U. S. TREASURY PROBLEMS AND PRACTICES

25 February 1959

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NOTICE

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

Honorable Fred C. Scribner, Jr., Under Secretary of the Treasury, was born in Bath, Maine, on 14 February 1908. He received his A.B. degree from Dartmouth, 1930; and his LL.B. from Harvard, 1933. He was admitted to the bar in Maine and Massachusetts in 1933, and immediately became associated with the law firm of Cook, Hutchinson, Pierce, and Connell. In 1946 he became general counsel, vice president, and treasurer of the Bates Manufacturing Company, Lewiston, Maine. In July 1955 he was nominated as General Counsel of the Treasury Department and resigned his connections with the Bates Manufacturing Company and his law firm. Since July 1955 he has been successively General Counsel, Assistant Secretary of the Treasury and Under Secretary of the Treasury, the position he now holds. This is his first lecture at the Industrial College.

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GENERAL MUNDY: This morning in our Economic Stabilization Course we are going to discuss a major national problem, a problem that each of us has an impersonal as well as a personal interest in. Everybody in this room, I believe draws his pay in the form of a Treasury check and in return gives a good portion of that money back to the Treasury in the form of income taxes. Each of us shares in the per capita burden of our national debt to the amount of about $1, 625.

The problem of financing this Nation's current obligations and of managing the national debt is a tremendous problem. It is one that is growing in scope each year, as you probably know from just the casual reports in the papers. It appears that we're going to run about 12 billion in the red this year. We don't know what will happen next year, since Congress hasn't acted yet, but it is anticipated that we will probably have another deficit next year. At any rate, it's getting to be a more serious problem for the Treasury to sell Government bonds, because the people seem to have a belief that we're going to have a long-time period of inflation.

Our speaker this morning is the Under Secretary of the Treasury, the Honorable Fred C. Scribner, Jr. Since you've been given Mr. Scribner's biography, suffice it for me to say that we in the College feel that we are very fortunate this morning that he is able to take time out from his very busy schedule to come over and talk to us about these and related problems.

Sir, it's a pleasure to welcome you to this platform and to present you to this year's class at the Industrial College.

Gentlemen, Mr. Scribner.

MR. SCRIBNER: General Mundy and Gentlemen: It's a very real pleasure for me to have this opportunity to meet with you this morning to review some of the facts, which I know most of you are familiar with, but perhaps I can bring them together in a somewhat different form. I would like to talk with you about some of the problems which we have in the Treasury Department and which you have as citizens of this country and as taxpayers.

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Perhaps we ought to set the stage a little bit. We are concerned, of course, with the budget, which General Mundy has spoken to you about. I hope he's wrong in his prediction that the budget for next year is going to be out of balance. But the Treasury Department does not create the budget. The budget is the creation of the President of the United States, working through the Budget Bureau. We are called upon at the Treasury Department to give the projected revenue income figures, because of course, we collect the taxes and we have the historical records and the reports from business on which to base an estimate of what the income may be.

Now, have in mind that we are trying to project income 18 months ahead. While it has been said at times that we always underestimate and at other times that we always overestimate, I can assure you that the best attempt possible is made on the data available to arrive at what we really believe the tax income from the various sources is going to be. But with our economy able to move up and down as rapidly as it can, as has been demonstrated in the last few months, a prediction made 18 months in advance can prove to be pretty well out of line.

We do try to persuade other agencies to cooperate insofar as the expenditure side is concerned. We have our own budget--some $700 million. This is exclusive of the amount necessary to pay interest on the national debt, over which we have little control and which you know runs now about $8 billion a year. We have the same restrictions placed on our budget as other agencies have. But the national budget is the Administration's budget, the budget of the executive branch. It is the responsibility of the President and it's just that. It's his budget. It's what he sends up to Congress--his prediction of what will need to be spent to do what he feels the country requires and what he projects as the income available to meet it.

Now, the expenditures must all be authorized by the Congress, as you know. Expenditure bills originate in the House and no Federal money can be spent by any individual or agency until it has been authorized by the Congress. So it's the Congress that decides the amount of the expenditures. In the last analysis its the Congress that decides whether or not there will be a deficit. They also decide how fast this money will be spent, which has a bearing on how we have to finance our obligations.

In like fashion, the taxes which come in to pay at least a part of the expenditures are determined by the Congress. Again, tax bills must originate in the House of Representatives. That perhaps is more in theory than in fact, because they can be rewritten when they get into the Senate. Once a bill which has anything to do with taxes gets over to the other side of the Congress, almost anything can be tacked on to it. While we at the Treasury have the responsibility of indicating to the Congress areas where we feel there should be some tax improvement--that is, some tax increases or some tax decreases--and while we certainly have the full responsibility of indicating what we believe the taxes will produce in revenue and what their impact may be on our economy, the final decision on what taxes shall be imposed is a decision made by the Congress.

Of course, this all has a bearing on the amount of our debt, because there are only three ways in which we can finance obligations that are imposed upon us to pay bills. We can collect money from taxes. We can resort to the printing presses and just print money and get away with it perhaps for a short period of time. Or we can borrow. The amount that we have to borrow, and when we have to borrow it, are also determined in the policy laid down by the Congress.

Back of the Congressmen there are the people whom they represent. If the people understand what the issues are, they are apt to make themselves pretty clearly heard by their Congressmen. They may be heard on the side of spending or they may be heard on the side of economy. The important thing is to make sure that they understand fully what the issues are, where the obligation is, and what the long-term results may be.

I thought it useful to give you this background so you would see that we in the Treasury, who are many times spoken of as having some very major responsibilities in these areas--and we do--are limited in what we can do insofar as determining the size of the debt or how it will be financed.

I am reminded of a New England story, a story which takes place in the State of Vermont. A gentleman moved up into the State of Vermont from the New York area and he thought he wanted to become a good citizen. He noticed that the town seemed to be rather poor, and he felt that one way of establishing himself would be to provide work for some of the people there who seemed to be unemployed and in need of work. He remodeled his house, he decided to build a swimming pool, and he did some work grading the lawn. But he felt that the more he spent and the more he poured into this community, the less popular he was. Finally he found that some people were refusing to work for him.

So he spoke to one of the natives, a man whom he felt he knew the best, and he said: "I don't understand this. I've tried to do everything which I felt was indicated here. I have tried to be a good citizen. I have spent my money as freely as I could. I have created work. And yet I have a feeling that there's an animosity here in this area. What's causing it?"

