the enclosed table, cover operations in the first 7 months of 1962; corresponding figures for the months of 1961 were published in the Federal Reserve Board's annual report for 1961 (p. 132). The tables on System exchanges and dealer transactions cover the year 1961 and the period to date in 1962.

It should be pointed out that the figures on System transactions and those on dealer purchases and sales are not strictly comparable in two respects. First, System open market operations, particularly in the shorter maturity categories, frequently involve direct transactions with foreign official and international accounts as well as transactions with dealers. The former transactions of course are not reflected in the data reported by dealers. Secondly, the two sets of data differ slightly in respect to their timing. Thus, dealer transactions are reported in terms of the date when commitments to buy or sell were made, while System operations are recorded in terms of the date when securities purchased or sold were actually delivered—which may often be 1 business day following the commitment. For these reasons, inferences from the data concerning the System's "share" of total market activity cannot be precise.

Tables 3 and 4 show an unpublished breakdown of dealer transactions between purchases and sales. When the publication program on the Government securities market was initiated just over a year ago, it was with the understanding with the reporting dealers that data on purchases and sales would be published on a combined basis only. In this way it was felt that the public's interest in having adequate and prompt information on volume of trading in the market would be served. Accordingly, should the Joint Economic Committee want to make use of the data in a way involving their public release, it would be desirable for us to discuss the matter with those who voluntarily supply this information.

We shall, of course, be glad to try to answer any questions that the committee or its staff may have concerning technical or other aspects of the data.

Sincerely yours,

WM. MCC. MARTIN, Jr.

*U.S. Government securities dealer sales and purchases (this table combines the data referred to as tables 3 and 4 in above letter)*

[In millions of dollars]

| Month             | Total   | Within 1 year | 1 to 5 years | 5 to 10 years | Over 10 years |
|-------------------|---------|---------------|--------------|---------------|---------------|
| 1961—January..... | 33,919  | 23,363        | 8,873        | 1,193         | 490           |
| February.....     | 24,567  | 16,817        | 6,352        | 836           | 562           |
| March.....        | 34,512  | 25,166        | 7,058        | 1,552         | 734           |
| April.....        | 30,450  | 23,992        | 4,124        | 1,645         | 688           |
| May.....          | 33,413  | 24,030        | 6,585        | 2,022         | 775           |
| June.....         | 30,424  | 25,147        | 3,841        | 923           | 514           |
| July.....         | 35,666  | 28,814        | 5,613        | 974           | 267           |
| August.....       | 32,089  | 26,969        | 3,720        | 952           | 450           |
| September.....    | 28,839  | 23,695        | 3,530        | 934           | 680           |
| October.....      | 35,488  | 29,168        | 5,341        | 574           | 404           |
| November.....     | 33,728  | 25,893        | 6,174        | 812           | 849           |
| December.....     | 33,052  | 26,557        | 4,557        | 904           | 1,033         |
| Total.....        | 386,145 | 299,609       | 65,769       | 13,320        | 7,448         |
| 1962—January..... | 37,764  | 32,502        | 3,268        | 1,415         | 579           |
| February.....     | 35,453  | 27,363        | 5,316        | 1,707         | 1,071         |
| March.....        | 36,838  | 29,307        | 4,764        | 1,525         | 1,240         |
| April.....        | 33,773  | 27,000        | 3,593        | 2,277         | 902           |
| May.....          | 37,257  | 29,420        | 4,785        | 2,506         | 544           |
| June.....         | 35,291  | 28,497        | 4,006        | 2,090         | 699           |
| July.....         | 35,323  | 30,588        | 2,916        | 1,329         | 490           |

NOTE 1.—Does not include redemptions of Treasury issues or transactions under repurchase agreements, reverse repurchase (resale) or similar contracts.

NOTE 2.—Does not include securities received on direct allotment from the Treasury or transactions under repurchase agreements, reverse repurchase (resale) or similar contracts.

*Total Federal Reserve credit and net free reserves by class of bank*

[In millions of dollars]

|              | Total<br>Federal<br>Reserve<br>credit <sup>1</sup> | New York | Net free reserves <sup>2</sup> |                   |                  | Total |
|--------------|----------------------------------------------------|----------|--------------------------------|-------------------|------------------|-------|
|              |                                                    |          | Chicago                        | Reserve<br>cities | Country<br>banks |       |
|              | 18,567                                             | 60       | -6                             | 122               | 506              | 682   |
| 1951-----    | 23,916                                             | 31       | -5                             | 98                | 412              | 535   |
| 1952-----    | 23,753                                             | -2       | -11                            | -58               | 471              | 400   |
| 1953-----    | 25,752                                             | 117      | -18                            | -31               | 296              | 364   |
| 1954-----    | 25,642                                             | 49       | 7                              | 92                | 563              | 711   |
| 1955-----    | 25,002                                             | 2        | -43                            | -168              | 377              | 168   |
| 1956-----    | 25,203                                             | -33      | -111                           | -356              | 305              | -195  |
| 1957-----    | 24,785                                             | -185     | -48                            | -486              | 210              | -509  |
| 1958-----    | 25,967                                             | 7        | 12                             | 57                | 408              | 484   |
| 1959-----    | 27,627                                             | -15      | -63                            | -536              | 101              | -513  |
| 1960-----    | 27,383                                             | 16       | -59                            | -120              | 204              | 41    |
| 1961-----    | 27,988                                             | 40       | 5                              | 66                | 438              | 549   |
| 1962-----    | 31,052                                             | -12      | -3                             | -5                | 390              | 370   |
| 1962 weekly: |                                                    |          |                                |                   |                  |       |
| July 4-----  | 31,597                                             | 10       | 10                             | 34                | 369              | 424   |
| July 11----- | 31,729                                             | 8        | -5                             | 23                | 464              | 489   |
| July 19----- | 31,561                                             | -33      | -15                            | -75               | 522              | 399   |
| July 26----- | 31,315                                             | 75       | 10                             | 32                | 399              | 517   |
| Aug. 1-----  | 31,066                                             | 15       | 6                              | 4                 | 338              | 366   |
| Aug. 9-----  | 31,559                                             | -15      | -15                            | ( <sup>3</sup> )  | 411              | 351   |

<sup>1</sup> Yearly data as of Wednesday nearest June 30.<sup>2</sup> Averages of daily closing figures. 1950-62: for 2d half of June. 1953-62 for all of June.

Preliminary, June 1962 through Aug. 9.

<sup>3</sup> Not available.*Federal Reserve System exchanges in Treasury refundings, Aug. 8, 1962*

[In millions of dollars]

| Month                    | Amount of<br>maturing<br>securities<br>held | Exchanged                                    |        | Redeemed |
|--------------------------|---------------------------------------------|----------------------------------------------|--------|----------|
|                          |                                             | New or reopened issue                        | Amount |          |
| 1961—February---         | 3,583                                       | 3¼ percent note of Aug. 15, 1962-----        | 3,583  | -----    |
| March <sup>1</sup> ----- | 350                                         | 3½ percent bond of Nov. 15, 1967-----        | 350    | -----    |
| May-----                 | 2,695                                       | 3 percent certificate of May 15, 1962-----   | 1,700  | 295      |
|                          |                                             | 3¼ percent note of May 15, 1963-----         | 700    | -----    |
| August-----              | 4,835                                       | 3¼ percent note of Nov. 15, 1962-----        | 3,235  | -----    |
|                          |                                             | 3¾ percent note of Aug. 15, 1964-----        | 1,600  | -----    |
| November-----            | None                                        |                                              |        | -----    |
| 1962—February---         | 4,806                                       | 3½ percent certificate of Feb. 15, 1963----- | 3,306  | -----    |
|                          |                                             | 4 percent note of Aug. 15, 1966-----         | 1,500  | -----    |
| May-----                 | 2,164                                       | 3¼ percent certificate of May 15, 1963-----  | 2,164  | -----    |
| August-----              | 3,717                                       | 3½ percent certificate of Aug. 15, 1963----- | 3,717  | -----    |

<sup>1</sup> Advance refunding.

*Open market transactions of the Federal Reserve System during 1962*

[In millions of dollars]

| Month             | Outright transactions in U.S. Government securities, by maturity |             |                             |                 |             |                             |                      |             |                                            |        |
|-------------------|------------------------------------------------------------------|-------------|-----------------------------|-----------------|-------------|-----------------------------|----------------------|-------------|--------------------------------------------|--------|
|                   | Total                                                            |             |                             | Treasury bills  |             |                             | Others within 1 year |             |                                            |        |
|                   | Gross purchases                                                  | Gross sales | Redemptions                 | Gross purchases | Gross sales | Redemptions                 | Gross purchases      | Gross sales | Exchanges, maturity shifts, or redemptions |        |
| 1962-January..... | 510                                                              | 527         | 173                         | 486             | 474         | 173                         | 10                   | 53          |                                            |        |
| February.....     | 535                                                              | 646         | 61                          | 380             | 522         | 61                          | 132                  | 124         |                                            |        |
| March.....        | 1,112                                                            | 380         | 136                         | 691             | 380         | 156                         | 54                   |             |                                            | -1,307 |
| April.....        | 1,542                                                            | 333         | 36                          | 471             | 333         | 36                          | 11                   |             |                                            |        |
| May.....          | 1,136                                                            | 622         |                             | 702             | 622         |                             | 307                  |             |                                            |        |
| June.....         | 747                                                              | 702         |                             | 459             | 625         |                             | 152                  |             |                                            |        |
| July.....         | 1,680                                                            | 1,200       | 174                         | 1,310           | 1,117       | 174                         | 234                  | 70          |                                            |        |
|                   |                                                                  |             | 185                         |                 |             | 185                         |                      | 73          |                                            |        |
| Month             | Outright transactions in U.S. Government securities, by maturity |             |                             |                 |             |                             |                      |             |                                            |        |
|                   | 1 to 5 years                                                     |             |                             | 5 to 10 years   |             |                             | Over 10 years        |             |                                            |        |
|                   | Gross purchases                                                  | Gross sales | Exchanges or maturity shift | Gross purchases | Gross sales | Exchanges or maturity shift | Gross purchases      | Gross sales | Exchanges or maturity shift                |        |
| 1962-January..... | 14                                                               |             |                             |                 |             |                             |                      |             |                                            |        |
| February.....     | 23                                                               |             |                             |                 |             |                             |                      |             |                                            |        |
| March.....        | 357                                                              |             | +1,307                      | 10              |             |                             |                      |             |                                            |        |
| April.....        | 50                                                               |             |                             | 10              |             |                             |                      |             |                                            |        |
| May.....          | 127                                                              |             | -793                        |                 |             |                             |                      |             |                                            |        |
| June.....         | 136                                                              | 7           | +81                         |                 |             |                             |                      |             |                                            |        |
| July.....         | 136                                                              | 10          |                             |                 |             | -28                         |                      |             |                                            | -53    |

## INTEREST RATES AND FOREIGN DOLLAR BALANCES

(By Robert F. Gemmill, Board of Governors of the Federal Reserve System)

### INTRODUCTION AND CONCLUSIONS

Large U.S. balance-of-payments deficits since 1957 have led to substantial increases in foreign liquid-dollar holdings and to a decline of about one-fourth in the U.S. gold stock. These developments have stimulated discussion of the extent to which financial policy, and especially monetary policy, in this country might be influenced by the international reserve position of the dollar. Obviously, a country that acts as an international reserve center and in this role accumulates a large volume of outstanding short-term liabilities to foreigners must take care to insure that doubts do not arise concerning the stability of its currency. Even though a country maintains a high degree of financial stability, however, questions can be raised regarding the effect on its reserve position of countercyclical financial policies, such policies may contribute to the outflow of domestic capital and thereby worsen the country's payments position. In addition, however, concern has been expressed that antirecessionary policies involving low interest rates might put pressure on the reserve position of the United States by bringing about a conversion of foreign-held dollar balances into gold.<sup>1</sup> In this paper, we shall examine the latter problem, attempting to assess the extent to which past behavior of foreign-held balances affords a basis for such concern.

The actual U.S. balance-of-payments deficits since 1957, which have stimulated discussion of the reserve position of the United States, have reflected major developments in U.S. international transactions on both current and capital account. The proportion of these deficits that has taken the form of net foreign gold purchases has reflected the overall payments surplus of major foreign countries, the proportions of their payments surpluses, in the form of additions to official reserves, and the extent to which they hold reserves in gold.<sup>2</sup> The general conclusion of this paper is that those movements in foreign holdings between gold and dollar assets in recent years which could be attributed to interest-rate changes account for only a very small fraction of total foreign dollar holdings. The main findings upon which this conclusion is based are as follows:

1. There is no basis either on theoretical grounds or in available statistical materials for believing that foreign official institutions adjust their reserve holdings between gold and liquid-dollar assets in response to short-term or cyclical movements in interest rates. This finding is not inconsistent with evidence that such institutions do alter to some extent the composition of their holdings of liquid-dollar assets as changes occur in yields on these assets.

2. There is reason to believe that some foreign private liquid-dollar holdings are drawn down when yields on liquid-dollar assets are substantially lower than yields obtainable in other international money markets and rise when the yield advantages on short-term investments in other money markets disappears.

Foreign private dollar holdings (excluding those of Canada) rose about \$1 billion between mid-1958 and early 1960 and had declined by a somewhat smaller amount by early 1961. During these years, U.S. interest rates moved from a cyclical trough to a peak and then receded to a substantially lower level. These fluctuations in foreign private holdings are greater than the movements

<sup>1</sup> See, for example, Robert Triffin, "Gold and the Dollar Crisis" (New Haven: Yale University Press, 1960), p. 9: "Our huge gold losses of last year [1958] were due in part to such a repatriation of foreign capital at a time when interest rates had fallen here well below the rates available in Europe. They have been slowed down this year [1959] by an extremely sharp rise of interest rates in this country, prompted by our domestic concern about creeping inflation. In this case, external and internal interest rates policy criteria happily coincided, but they may diverge tomorrow. If and when we feel reassured about our internal price and cost trends we may wish to ease credit and lower interest rates in order to spur our laggard rate of economic growth in comparison not only with Russia, but with Europe as well. We may then be caught, however, exactly as the British were in the 1920's between these legitimate and essential policy objectives and the need to retain short-term funds here in order to avoid excessive gold losses."

<sup>2</sup> See articles on gold and dollar flows in the Federal Reserve Bulletin, March 1959, 1960, and 1961.

which may be attributed to international interest-rate differentials, since other factors are known to have contributed to the changes in foreign holdings.

3. A transfer of foreign private holdings from the United States to European money markets results in some increased foreign purchases of gold from the United States. However, the gold purchases may be expected to be smaller than the volume of funds transferred, unless all funds were moved to foreign countries that take all reserve gains in gold. Such was apparently not the case in 1960 and 1961.