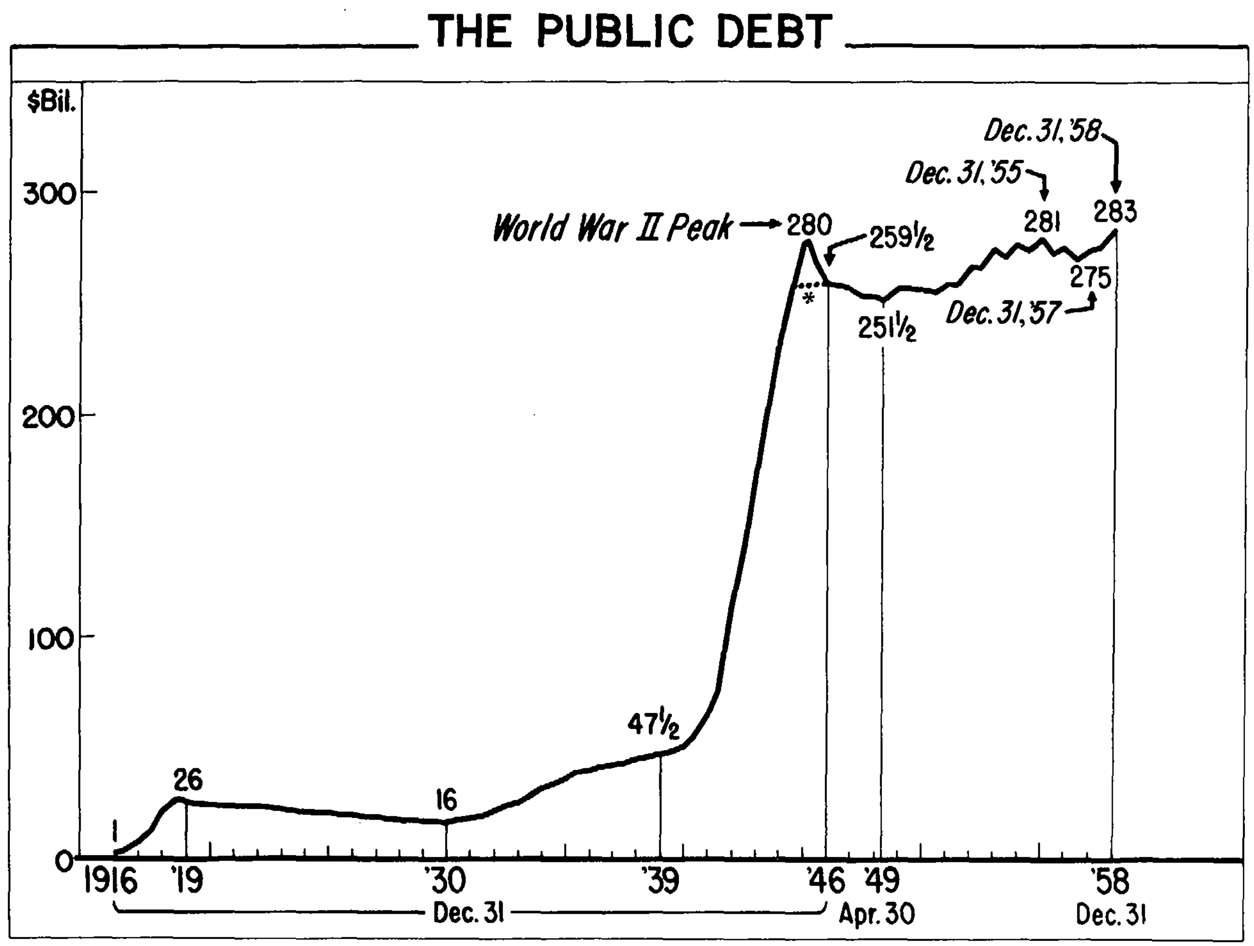
"Well," the native said, "the whole thing is this: You see, there seems to be a feeling around this community that you're spending your principal."

Well, I can assure you gentlemen that in the Treasury Department we're spending all the income that we have and we're also spending our principal. We have been spending in sizable amounts, funds that we do not have. So that the story of New England thrift, which is characteristic of Vermont, is not at the present time entirely characteristic of our policies in the Federal Government.

I have with me today a few charts which I think will in graphic form help to bring out some idea of the factual situation which we confront and some idea of the problems which we will have to face in the next few months in the field of financing or refinancing our debt situation.

Chart 1, page 5.--This gives you the story of our public debt since 1916. You will note that we started with about a billion dollars of debt in 1916. In order to finance the First World War, the debt built up. Then we were able to pay off some $10 billion up to the thirties. Thereafter, in order to finance various programs which were thought advisable to help the economy, we built up to a total debt in 1939 of $47.5 billion. That was thought to be a tremendous sum at that time. To finance World War II we went up to a peak of $280 billion. Actually we went up to a peak of only about $260 billion. Because, as you will recall those days, we overfinanced at the very end of World War II. We had on hand at the end of the war a lot of money in the Treasury. It was thought that there might be a substantial falling off of economic activity in the United States when peace came. These funds were kept on hand to meet the projected situation. There was not the expected fall-off, and so that extra amount of money on hand was very quickly used to reduce the debt.

CHART 1



*Excluding Victory Loan proceeds used to repay debt in 1946.

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There was some success following that in getting the debt down to $251.5 billion in 1949. Then with the world developments and our own developments in the economy, we built up to a debt on 31 December 1955, of $281 billion. We had two years then with some surplus and we brought the debt down to $275 billion. Now we're back up again to an all-time peak of $283 billion.

To me it is extremely interesting that from the beginning of this country back in the 1780's, we have spent as a nation, on the Federal level, $1.25 trillion. A trillion dollars is a thousand billion. But we owe one-fifth of that. In other words, during the time that we have existed as a nation we have been unable to pay our way as we went to the extent of one-fifth of all of the money that we have spent.

Chart 2, page 7.--This chart is a statement for your information of our budget operations, indicating where the additions to our deficit came from since 1953.

You will note the very limited period of time when we had a surplus and how small that surplus was. You will note that in the fiscal year 1959, the year that we are in at the present time, we expect to have expenditures of about $81 billion, income of around $68 billion, and a probable deficit for this year of $13 billion.

We now project a very narrow surplus for fiscal 1960, the budget we are working on at the present time. This does call for a step-up in revenue of about $9 billion. That seems a very sizable step-up. However, we have checked this very carefully with various private business organizations. We have checked with some of the larger corporations as to what they predict for their own business and what their own business planning is. We think that this is a proper figure and one which is entirely feasible, assuming there is no unexpected downturn in the economy. Certainly no such downturn seems to be on the horizon at the present time.

Chart 3, page 8.--Using this chart, I will very quickly touch on Federal budget receipts. This will give you a picture of the sources over the years and how they break down now.