#### THE PROBLEM

A country's financial policies affect its reserves primarily through impact on its balance-of-payments position. Monetary and fiscal measures can influence payments on current account through their effect on overall levels of economic activity and on prices and competitive behavior. Moreover, they can influence payments on capital account through changes in the terms of payment in international transactions (so-called leads and lags), in other movements of domestic short-term capital, and in flows of domestic and foreign long-term capital.

However, financial policies can also affect the reserve position of a country acting as an international reserve center if they lead to shifts between foreign short-term claims and gold. The reserve (or liquidity) position of such a country is most conveniently measured by the ratio of its holdings of international means of payment (gold, in the case of the United States) to its short-term liabilities to foreigners.<sup>3</sup> Shifts in foreign holdings between short-term claims and gold affect that ratio, whether or not there is any change in the aggregate of foreign short-term claims and gold and hence any surplus or deficit (as customarily defined) in the balance of payments of the reserve currency country.

This paper is concerned with the effect which movements of foreign short-term capital might be expected to have on the reserve position of the United States, given a specific overall balance-of-payments surplus or deficit. If shifts of foreign short-term capital were likely to be large, the international aspects of U.S. financial policies could not be judged solely on the basis of existing and prospective balance-of-payments developments, including movements of U.S. capital and changes in unrecorded transactions. Instead, any proposed changes in these policies would have to take into account the additional consequences that such potential shifts would be likely to have on the U.S. reserve position.

If cyclical changes in interest rates are likely to produce significant fluctuations in the gold stock of a reserve currency country, over and above those fluctuations resulting from balance-of-payments developments, that country may be more restricted in the extent to which it can permit fluctuations in its balance of payments. It may thus be more restricted in the extent to which it employs flexible financial policies as countercyclical measures.

If possible shifts of foreign short-term funds were felt to be a substantial constraint on the financial policies of a reserve currency country, the country might find that the resulting disadvantages outweighed the advantages of being a reserve center. In fact, this argument has already been applied to the position of the United States. Triffin, for example, in making a case for the establishment of the International Monetary Fund as the principal international reserve center, maintains that, by this change, "we would \* \* \* have consolidated in the hands of the Fund a large portion of highly volatile foreign funds, whose sudden and unpredictable outflow might otherwise unleash, at any time, an unbearable drain on our gold reserves. Most of all, we should have shed thereby the straitjacket which the need to prevent such an outflow would impose upon monetary management and interest rates in this country."<sup>4</sup>

Empirical evidence on the extent to which foreign short-term dollar assets may have been shifted in response to interest-rate movements can best be examined separately for foreign official and foreign private holdings.

#### FOREIGN OFFICIAL DOLLAR HOLDINGS

There is no evidence that any major foreign country has changed the relative proportion of gold in its official reserves in response to short-term or cyclical changes in interest rates. After comparing changes in the composition of reserves of foreign countries with changes in U.S. interest rates, we shall indicate

<sup>3</sup> R. Gemmill, "Notes on the Measurement of International Liquidity," *Journal of Finance*, March 1960, pp. 53-61.

<sup>4</sup> Triffin, *op. cit.*, p. 12.

why, on theoretical grounds, there is no basis for expecting changes in the holdings of foreign official institutions to correspond to interest-rate movements.

It would be most appropriate for our purpose to examine shifts in a country's reserve holdings between gold and liquid-dollar assets. However, most countries do not publish data on dollar holdings separately, and therefore data on foreign-exchange holdings will be substituted. Since holdings of foreign exchange other than dollars have been extremely small, the conclusions would not differ significantly if official dollar holdings were used.<sup>5</sup>

The relative proportions of gold and foreign-exchange assets can, of course, vary as a result of changes in either form of reserve holdings; many countries have kept gold reserves constant over long periods of time and permitted moderate changes in payments positions to be reflected in variations in exchange reserves. We shall examine only those instances in which gold holdings were changed between the end of 1956 and the end of 1960. In this period, there were wide fluctuations in U.S. interest rates, and a country that regularly shifted even a part of its reserves between gold and dollars in response to changes in yields on dollar investments would presumably have made changes in gold holdings.

Twenty-six foreign countries changed their gold reserves by \$10 million or more between the end of 1956 and the end of 1960, excluding changes resulting from gold subscription payments to the International Monetary Fund. We consider, first, the 18 countries that increased gold reserves, dividing them into groups according to the pattern of changes in reserves. A number of foreign countries purchased substantial amounts of gold in the fourth quarter of 1960 when speculative demand for gold led to the establishment of a premium price in the London gold market. We shall regard these purchases as precautionary in nature rather than as shifts in the composition of reserves in response to the lower level of U.S. moneymarket rates compared with those in the first half of the year.

(a) Four countries (Belgium, the Netherlands, Switzerland, and the United Kingdom) have traditionally kept practically all reserves in gold, and the gains in gold reserves of these four countries have thus paralleled overall reserve gains, aside from some lags in periods of rapid increases in reserves.

(b) Three countries (Australia, Iraq, and Lebanon) do not maintain significant reserves in dollars. Parenthetically, both Iraq and Lebanon added to gold reserves in late 1960.

(c) Eleven countries have added both to gold and to dollar holdings at times during the period.

Five countries (Austria, Colombia, Greece, Italy, and Portugal) have increased their gold reserves both in years of high and in years of low U.S. interest rates, and all except Colombia (which experienced large fluctuations in total reserves) have steadily increased the proportion of total reserves held in gold. Increases in gold reserves of Austria and Portugal occurred primarily in 1958 and 1959; U.S. interest rates were relatively low in 1958 and high the following year. Italy increased its gold reserves throughout the period, while Greek gold purchases were concentrated principally at the end of 1960.

Three countries (Indonesia, Peru, and Spain) decreased gold holdings at total reserves declined from 1956 to 1958, and increased gold holdings again after total reserves rose. Peru added to its gold reserves in the fourth quarter of 1959 when yields on dollar assets were at a peak, and all three countries substantially increased gold reserves in the last quarter of 1960. In fact, the rise in Spanish gold reserves in the second half of the year was almost equal to the rise in total reserves.

Variations in the proportion of gold to total reserves for the three remaining countries, France, Germany, and Japan, are shown in chart 1 [not printed in the Record]. The decline in the gold proportion of French reserves that began in mid-1958 resulted from a sharp improvement in total reserves that more than offset substantial rebuilding of French gold reserves. The marked drop in holdings of convertible currencies at the end of 1959 resulted partly from large gold purchases and partly from slower additions to total reserves in consequence of special debt repayments. In 1960 French reserve gains were taken entirely in gold.

<sup>5</sup> Official foreign-exchange holdings of the European countries for which exchange holdings were used consist mainly of dollar assets but include some sterling holdings. These latter holdings are relatively small, however. Official sterling holdings of all OEEC countries at the end of 1957 were \$360 million (see "International Financial Statistics," June 1960, p. 260), while official dollar holdings were in excess of 10 times this amount (see Federal Reserve Bulletin, March 1959, chart on p. 247).

The proportion of gold in German reserves increased steadily through 1957. In 1958 and 1959 it fluctuated primarily as a result of variation in official German dollar holdings. In 1959, when total German reserves declined, the reduction was in dollar holdings. The sharp decline in the gold proportion which began in the fourth quarter of 1959 and continued through the period of declining rates in 1960 reflected additions of almost \$2.5 billion to German reserves in the form of dollar assets. If, during this rise in reserves, Germany had continued to keep two-thirds of its reserves in gold, the additional demand for monetary gold would have been about \$1.5 billion.