CHART 2

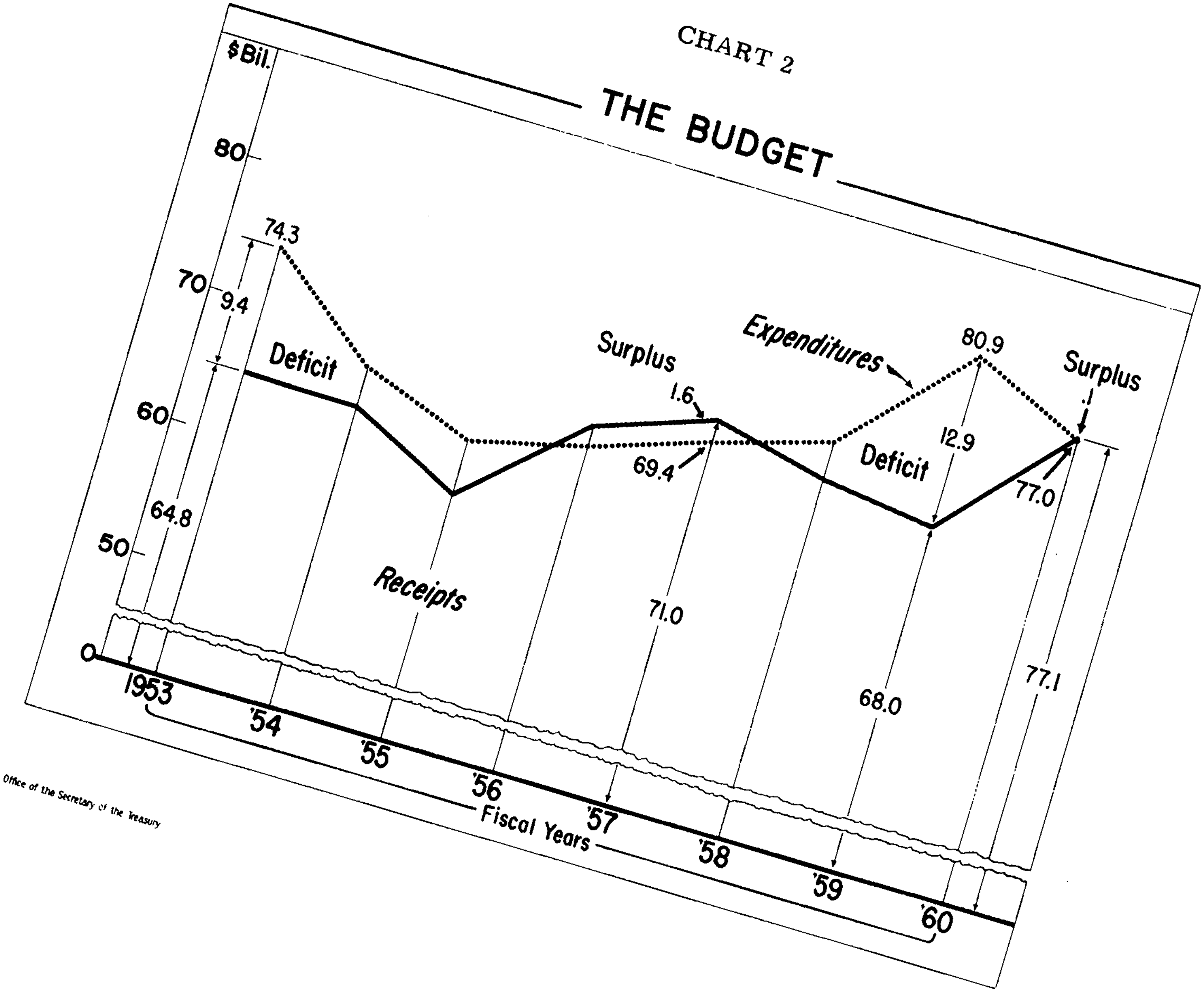

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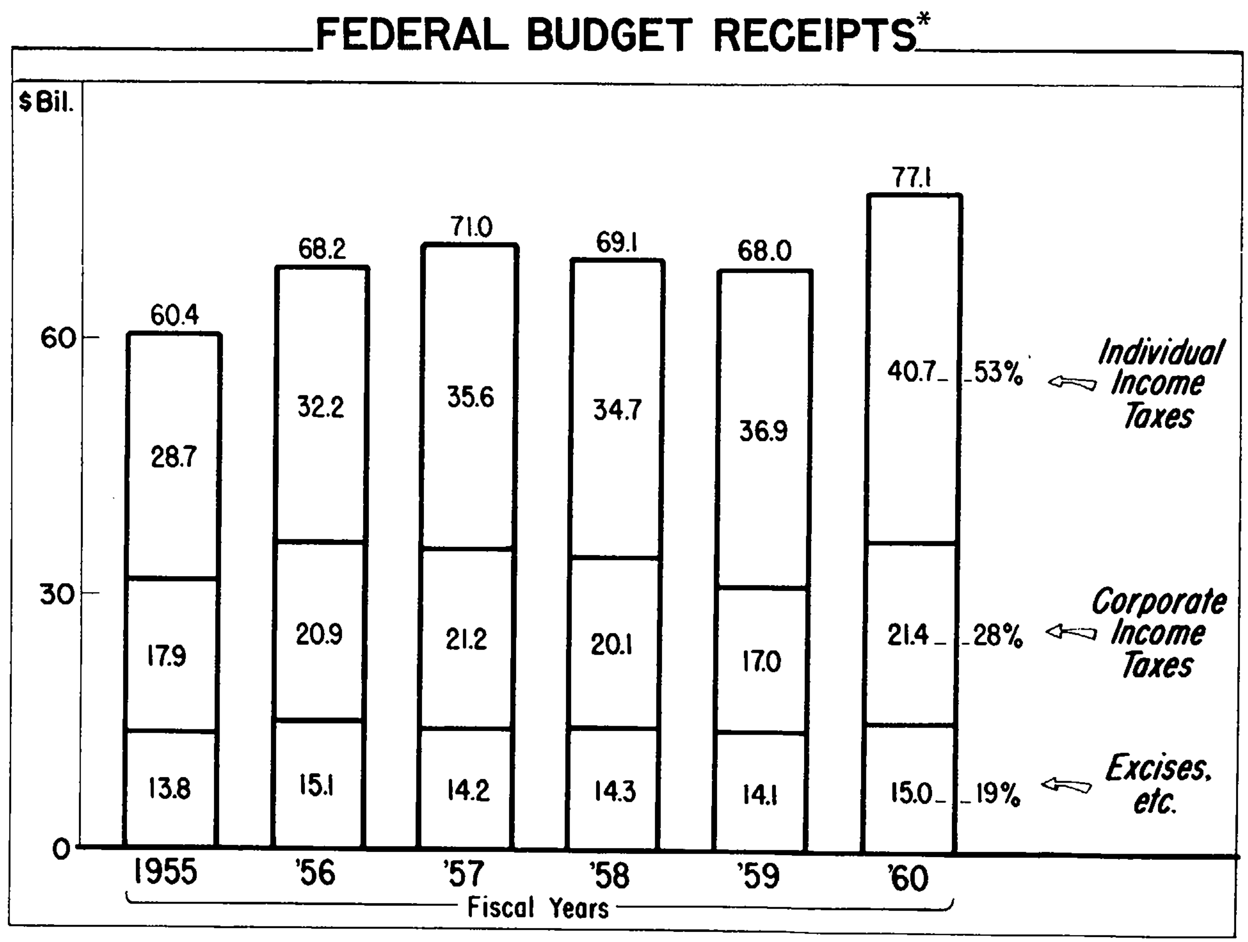
CHART 3



*Net receipts after refunds.

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I think it's rather interesting to note that our income from excise taxes, in spite of the varied types of economy that we have had since 1955, has remained steady--at about the $15 billion level. Corporate income taxes have not fluctuated nearly as much as might be expected. They have gone down, of course at times. We expect them to go down during this year, 1959, reflecting the fall-off in business. But then we expect them to go back up again in fiscal year 1960 to about where they were in 1956, 1957, and 1958.

Of course, the substantial part of the revenue step-up is expected to come in individual income taxes. I think you should note that we collect more than one-half of our total income from our individual income tax setup.