The gold proportion of Japanese reserves increased from 1957 to 1959 but declined thereafter, as gold holdings remained constant while total reserves continued to rise. Press reports indicate that Japan postponed implementation of a long-range policy of increasing its gold proportion in order to avoid contributing to instability in the international financial system.<sup>6</sup>

In summary, most of these 11 countries increased gold holdings at times of high as well as of low yields on dollar assets. Germany and Japan added large amounts to their dollar reserves in 1960, but there is no indication that yields (which declined during the year) were a factor in these decisions. Changes in gold reserves of a few countries appear to have resulted from large fluctuations in total reserves.

Eight countries experienced overall declines in gold reserves. The gold proportion of Canadian reserves has declined since the end of 1957; up to mid-1959 the decline resulted from a rise in dollar holdings, and after that time it stemmed mainly from a fall in gold reserves. Six countries (Argentina, Cuba, Egypt, Mexico, and Venezuela, plus the Union of South Africa, which does not maintain substantial reserves in dollars) reduced gold reserves, as total reserves declined in consequence of balance-of-payments deficits. Argentina and Mexico have added again to gold reserves as their total reserves were rebuilt. Swedish gold reserves declined by one-fourth in 1957 and early 1958 but remained stable thereafter. This decline, which is not explained in the annual reports of the Riksbank, could represent an increased long-term preference for dollar assets but could not reflect a policy of cyclical variation in composition of reserves.

In conclusion, data on changes in reserves for these 26 countries show no evidence of shifts in the composition of reserves in response to changes in yields on dollar assets.

Furthermore, on theoretical grounds one would not expect central banks and other official institutions that hold international reserves generally to base such major policy decisions as those affecting composition of reserves on considerations of short-run profitability. Short-run fluctuations in the composition of reserve holdings, which resulted from weighing the return on investments against the potential gain through holding gold, would be recognized as constituting speculation on a change in the price of gold and, as such, would be highly disruptive of both internal and international financial transactions.<sup>7</sup> Shifts in reserve holdings between gold and dollars on the basis of short-run profitability could thus contribute directly to instability in international financial relations and make increasingly difficult the achievement of basic domestic objectives of the central banks.

Gold purchases by some foreign central banks in the fourth quarter of 1960 undoubtedly did not contribute to the stability of the international financial system. However, if we assume that these purchases were precautionary, it is highly doubtful that they would have been smaller if yields on dollar assets had been maintained at, say, 1959 levels.

Shifts of central bank funds among various types of dollar assets do not involve the dangers associated with implied speculation, and such shifts frequently occur with changes in the relative yields on these assets; however, even movements of this type are small relative to the total volume of official dollar holdings.

<sup>6</sup> See the London Times, Mar. 4, p. 11.

<sup>7</sup> In determining a long-run policy with respect to the composition of reserves, a central bank will, of course, have to consider both yields on foreign-exchange assets and the possibility of a change in the price of gold, along with a wide range of other factors. A long-run policy on amounts or relative proportions of gold and foreign exchange in reserves carries no presumption as to timing of a possible change in the price of gold (whether or not such a consideration is given appreciable weight in the formulation of the policy), and such a policy, therefore, does not imply an open element of speculation.



## FOREIGN PRIVATE DOLLAR HOLDINGS

While there is no evidence that foreign official institutions adjust their gold holdings in accordance with changes in yields, shifts of funds among international money markets by banks and other private investors could lead to changes in foreign gold holdings, over and above the changes that might be associated with a particular payments surplus in deficit on the part of a reserve currency country. For example, a shift of funds might cause a substitution of gold holding (by official institutions) for liquid-dollar holdings (by banks and other private investors). This result would occur if private investors sold dollar exchange for another currency and if neither the commercial banking system nor the central bank of that country added correspondingly to its dollar holdings;<sup>8</sup> under these conditions, initial acquisition of the dollar exchange by the central bank would be followed by a purchase of gold and (assuming that this transaction added to net foreign purchases from the United States) to a corresponding reduction in the U.S. gold stock.

Since some European central banks traditionally hold their reserves in gold and most others take part of their reserve gains in gold, any large net movement of private funds from the United States to other major financial markets (except Canada) would probably lead to a reduction in the U.S. gold stock, although the extent of the reduction would be strongly influenced by the particular markets to which funds moved. Shifts of funds to or from Canada would be reflected primarily in pressure on the Canadian exchange rate, since the Bank of Canada changes its reserves little and permits transfers of funds to affect the exchange rate.

We shall examine fluctuations in foreign private dollar holdings in order to estimate the extent to which variations in these holdings appear attributable to interest-rate movements or differentials. Analysis of changes in the holdings of different geographical areas would assist in identifying movements that might have been associated with the transfer of funds between the United States and European money markets, but data are available separately only for Canada.

The present study will be limited to examination of fluctuations in aggregate non-Canadian private holdings for two reasons. First, private dollar holdings of European countries probably account for three-fifths of total private holdings (excluding Canada), and these European funds are generally thought to be more likely to be shifted to European money markets than are Canadian funds. Second, the influence of balance-of-payments developments is likely to be much greater in the case of Canada and thus the changes attributable to interest-rate changes much less discernible than for other countries. While developments in the U.S. balance of payments may have an influence on the volume of private, as well as official, dollar holdings of foreign countries, private Canadian dollar holdings appear likely to reflect changes in the Canadian balance of payments much more directly. The Bank of Canada's policy of maintaining its reserves relatively stable has the result that a Canadian payments surplus or deficit leads immediately to a change in Canadian holdings of foreign exchange (almost exclusively U.S. dollars) or in foreign short-term claims on Canada.

To facilitate examination of the fluctuation in non-Canadian holdings, we have computed deviations of the holdings from a straight-line trend fitted to the data by the method of least squares. The results are compared in chart 2 [not printed in Record] both with yields on U.S. Treasury bills and with the yield differential between United States and United Kingdom Treasury bills, after allowing for the cost of covering the foreign-exchange risk. We have also computed a second set of deviations from a trend line adjusted to minimize variations resulting from purely statistical factors. These deviations appear as the dotted line in the chart.<sup>9</sup>

As shown in chart 2 [not printed in Record], both private holdings (measured as deviations from trend) and interest rates have exhibited cyclical fluctuations, with changes in private holdings generally lagging behind those

<sup>8</sup> Or to holdings of the currency of another country, where the banking system was willing to increase its dollar holdings.

<sup>9</sup> In the third quarter of 1956 and again in the second quarter of 1957, certain dollar holdings previously reported as privately owned were included with official holdings (see Federal Reserve Bulletin, September 1957, p. 1096). The overstatement of private holdings in published Federal Reserve figures from the end of 1955 to mid-1957 has been corrected by using estimates of the International Monetary Fund. These estimates may be derived from data on U.S. short-term liabilities to foreign official institutions published in "International Financial Statistics," June 1958, p. 242.

in interest rates. On the whole, variations in foreign private holdings appear to have corresponded more closely to changes in the absolute yield on U.S. Treasury bills than to changes in the covered differential between United States and United Kingdom bills. This fact suggests that fluctuations in foreign private holdings may have occurred in response to changes in conditions in the U.S. market relative to those in a number of foreign money markets, rather than solely in response to changes between New York and London. This conclusion is in accord with other evidence; the reports of the Bundesbank indicate that German bank funds were repatriated from abroad in mid-1960 following increased monetary restraint in that country.

However, it is also clear that factors other than interest-rate movements affected foreign private dollar holdings during the periods in the last half of 1960; for example, speculative capital movements undoubtedly contributed to the decline in foreign private dollar holdings. Thus one should not expect to find an exceptionally close relationship between movements in an aggregate of foreign private holdings and a single interest rate or rate differential. On the whole, there seems to be sufficient correspondence between movements in rates and foreign private holdings to provide support for the thesis that interest-rate movements (or factors producing these movements) have affected such holdings.<sup>10</sup>

The extent of the influence of interest-rate movements or other money-market developments cannot be estimated with accuracy, but the amplitude of the fluctuations in the deviations of foreign private holdings from trend can assist in supplying some indication. As shown in chart 2 [not printed], the amplitude of fluctuations during the period 1958-60 has been one of the magnitude of \$0.3 billion to \$0.5 billion, depending on the series used. These figures suggest that foreign private holdings might decrease by amounts ranging from \$0.6 billion to \$1 billion from a peak associated with high U.S. interest rates to a trough associated with low rates.

The actual decline in foreign holdings (as distinct from the changes in deviations from trend) which began in mid-1960 continued early in 1961 (not shown on the chart) and, through February, totaled \$0.8 billion. However, a substantial portion of the decline could have been accounted for by speculative movements of funds connected with possible changes in foreign-exchange rates, and the entire decrease clearly cannot be attributable to changes in relative money-market conditions.

Correspondingly, a part of the \$1 billion increase in foreign private dollar holdings that occurred from late 1958 to early 1960 represented increased working balances following the establishment of convertibility by major European countries. The opportunities for employing such working balances profitably have been substantially enlarged by the development of the Euro-dollar market.<sup>11</sup> A European bank accepting deposits denominated in U.S. dollars (Euro-dollars) would have a U.S. dollar asset as a counterpart to its dollar liability, and a part of the rise in foreign bank holdings of dollars in 1959 undoubtedly represented such dollar assets. European banks attracted Euro-dollar deposits by paying interest (often in excess of rates payable on time deposits in U.S. banks), and they have used the deposit claims on U.S. banks which were thus acquired for various types of financing, especially foreign trade. So long as attractive opportunities exist for employing Euro-dollar funds for dollar financing, these funds are relatively unlikely to be shifted abroad in response to changes in money-market rates.

Thus less than \$1 billion of the fluctuations between peak and trough in foreign private dollar holdings can be attributed to interest-rate movements. This figure, as an outside limit, may be compared with total foreign private dollar holdings (excluding Canada) of \$6 billion at the 1960 peak. A shift abroad of up to one-sixth of foreign private dollar holdings would lead to an increased demand for monetary gold by foreign central banks of somewhat less than the amount of funds shifted, unless the funds moved to those countries that take all reserve gains in gold, and this apparently was not the case in 1960. The gold outflow associated with such a shift might therefore be quite small, relative to

<sup>10</sup> A coefficient of correlation of about 0.8 was obtained from a correlation of U.S. Treasury bill rates (as the independent variable) with adjusted deviations from trend of foreign private holdings lagged one-quarter of a year. Calculations involving other series produced smaller coefficients.

<sup>11</sup> See Alan Holmes and Fred Klopstock, "The Market for Dollar Deposits in Europe," Monthly Review, Federal Reserve Bank of New York, November 1960.

total foreign private holdings. If the movements of funds were recognized as the result of cyclical changes in interest rates and were thought likely to be reversed in a short time, there might even be no conversion of newly accruing dollars into gold by foreign central banks.

#### CONCLUSION

Our examination of the practices of foreign countries has shown no evidence that official reserves are shifted from dollar assets to gold (or vice versa) in response to short-term variations in interest rates. Some foreign private funds are undoubtedly shifted from dollars to other currencies in response to international interest-rate differentials, and such movements can probably be expected to lead to increased demand for monetary gold by foreign central banks. Recent experience indicates that the volume of foreign private funds shifted abroad could be expected to be less than \$1 billion.

While this sum is not negligible, it is small in relation to recent changes in major components of the U.S. balance of payments. For example, the improvement in the current account of the U.S. balance of payments from the 1959 average to the second half of 1960 was more than \$5 billion at an annual rate. Similarly, in the last half of 1960 the net outflow on unrecorded transactions and U.S. short-term capital was at an annual rate close to \$7 billion.

In the light of these relative magnitudes, we may conclude that, so long as confidence in the U.S. dollar as a reserve currency remains undisturbed, major changes in the international reserve position of the United States are likely to result only from shifts in the balance of payments on current account or in capital movements that are reflected in changes in the U.S. payments surplus or deficit. The U.S. payments position therefore appears to represent an adequate guide to the external or international consequences of domestic financial policies. Moreover, the role of the United States as an international reserve center does not, at least at present, appear to impose significant restrictions on the range of domestic financial policies which this country is able to pursue. Effective arguments may exist for some of the recently proposed reforms to the international financial system, but the sensitivity of foreign-held dollar assets to international interest-rate movements does not appear to be among them.

OFFICIAL CENTRAL BANKING THEORY IN THE UNITED STATES,  
1939-61: FOUR EDITIONS OF *THE FEDERAL RESERVE*  
*SYSTEM: PURPOSES AND FUNCTIONS*<sup>1</sup>

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THE past decade has witnessed a resurgence of controversy over the perennial issues of monetary policy. What should be the objectives of monetary policy? What methods should it employ? What are the channels or processes through which it influences economic activity? By now, opinion has become so sharply divided—fragmented would perhaps be the better word—on so many issues as to almost defy classification, much less resolution.

What influence, if any, has this intellectual ferment had on the thinking of the monetary authorities? The purpose of this paper is to trace the evolution of official Federal Reserve views on these questions, as they have been reflected in the changes made between 1939 and 1961 in the four successive editions of the widely read Board of Governors publication, *The Federal Reserve System: Purposes and Functions*.

There seems to be a rather widely held impression that the Federal Reserve stands aloof, impervious to gratuitous advice or dissident opinion. Journal editors are all too aware of the almost tropistic reaction of academicians to policy actions and statements of the Federal Reserve. Is there any evidence of reaction in the other direction, with the System modifying its own conception of its *raison d'être* in light of commentary from

the academic community? If we are to have a viable central bank, some degree of such interchange would seem to be imperative. It is with the hope of shedding some light on this matter that the present paper has been written. But a disclaimer is quickly in order: to explore this topic fully requires a much wider inquiry than has been attempted here. My aim has been only to piece together one particular chain of evidence—namely, the changes made between 1939 and 1961 in the four editions of *Purposes and Functions*—which, while suggestive, is but one strand among many.

First a word about the book itself. *Purposes and Functions* was published originally in May, 1939. A revised second edition was published in 1947, a third edition in 1954, and the fourth and most recent in February, 1961. Bray Hammond was primarily responsible for the text of the first edition, E. A. Goldenweiser for the second, and Ralph Young for the third and fourth. However, all four editions were joint efforts, written in collaboration with other members of the Board's staff, and all bear the imprimatur of the Board of Governors. As described in the Foreword to the first edition, the volume is intended "primarily for students, bankers, businessmen and others who desire an authoritative statement of the purposes and functions of the Federal Reserve System. It is neither a primer, nor is it an exhaustive treatise. The aim has been to have it cover the

<sup>1</sup> The author is indebted to his colleagues, Clifford Clark, Robert Kavesch, and Herman Krooss, for helpful criticisms of earlier drafts of this paper.

middle ground between those extremes and to make it clear and readable without neglect of essentials."