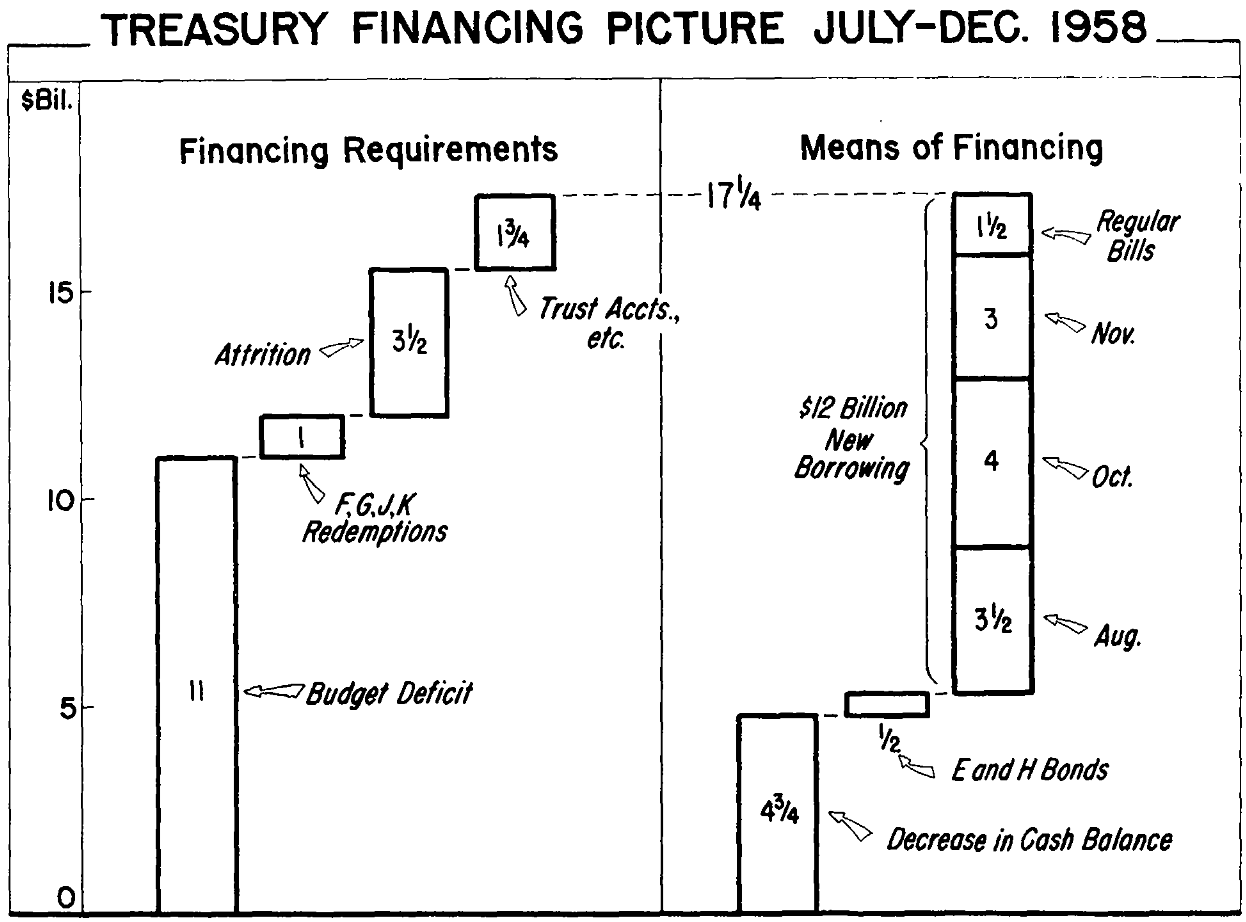
Chart 4, page 10.--This chart shows the Treasury finance requirements. These were the finance requirements which we had in the six-month period that ended December, 1958.

You will notice the total amount of $17.25 billion which we were required to finance. That is a tremendous sum of money. It is substantially in excess of all of the money that all private business in the United States borrows in the course of a year. This had to be refinanced within a period of six months. We arrived at that amount because of an $11 billion budget deficit. We spent in this period, in other words, $11 billion more than we took in from taxes and from rolling over the securities that were outstanding.

We had a billion dollars to meet from the F, G, J, and K bond redemptions. Those are large-size investment bonds which we are no longer issuing. We had an attrition of $3.5 billion. That is, we gave people holding bonds an opportunity to take new bonds and they were not willing to do so to the extent of $3.5 billion.

We needed $1.75 billion for our trust accounts, because during this period of time more money went out of our trust accounts than came in. Those are the unemployment account, the railway pension account, and similar accounts, which the Federal Government holds. In some periods the payments build up and therefore the funds that we can borrow from them are increased. When they are spending more than they are receiving, their loaning capacity is reduced.

CHART 4



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The other side of the chart indicates how we did that financing. At the start of the period we had a substantial amount of cash on hand. That was partly due to the fact that we receive the bulk of our taxes in the first of the calendar year, and therefore we are apt to have a fairly good balance on hand at the start of a fiscal year. We reach a low peak at the end of the calendar year, because our tax take is not even during the year.

We sold a half billion dollars more of the E and H bonds than were redeemed.

We had $12 billion of new borrowings. Part of that was done by going to the market in August, October, and November in the amounts there indicated. One and one-half billion dollars was done by increasing the amount of our outstanding bills. Those are the very short-term bills that come out and that we roll over every 60 or every 120 days.

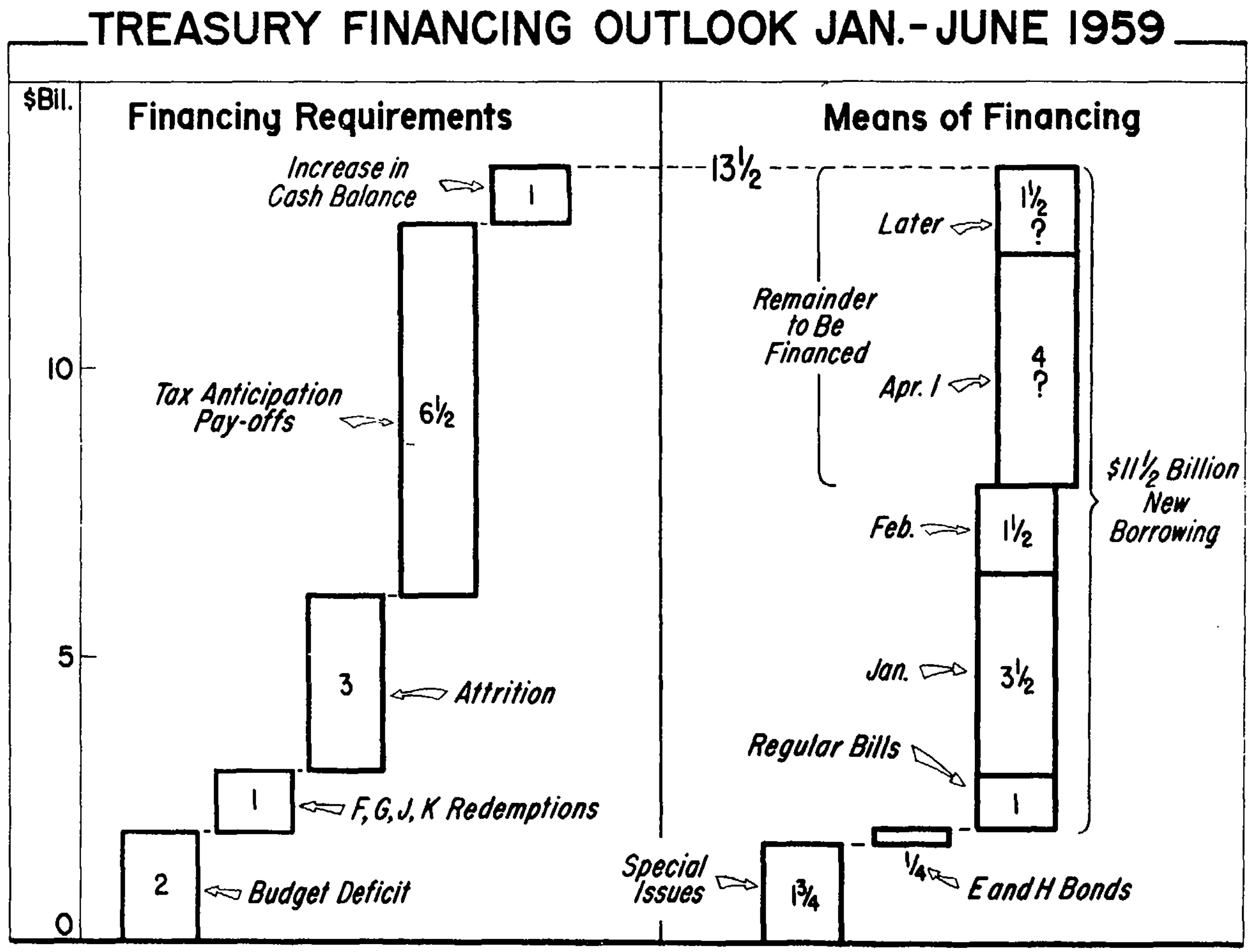
Chart 5, page 12.--This chart shows the financing outlook from January to June of 1959. This is what we're going to have to do in the six-month period that we are in at the present time. You can see that in the last six months we have taken care of most of our budget deficit, but we still will have a $2 billion deficit in this period.

Some of these investment bonds, F's, G's, J's, and K's, to the extent of a billion dollars, will be turned in. We expect an attrition of $2.75 billion.

There will be tax-anticipation payoffs. Corporations buy short-term securities earmarked to pay their taxes. We know that that's what they're going to be used for, and we want to increase our cash balance somewhat to meet them. That will amount to $13 billion in this six-month period.

We will have special issues set up for some of the trust funds, possibly for some of the International Monetary Fund financing, where certain types of securities can perhaps be issued.

CHART 5



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We again hope to sell a half billion dollars more of E and H bonds than are turned in. Incidentally, we have about 400 of the country's top executives in Washington this week--and the President will address them today--to further enlist their support for this program insofar as buying bonds by payroll deduction is concerned. We expect to do some of this financing--half a billion dollars--by again increasing the amount of regular bills that are put out.

We have already done $5 billion worth of financing in January and February. We have $5 billion left to be done between now and the end of June.

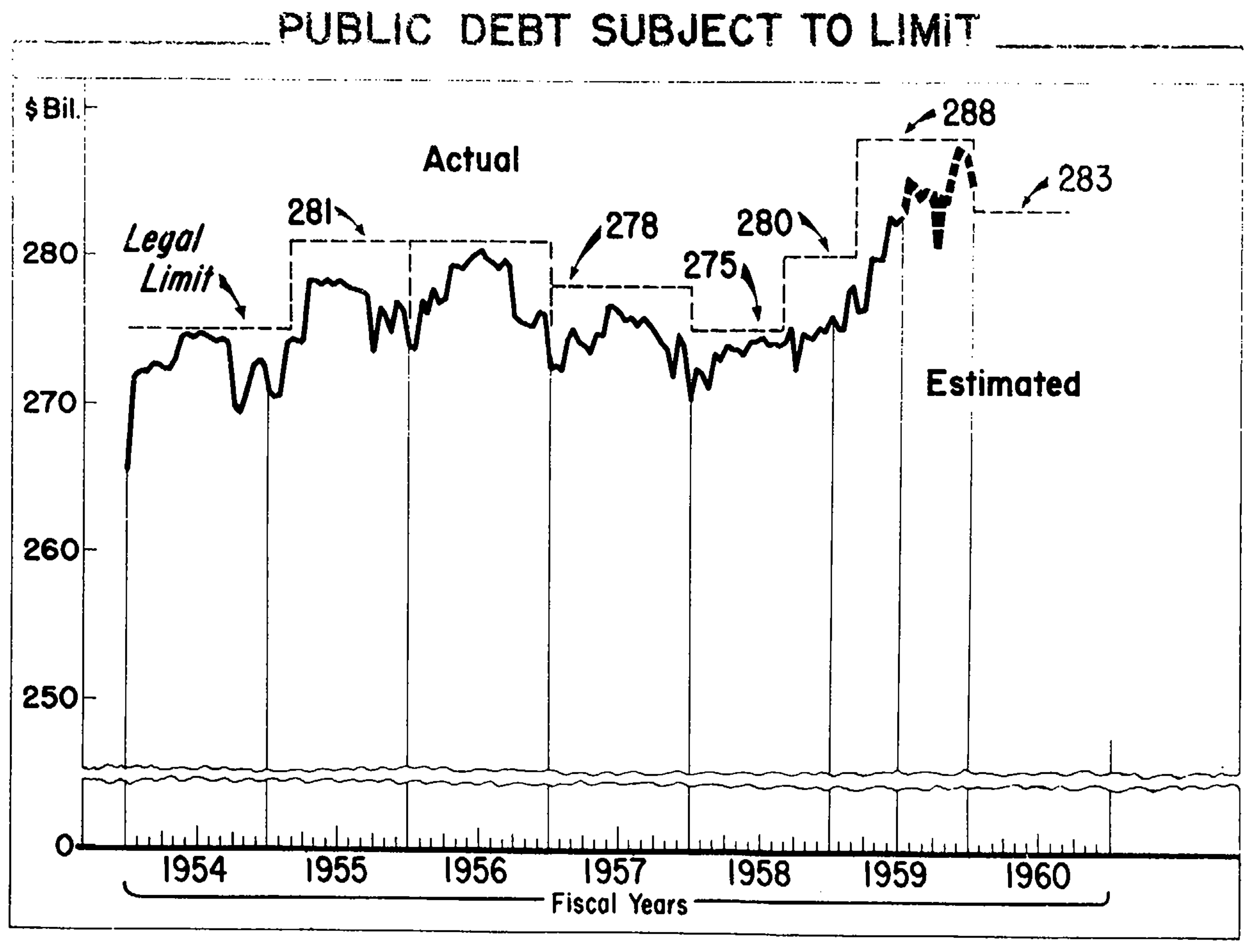
Chart 6, page 14.--Congress itself in the early days of this country handled the borrowing of money and the setting of terms. But it became evident at an early date that that was not practical, and the responsibility was turned over to the Secretary of the Treasury. He does have wide powers in this area. There are a few limitations. We cannot on bonds, which are Federal securities maturing more than five years after issuance, have a coupon of more than 4.25 percent. Any issue which matures more than a year after it is issued must be approved in writing by the President.

Then, of course, there is the debt limit. At the present time we are acting under a temporary debt limit of $288 billion. The permanent debt limit now is $283 billion. We will revert to that in June. We will not be able to get under that. So we will have to go to the Congress between now and the end of June and ask for a further increase in the debt limit.