The attainment of this goal is attested to by its widespread popularity. Not including the new fourth edition, which will probably have the largest circulation of all, over one million copies had been distributed by early 1961—160,000 copies of the first edition, 280,000 copies of the second, and 600,000 of the third. In addition, its influence is clearly evident in most of the money and banking and principles textbooks that have been published in the last two decades. It has become, rather unobtrusively, one of the most widely read and influential economics books of the day. One reason for this is the high caliber of both the analysis and the writing style throughout all four editions. Another is its uniqueness, for it has never been the custom for central banks to publicize their *modus operandi*. Almost a century ago, Bagehot complained that "there is always great uncertainty as to the conduct of the Bank of England: the Bank has never laid down any clear and sound policy on the subject."<sup>2</sup> And only two years ago the Radcliffe Committee was still prodding the Bank of England to make "a more determined effort . . . to illuminate the problems of monetary management."<sup>3</sup>

The revisions of *Purposes and Functions* have not been confined to superficial matters such as chapter organization or the updating of statistical or historical information. They have also, as will be seen, reflected significant changes in the Federal Reserve's views on the role and mechanics of central banking. Indeed, it would seem to be no accident that each

revised edition appeared shortly after either a considerable change in economic conditions or a congressional or other inquiry that helped to induce a re-examination of previously accepted principles. Thus the second (1947) edition appeared shortly after the end of the war, the third (1954) shortly after the Patman Hearings, and the fourth (1961) shortly after the publication of the Radcliffe Report and the Joint Economic Committee's *Study of Employment, Growth, and Price Levels*. Those portions of congressional testimony or other statements that evidently were thought to be of more enduring value have been incorporated into subsequent editions of *Purposes and Functions*. It is also worthy of note that from edition to edition the volume has become more technical and more oriented toward the student and the professional as compared with the lay reader. The 1939 edition, for example, contained 128 pages and emphasized an explanation of bank reserves and their role in monetary expansion and contraction. The 1961 edition, in contrast, contains 238 pages and is a well-rounded general treatise on the many aspects of central banking.

#### I. THE OBJECTIVES OF MONETARY POLICY

*Ultimate objectives.*—As is well known, the Federal Reserve Act contains exceedingly narrow mandates, perhaps the broadest of which is to conduct monetary policy "with a view to accommodating commerce and business and with regard to . . . the general credit situation of the country."<sup>4</sup> Nevertheless, well before publication in 1939 of the first edition of *Purposes and Functions*, the System had included the mitigation of cyclical fluctu-

<sup>2</sup> Walter Bagehot, *Lombard Street* (London, 1873), p. 206. See also p. 160.

<sup>3</sup> Committee on the Working of the Monetary System, *Report* (London, 1959), paragraph 859.

<sup>4</sup> Federal Reserve Act, Section 12A, as amended (United States Congress, Title 12, Sec. 263).

tuations among its responsibilities. Indeed, Marriner Eccles had attempted to include passages in the Banking Act of 1935 which would have anticipated by over a decade the intent of the Employment Act of 1946.<sup>5</sup>

Thus, the 1939 edition described the objectives of Federal Reserve policy as "to contribute, with other agencies, to economic stability" and "to maintain monetary conditions favorable for an active and sound use of the country's productive facilities, full employment and a rate of consumption reflecting widely diffuse well-being" (1939, p. 115). However, nothing was said in 1939 about economic growth or the need to maintain price stability.

In the 1947 edition the objectives of monetary policy were "to help prevent inflations and deflations, and to share in creating conditions favorable to sustained high employment, stable values and a rising level of consumption" (1947, p. 1). The main differences between 1939 and 1947 are the explicit introduction of price stability and a change from "full employment" to "sustained high employment." Those seeking a harbinger of the growth objective can perhaps fasten on the statement that the Federal Reserve endeavors "to see that the money supply is neither too large nor too small for the maintenance of stable economic progress" (1947, p. ix).

By 1954 economic growth had been explicitly introduced. The objectives of monetary policy were "to help counteract inflationary and deflationary movements, and to share in creating conditions favorable to sustained high employment, stable values, growth of the country, and a rising level of consumption" (1954, p. 1). The growth objective was frequent-

ly expressed in terms of achieving "sustainable" or "orderly" growth. However, this was about the end of the story on growth in 1954, for it received scant additional mention beyond being included among the stated policy objectives.

Although the objectives set forth in the recent 1961 edition are for the most part identical with those of 1954, two notable changes appear. In the first place, there is now considerable substantive discussion of growth throughout the volume, including a section on secular expansion of the money supply in line with the public's long-run needs for cash balances. Second, the objective of price stability is occasionally—not always, but occasionally—expressed in terms of achieving "relatively" stable prices.

None of the editions recognizes any possible incompatibility among the various objectives. Quite the contrary; it is implied in the 1954 edition that price stability is a *sine qua non* of sustained high employment and in the 1961 edition that both are prerequisites for sustainable economic growth. Similarly, the potential conflict, at least in the short run, between the growth objective and the always stated goal of rising consumption is not mentioned, despite recognition in the 1961 edition that growth is intimately related not to consumption but to investment (see 1961, p. 142). The problem of the appropriate policy mix between monetary and fiscal policy also receives only passing mention, despite the statement that "the mechanism of credit tightness and of related increases in interest rates counteracts unsound business booms to a large extent by curbing the pace of investment" (1954, p. 151).

It is of interest to note that international considerations receive relatively little attention in every one of the four editions, including the 1961 version.

<sup>5</sup> See Marriner Eccles, *Beckoning Frontiers* (New York, 1951), p. 228.

What discussion there is, is confined almost exclusively to technical factors, such as the impact of gold flows on member-bank reserve positions. While this is as would be expected in the first three editions, it is rather surprising that external objectives are not given more emphasis in the 1961 edition.

*Monetary policy or credit policy?*—I have thus far been using the term “monetary policy” in its broadest sense, as it is usually used. Within the generic context, however, controversy has long existed as to whether “monetary policy” is or should be concerned directly with money, with credit, or with both. Considerable confusion is apparent on this matter in at least the first three editions of *Purposes and Functions*.

For years quantity theorists have urged that a clear distinction be made between “money” and “credit,” and consequently between “monetary policy” and “credit policy.” To the Chicago school, the volume of money is unique, identifiable, and of crucial significance in spending decisions. It is a legitimate object of government intervention, while credit is not. It remained, however, for Gurley-Shaw and the Radcliffe Report to inculcate an awareness of this distinction in a wider audience.<sup>6</sup> Ironically, they did this by arguing exactly the opposite: that money is not unique and if central banking is to be effective it must operate directly on a wide spectrum of financial assets. In the process of rushing to the defense of orthodox central banking, many an economist discovered, somewhat painfully, that he was more of a quantity theorist than he had realized.

Technically, “money” refers to the

*liability* side of commercial bank balance sheets, at least insofar as it consists of demand deposits. “Bank credit” properly refers to the *asset* side of commercial bank balance sheets, to their loans and investments. “Credit” in general refers to lending by *any* economic unit. Now money may be uniquely related to commercial banks, but credit is not; many economic units, financial and non-financial, extend credit (supply loanable funds) besides banks. Thus if the central bank believes its function is to control the money supply, it can logically confine its direct regulation to the commercial banks. However, if it believes its function is to control the extension of credit, then the rationale for confining its regulation to the commercial banks rests on rather shaky foundations.<sup>7</sup>

Throughout the 1939 edition, the System’s responsibilities were described as altering bank reserves in order to regulate both “money and credit.”<sup>8</sup> It was made clear that “money” referred to currency plus demand deposits, while “credit” referred to *bank* credit, or the asset side of the commercial bank balance sheet. It was also made clear that the concern was twofold because the creation of money stemmed from the extension of bank credit.