I think this gives you a rather graphic picture of our problem. It shows the great difficulty we have had in getting the debt down. It shows how close we work up to the debt limit.

There has been much discussion as to whether or not a debt limit is a good thing, whether we need a debt limit. People ask: "Wouldn't it be better to have greater freedom?" If it seemed advisable now to put out a long-term security--and we're always fighting to get out long-term securities--wouldn't it be helpful to have some room in which to move, so that perhaps we could put out $5 billion of long-term securities to refinance some short-term securities that would be coming due, say, in 30 days? Also isn't this another restriction that is unnecessary in that we don't spend any money unless Congress appropriates it? If Congress wants to prevent the debt from going up, they have an effective means of doing that by not voting any extra money.

CHART 6



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Well, frankly, we in the Treasury do not urge the removal of the debt limit. We think that it has some significance to the public. It is something that people can understand. We ourselves in our operations are willing to have that benchmark, if you will, that we must work against.

We do think that there should be a liveable margin under it. We think, for example, that to make us stay within a half billion dollars or even a billion dollars for any given period of time is an unreasonable restriction. It calls on us for too close an operation. We'd like to have some moving space of a reasonable nature, having in mind the tremendous debt that we have and the amount of refinancing we must do every year.

Chart 7, page 17.--This shows the structure of the public debt, which is of major interest. Of course, the closer you get to a bond being due, the closer you get to that bond being nothing but currency. If it's due tomorrow, it's pretty much like a dollar bill that's floating about.

We like to have the debt spaced out. In the first place, in this country of ours, with its involvements in the business field, it's a good thing to have different types of Federal securities. It is good to have some that people can buy if they want to invest their money for a short period of time, others that can go into trust funds, and so forth. But, further than that, you need some living room here, just as you do in your own private affairs. If all your indebtedness is going to come due in the next three months, even though you may be able to refinance it, it's a much more difficult problem, much more complicated for you to handle, than if you can refinance that same amount of debt over many years.

Now, $72.5 billion are going to come due within one year from 1 January of this year, $54 billion in from one to five years, and $49 billion in five years and over. We have been trying ever since this Administration came in--and I'm sure that other administrations did too--to lengthen out this debt. There is another chart, number 8 in this series, which will show you whether or not we have had much success. It has been an extremely difficult task.

We prefer to have more of the indebtedness over in the nonmarketable areas. Those are areas where the securities cannot be sold by the individual holders in the market. They are not freely tradable. They include the securities that we issue to our special trust funds, which I have described to you before. Then there are the investment bonds. Those are the ones that have been coming due and will continue to come due. Then you can see here the tremendous reliance that we are placing in our savings bonds. You see the large amount now in the picture--some $50 billion. This part of the debt has a very, very wide base. I think that these savings bonds are held by something like 40 million Americans. Many people have only a very few bonds. The average holding time now is about seven and one-half years. So you can see that it falls in the long-term debt area.

There are some who have said: "this is a bad type of debt to have out in such large amounts, because it can all be presented at any time. It's all a demand obligation." That's perfectly true. But you have to consider our experience. It was thought during World War II that immediately after the war, these bonds in the hands of the general public would come in in great numbers. They didn't. We now have had a number of years of experience. Just as people who are running a savings bank or an insurance company can make some prediction of what the rate of redemption will be, we can make some prediction here. It is a type of debt that, since we've got to have this heavy obligation anyway, we think is good to have in the picture. We hope that we can increase the holdings among the great rank and file of Americans in this savings bond area.

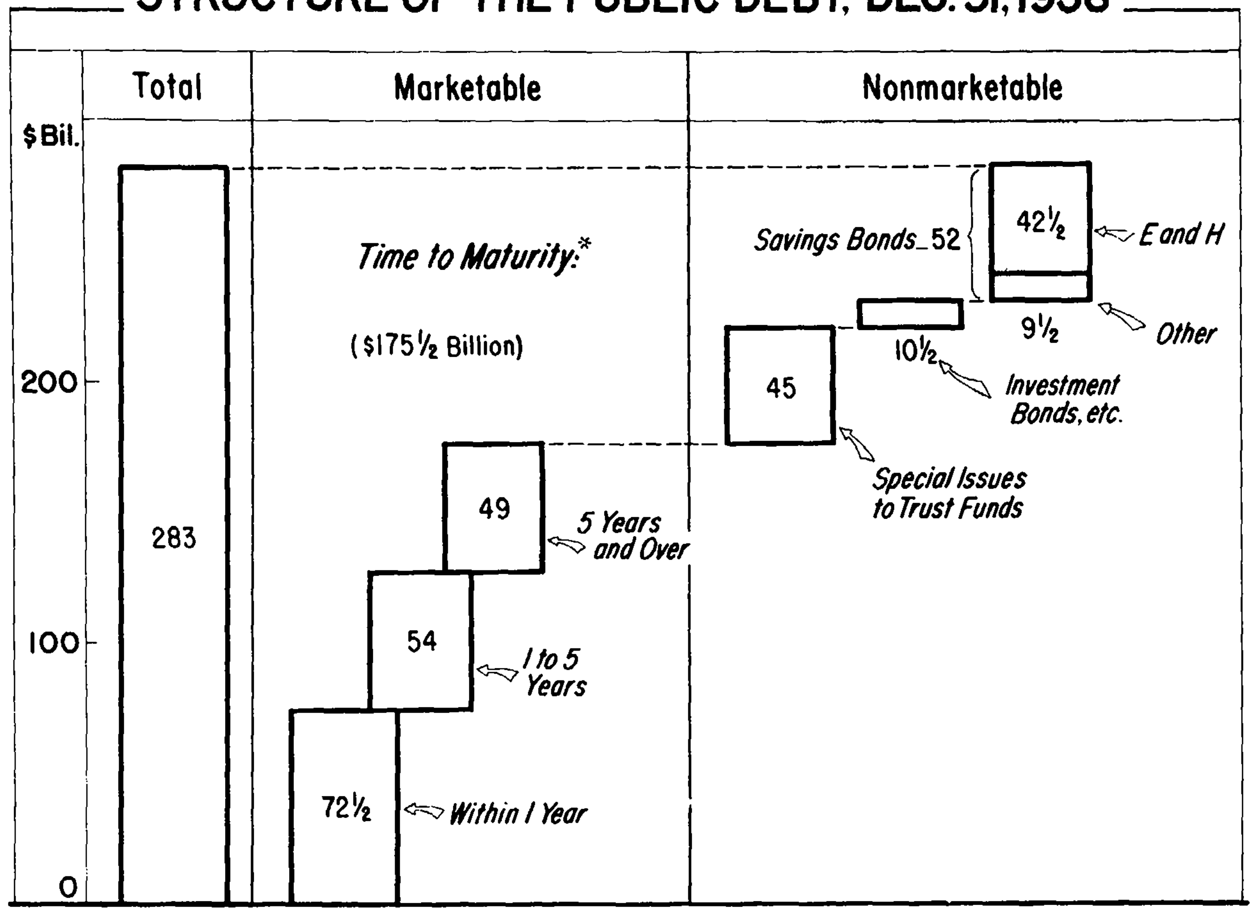
Chart 8, page 18.--This is a chart of the average length of the marketable debt. You can see that, beginning in 1952, we had a relatively long average time. It ran down pretty sharply until the end of 1953. In the period, 1954 and 1955, things were improving somewhat and we were able to put out longer issues. But from 1955 on it's been extremely difficult.

You know that we deal in a free market. We have no controlled market for Government securities. That means we must tailor the security we issue to the market we have, which is the buying public. If they are concerned about inflationary pressures, if they want their funds for other investments or for other reasons, they won't take a long-term obligation. We rather recently have had demonstrated to us that even with a very favorable interest rate, there is a limit to the amount of long-term securities that we can push out.

In the latter part of 1957 and during 1958 we had some success in pushing the long-term securities out again. We have slipped back a little bit since then. But, as you can see from this chart, if you averaged it out, it hasn't been too bad a job of holding the line, having in mind the rather substantial increase that we have experienced in the Federal debt during this period of time.

CHART 7

STRUCTURE OF THE PUBLIC DEBT, DEC. 31, 1958



*Partially tax-exempt bonds to earliest call date.

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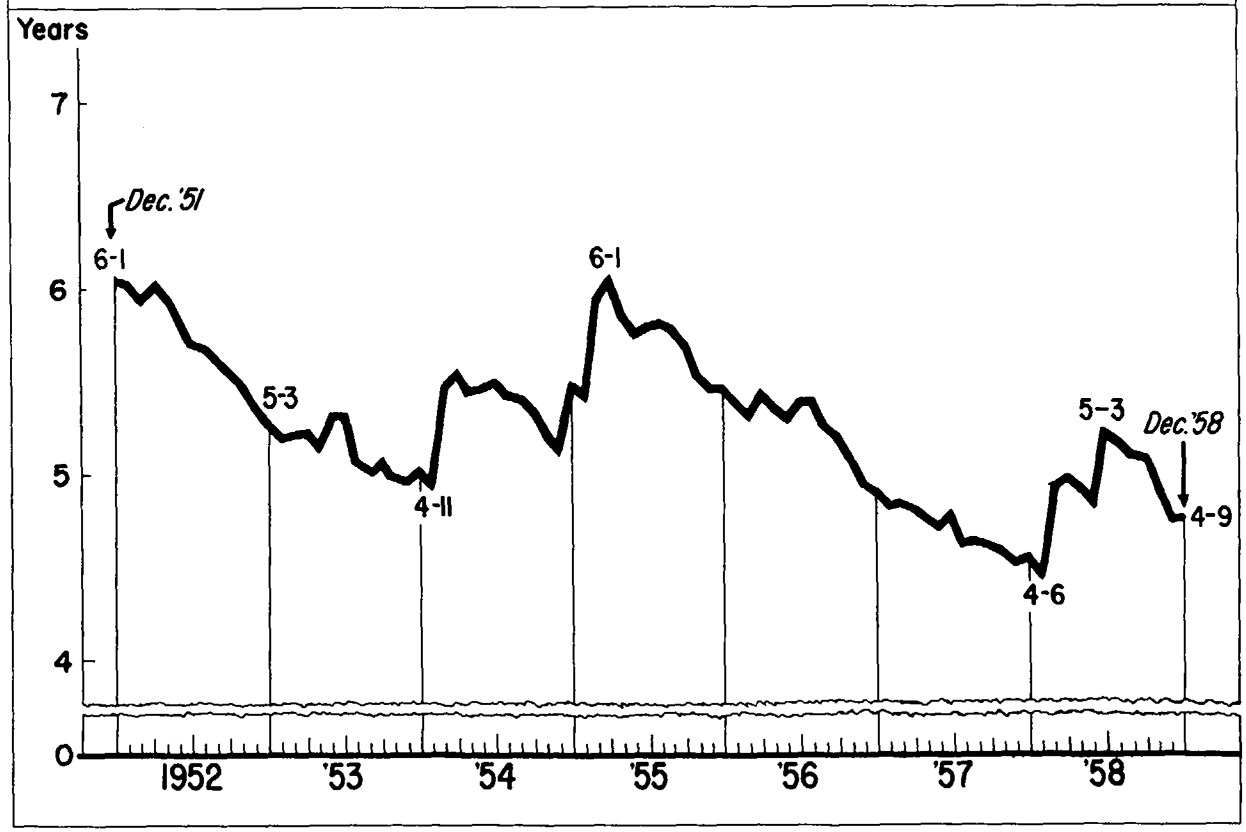
CHART 8

AVERAGE LENGTH OF THE MARKETABLE DEBT

(Callable Bonds to Maturity Date)*



Partially tax-exempt bonds to earliest call date.

Office of the Secretary of the Treasury

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Chart 9, page 20.--This chart is of interest as indicating the yield trends. Again we're in an open market. We have to pay what the market demands in the way of interest.

Some of these securities are sold at auction. Others are sold at prices fixed after our debt management people have carefully studied the market.

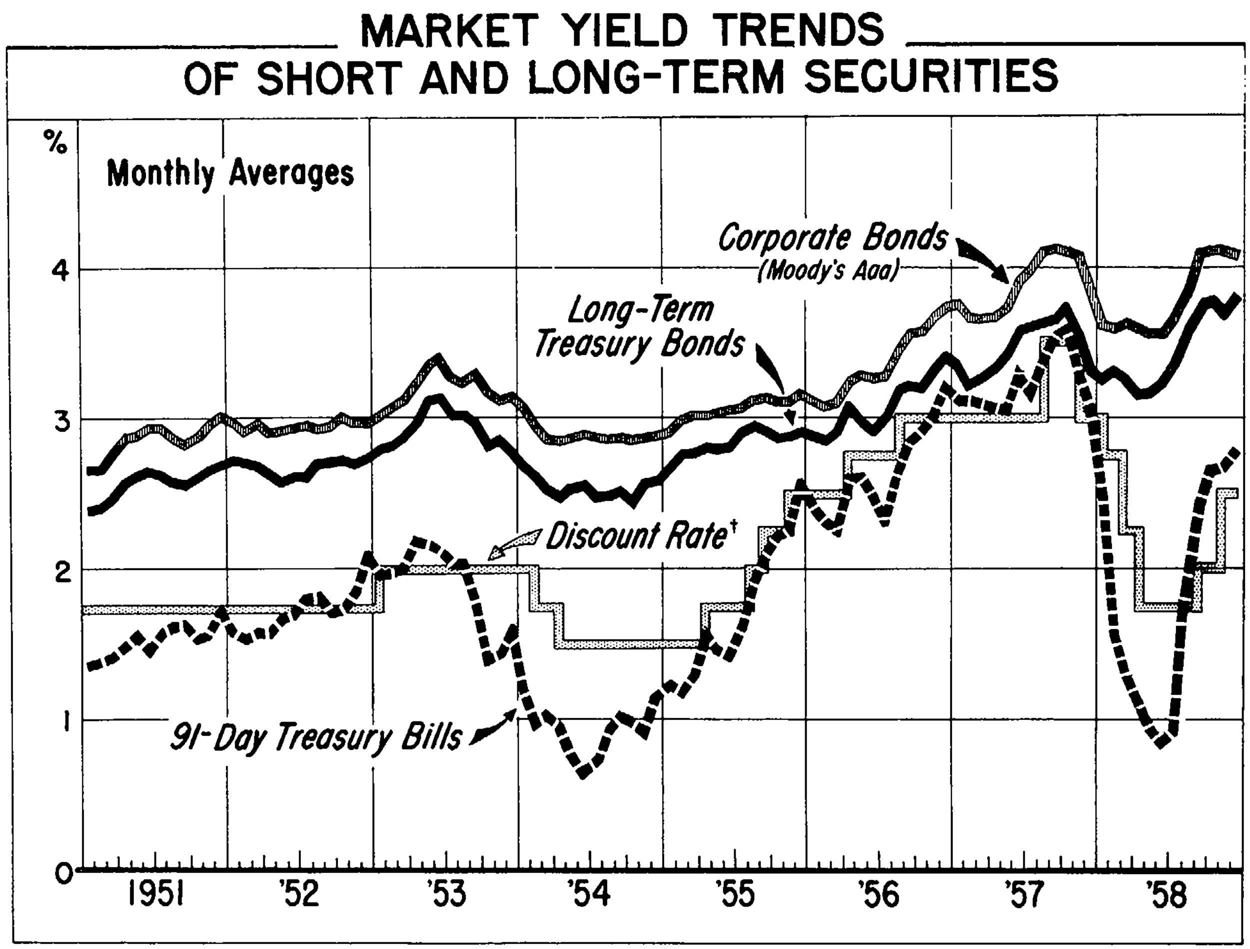
You will notice that the interest rates on the Treasury bills follow at least pretty much the discount rate. We have tried to find out which comes first--the discount rate or the rate on the Treasury bills. There doesn't seem to be any set answer on that. Apparently sometimes the discount rate changes and the Treasury bill rate will follow it, and at other times the Treasury bill rate will get a little bit ahead of the discount rate.