In the 1947 edition the concept of regulating both “money and credit” was

<sup>7</sup> “The supply of credit which can be immediately used for exercising demand is no monopoly of the banks; the power of the banks to create credit (and it is credit, not money, that is relevant here) thus provides no justification for control of the banks while other credit agencies are left uncontrolled” (R. S. Sayers, “Monetary Thought and Monetary Policy in England,” *Economic Journal*, LXX, No. 280 [December, 1960], 714; see also Sayers’ “Alternative Views of Central Banking,” *Economica*, N.S., XXVIII, No. 110 [May, 1961], 111–24).

<sup>8</sup> I have supplied the emphasis in this and all subsequent quotations that contain italicized words or phrases.

<sup>6</sup> I am myself indebted to John Dawson, of Grinnell College, and Paul Volcker, of the Chase Manhattan Bank, for the many hours they spent patiently giving me instruction in the new catechism.

superseded by emphasis on regulation of the money supply alone. However, this turned out to be at least partly a change in terminology. It rested on the confusing view that "because deposits and currency are closely related to loans and investments of banks, the phrases 'money supply' and 'volume of bank credit' as used in this study generally mean the same thing, namely the means of payment owned by the people of the county" (1947, p. 6). Confusion was compounded by a definition of money that included savings deposits in commercial and mutual savings banks.

In the 1954 edition the emphasis on regulation of the money supply alone was jettisoned. The System instead described its intent as to regulate "*the flow of credit and money*," and throughout the volume the phrase "flow of credit and money" systematically replaced what was formerly only "money." It is not clear to what extent the System believed itself to be regulating total credit, or bank credit, or total credit by the practically convenient method of regulating its bank credit component. "Federal Reserve actions affecting the credit market are directed *for the most part* to the functioning of banks. Such actions influence the market as a whole, however, since they affect the availability of funds to other lending institutions, their attitude toward prospective borrowers, and their appraisal of investments" (1954, p. 13). "Money" was also re-defined to consist of only currency plus demand deposits. (Unfortunately, a prominently featured chart, new to this edition, listed currency and demand deposits under the head of "money" and demand and time deposits under the heading "bank credit." This has been corrected in the 1961 edition.)

If regulating "the flow of credit and

money" is indeed the way the Federal Reserve views its function, then one would be hard put to distinguish its position from the views of Gurley-Shaw and the Racliffe Report. The 1961 edition hastens to rectify this: "regulating the flow of credit and money" has been systematically replaced throughout the volume by "regulating the flow of *bank* credit and money." It is still not altogether clear, however, whether the System wishes to regulate only bank credit because it believes it to be unique, resulting as it does in the creation of money, or because it simply believes it to be the most convenient and practicable way to go about altering the total credit flow. In any case, the 1961 edition affords some measure of clarification of the System's intent and reduces terminological confusion. Whether this resolution of the matter will prove to be compatible with the stabilization objective of the System remains to be seen.

## II. THE INSTRUMENTS OF MONETARY POLICY

*The discount rate and administration of the discount window.*—The volume of member bank rediscounting had been negligible for about five years when the first edition was published in 1939. It contained traces of nostalgia for the good old days, before the Great Depression and the gold inflow, when discount rate changes "were the principal instrument by which the Federal Reserve gave effect to credit policy" (1939, pp. 49-50). Discount-rate theory was confined to a few statements to the effect that the rate is lowered to encourage credit expansion and raised to discourage it. The discussion of discount-window administration was, as might be expected in view of the circumstances, permeated by a tone of ease and accommodation. Thus "addi-



tional reserve funds are *always* available" to the member banks, and "an individual bank in making loans is not limited to its excess reserves, because it can bring them up to the required level by borrowing from its Reserve Bank" (1939, p. 73).

By 1947, however, it was made clear that "when a member bank applies for accommodation, a Federal Reserve Bank is under no obligation to grant the credit" (1947, p. 26). Access to the discount window was seen as a privilege rather than a right. Nevertheless, "a member bank with satisfactory collateral can usually obtained the desired accommodation. . . . The policy of the Federal Reserve in encouraging or discouraging borrowing by member banks expresses itself principally *not in granting or refusing loans, but in the rate charged*" (1947, p. 26). Furthermore, the influence of the discount rate "is increased by the customary reluctance of member banks to show indebtedness on their balance sheets" (1947, p. 27). The 1947 edition also introduced the role of the discount rate as a *signal*: "The discount rate . . . and particularly a change in this rate, has at times been an important indication of Federal Reserve policy; [it] not only has represented the cost of accommodation at the Federal Reserve Banks, but has reflected Federal Reserve judgment as to whether there was too much, too little, or the right amount of money for doing the country's business" (1947, p. 26).

Administrative supervision over member-bank borrowing, as contrasted with lending freely at a price, as is the practice of the Bank of England, gained further acceptance between 1947 and 1954. In the 1954 edition it is stressed even more strongly that discounting is a privilege and not a right, and that, although the Federal Reserve is a lender of last

resort in emergency situations, it should be resorted to only "on occasion . . . to meet bona fide needs . . . to meet temporary requirements or unusual banking situations . . . and for a short time only" (1954, pp. 32, 35). In line with this, Federal Reserve policy with respect to member bank borrowing is no longer described as being expressed "principally not in granting or refusing loans, but in the rate charged"; now it is expressed "*not only in granting or discouraging loans but also in the rate charged*" (1954, p. 35). And although member bank reluctance to borrow is still stressed, a word of caution is also added to the effect that "special circumstances may at times weaken this reluctance" (1954, p. 35). Finally, the concept of the discount rate as a signal is elevated to a position of much greater significance than in the previous edition: "To the business community, the discount rate in effect at the Federal Reserve Banks, and particularly a change in this rate, serves as an *objective index* of Federal Reserve policy" (1954, p. 36).

In the 1961 edition there is no evidence that discretionary supervision of the discount window has declined, but there is a clear re-emphasis on the discount *rate* as a *cost* factor. In the first place, the discount rate as signal has fallen from grace. While "*in some circumstances* a change in discount rates may express a shift in direction of Federal Reserve policy," it may also represent "merely a technical adjustment of discount rates to market rates"; thus, although "it is only natural that the business and financial community should commonly interpret a change in the level of Reserve Bank discount rates as an important indication of the trend in Federal Reserve policy," there are unfortunately "no simple rules for interpreting changes

in discount rates" (1961, pp. 46-47). Second, confidence in reliance on member-bank reluctance to borrow has deteriorated still further. Now one of the "special circumstances" that "may at times weaken this reluctance" is specified as "continuing pressures on their reserve positions" (1961, p. 45)! Third, considerably more stress is laid in the 1961 edition on the interrelations among discount rates, open-market operations, and short-term interest rates, and on least-cost methods of adjusting bank reserve positions. Member-bank reluctance to borrow evidently becomes much stronger when the discount rate is above short-term market rates (see 1961, pp. 48-50 and 58-59). In this connection, the interesting statement is made that "experience since the re-establishment of flexible monetary operations in 1951 suggests that when the indebtedness of member banks as a group has reached about 5 per cent of their total required reserves, the pace of bank credit and monetary expansion has tended to slacken" (1961, p. 59). It is not stated whether this is due to member-bank reluctance to borrow further, stricter supervision of the discount window, increases in the discount rate, or other factors.

*Open-market operations.*—The 1939 and 1947 editions contained similar expositions regarding the effects of open-market operations on bank reserves and deposits. They differed primarily in that each called special attention to the particular problem of the day. In 1939 it was the large volume of member-bank excess reserves relative to System securities holdings, so that even if the System were to sell its entire portfolio it would still absorb only about half of the then-existing volume of excess reserves.

In 1947 it was the newly expanded national debt and the need to protect

government securities from price variation, especially in a downward direction. In 1947 the magnitude and distribution of the national debt were seen as hampering monetary policy in general and open-market operations in particular; pegging the interest-rate pattern was believed to be necessary, particularly at the long end. "The vast amount of Government securities held by individuals, corporations, endowments, and savings institutions, including insurance companies, makes it desirable to continue to protect these securities from wide variations in price" (1947, p. 110). It was to be several years later before the Federal Reserve advocated unpegging the long rate.

By 1954, of course, this view of the significance of the debt as hampering monetary policy had turned a full 180 degrees. The 1954 edition viewed the magnitude and wide distribution of the debt as strengthening monetary policy, rather than obstructing it, by serving as a principal vehicle through which monetary policy was transmitted throughout the economy. "Because Government securities play a key role in the credit market, and because all financial institutions are affected by changes in the yields and prices of such securities, as well as by changes in member bank reserve positions, open market operations have direct effects upon credit availability and the climate of business expectations" (1954, p. 195). In this vein, the section on open-market operations was greatly expanded in the 1954 edition. Previously they had been discussed almost exclusively in terms of their impact on member-bank reserves and deposits; in 1954, however, non-bank financial institutions were seen as being prominently involved in transmitting the impact of open-market operations through their

reactions to changes in interest rates and securities prices. We return to this subject in Part III below.

The 1961 edition expands the section on open-market operations still further. A new chapter has been added on "The Credit Market," the chapter on interest rates has been greatly enlarged, and the chapter titled "The Influence of Reserve Banking on Economic Stability" considerably reorganized; in all of these, open-market operations and their effects are intimately involved. Again, we shall return to this in Part III.

In addition, the 1961 edition devotes much more space than did its 1954 predecessor to "bills only" and the related ground rules adopted in 1953 for the conduct of open-market operations. The 1954 edition merely noted, almost in passing, that "Although such operations may be conducted in securities of any maturity, traditional reserve banking practice has been to limit transactions to short-term Government securities. Open market operations in these securities are rapidly communicated throughout the credit market by the mechanism of the market itself, as well as through their effects on bank reserves" (1961, p. 40; see also p. 46). The point was also made in 1954—and repeated in 1961—that "Traditionally, Reserve banking operations are not directed toward establishing any particular *level or pattern* of interest rates" (1954, p. 143).

In the 1961 edition, in contrast, seven full pages (1961, pp. 35–41) are devoted to the subject of "bills only" and related operating procedures. Basically, these pages repeat the arguments previously advanced by Riefler and Young-Yager for confining operations to the short end except to correct disorderly markets;<sup>9</sup> namely, that the purpose of open-market operations should be confined to altering

bank reserve positions, that "bills only" will improve the performance of the Government securities market, that direct intervention in the intermediate or long sector is dangerous because it distorts the true demand-supply relationships and gives rise to unjustified expectations, and is unnecessary because the effects on bank reserves and the market forces of substitution and arbitrage will effectively transmit yield impulses throughout the maturity range. Fundamentally, the structure and level of interest rates should be left to the determination of private market forces: "While the course of interest rates is necessarily influenced by reserve banking action, monetary policy decisions are themselves based primarily on judgment as to the flow of bank credit and money that is appropriate for the economy, and not on judgment as to some level and pattern of interest rates that is deemed to be appropriate. To the greatest extent possible, the setting of interest rates is left to the interplay of supply and demand forces expressed in the credit and security markets" (1961, p. 122).

Unfortunately, the 1961 edition of *Purposes and Functions* made its appearance in February of that year, the very month in which "bills only" was abandoned. In the second printing—dated April, 1961—an attempt has been made to take this change in System policy into account, while at the same time retaining intact the bulk of the still-new fourth edition. On pages 35 and 41 statements have been inserted in the second printing to the effect that "In early 1961, in view of conditions that had developed in the

<sup>9</sup> Winfield W. Riefler, "Open Market Operations in Long-Term Securities," *Federal Reserve Bulletin*, XLIV, No. 11 (November, 1958), 1260–74; and Ralph A. Young and Charles A. Yager, "The Economics of 'Bills Preferably,'" *Quarterly Journal of Economics*, LXXIV, No. 3 (August, 1960), 341–73.

domestic economy and in the United States balance of payments with other countries, the Open Market Committee authorized transactions in longer term securities" (1961, p. 35). Perhaps of more significance than these insertions, however, is the deletion in the second printing of one of the key paragraphs justifying the "bills only" policy, a paragraph that had just appeared for the first time in the first printing of that edition.<sup>10</sup> Nevertheless, the greater part of the argument for "bills only" and the doctrine of minimum intervention has been left unchanged in the second printing, including the above-quoted statement to the effect that the structure and level of interest rates should be left as far as possible to the determination of private market forces.

*Changes in reserve requirements.*—The treatment of reserve requirements is very similar through all four editions. About the only new material appears in the 1961 edition where, for the first time, the subject of equity is raised in connection with reserve requirements. In discussing the feasibility of frequent changes in reserve requirements, the Board notes that

<sup>10</sup> The deleted paragraph is the following: "If Federal Reserve operations were regularly conducted in all maturity sectors of the Government securities market, the portfolio managers of financial institutions, other investors, and professional traders might well become unduly sensitized to possible changes in monetary policy. A particular hazard, for instance, would be that the trading in the longer term area of the market, which normally experiences the widest price swings, might become overly influenced by guesses about the maturities that might be involved in System operations. In these circumstances, discontinuities in market performance and unsettled market tendencies might occur with increased frequency. Also, market prices and yields would not adequately reflect the interplay of primary supply and demand forces stemming from current economic tendencies. This would handicap market observers, including reserve banking officials in their efforts to follow and interpret current economic developments" (pp. 40-41, first printing, fourth edition).

even small changes in required would have a relatively large impact on member-bank reserve positions: "If, to avoid a large reserve effect, a change is limited to a particular class of bank, a perplexing problem of equity as between the different classes of banks is presented" (1961, p. 54). It is also noted that the contraction of the currency decreases in member-bank reserve requirements during the 1950's, which were not reversed in subsequent booms, "were facilitated by the fact that existing levels of reserve requirements were high in relation to past periods and also in relation to the standards for non-member banks adhered to by many States" (1961, p. 55). No similar equity considerations are mentioned with respect to reserve requirements on commercial banks vis-à-vis non-bank financial institutions.

*Selective credit controls.*—The topic of selective credit controls has had a rags-to-riches-and-back-to-rags odyssey through the four editions of *Purposes and Functions*. In 1939, of course, only margin requirements were mentioned. The point was made that the excessive use of stock market credit might have wide ramifications and that via margin requirements the System "is able to impose restrictions on the use of bank funds for stock market speculation without restricting the volume of credit available for commercial and industrial needs or raising its cost" (1939, p. 112).

More than three times as much space was devoted to selective credit controls in 1947, with a discussion of consumer credit controls added to the section on margin requirements. Again: "These methods are supplementary to methods of general regulation, and *their merit* is that they make it possible to restrain the flow of money into certain fields at times when conditions in the economy as a