Chart 10, page 21.--Now, what about the ownership of this public debt? Again it is our interest and desire to have as much of the debt held by nonbank investors as possible. The reason for that I am sure is clear to all of you. When we do our borrowing from the commercial banks or from the Federal Reserve System, we are adding to the inflationary pressure.

Why is that? Well let's consider the following example. If we went to any one of you gentlemen and said, "We'd like to sell you a thousand dollar bond," you'd have to get the thousand dollars from some place. You'd have to either draw it out of the bank, sell some securities that you had, or sell some personal property that you had, and put the money into the bond. So you would dispose of one asset and acquire another asset.

But if we borrow either from the Federal Reserve System or from banks, all that happens is that we give them a thousand dollar bond, which they put in on the asset side of their ledger and they credit the Federal Government with a thousand dollar deposit in the bank. They don't take a thousand dollars out of anybody else's account. They don't make any other change in their holdings. I'm not talking about the reserves that they might have to set up. They do create additional bank credit, which adds to the amount of credit available in the country and thus feeds inflationary pressures.

CHART 9



†Federal Reserve Bank of New York.

Office of the Secretary of the Treasury

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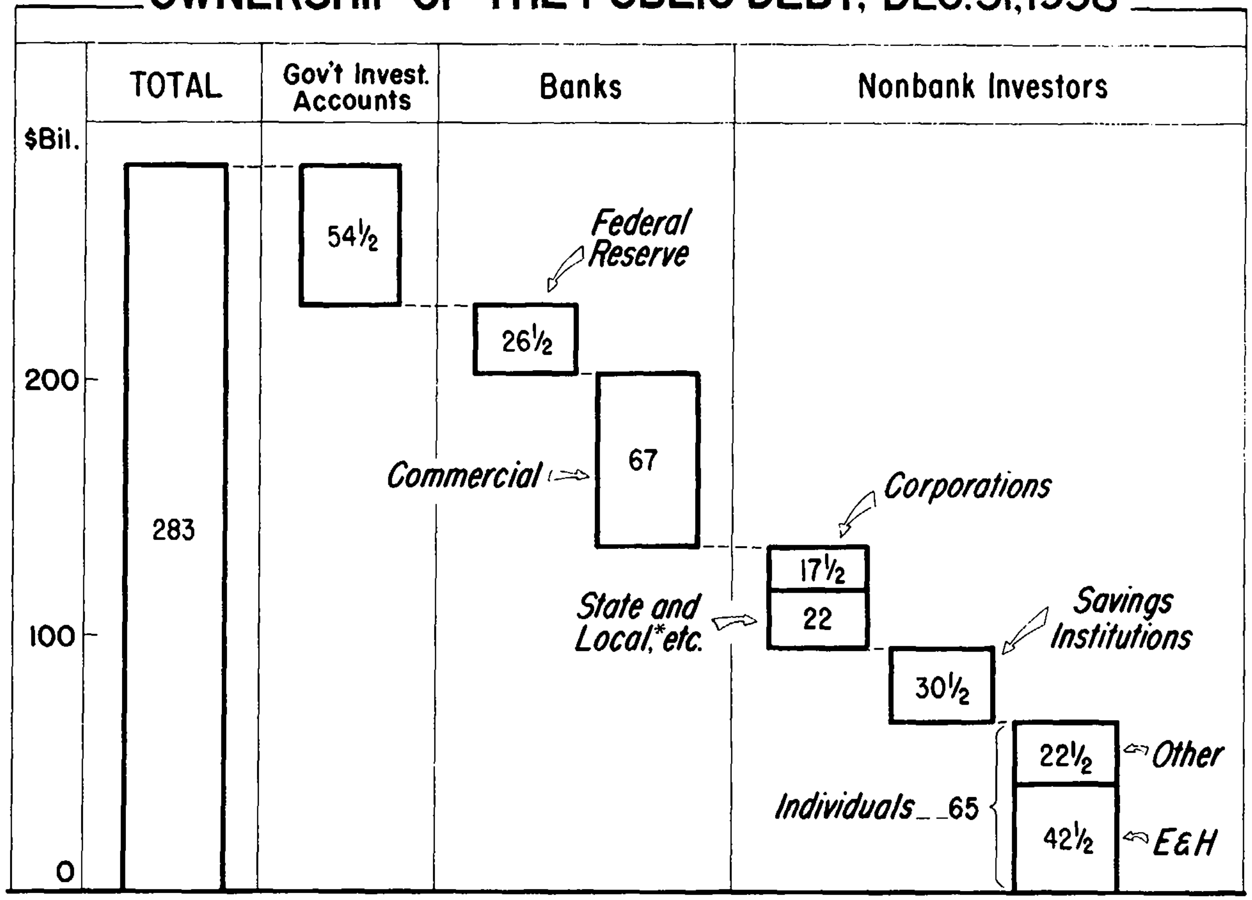
CHART 10

OWNERSHIP OF THE PUBLIC DEBT, DEC. 31, 1958



*State and local pension funds included with savings institutions.

Office of the Secretary of the Treasury

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The Government investment accounts I think speak for themselves. These are securities which the Federal Reserve buys from time to time, either in the open market or in connection with their financing. It is helpful to us at times when we have a refinancing to have them indicate that they will refinance all of their holdings. If an issue is held, let us say, one-half by the Fed and one-half by the general public, and we know that the Fed is going to take up all of their issue that is outstanding and refinance those bonds, it makes the rest of our job somewhat easier.

Then we have the commercial holdings--life insurance companies and so forth.

You have also the nonbank investors--the corporations. There you include both the corporations and the States. The States' investment will vary. Sometimes it's for their trust funds. Sometimes they invest for a short period of time with funds that they are going to use for State spending but don't need immediately.

Savings institutions speak for themselves. Then again you see the individual operations at the very end.

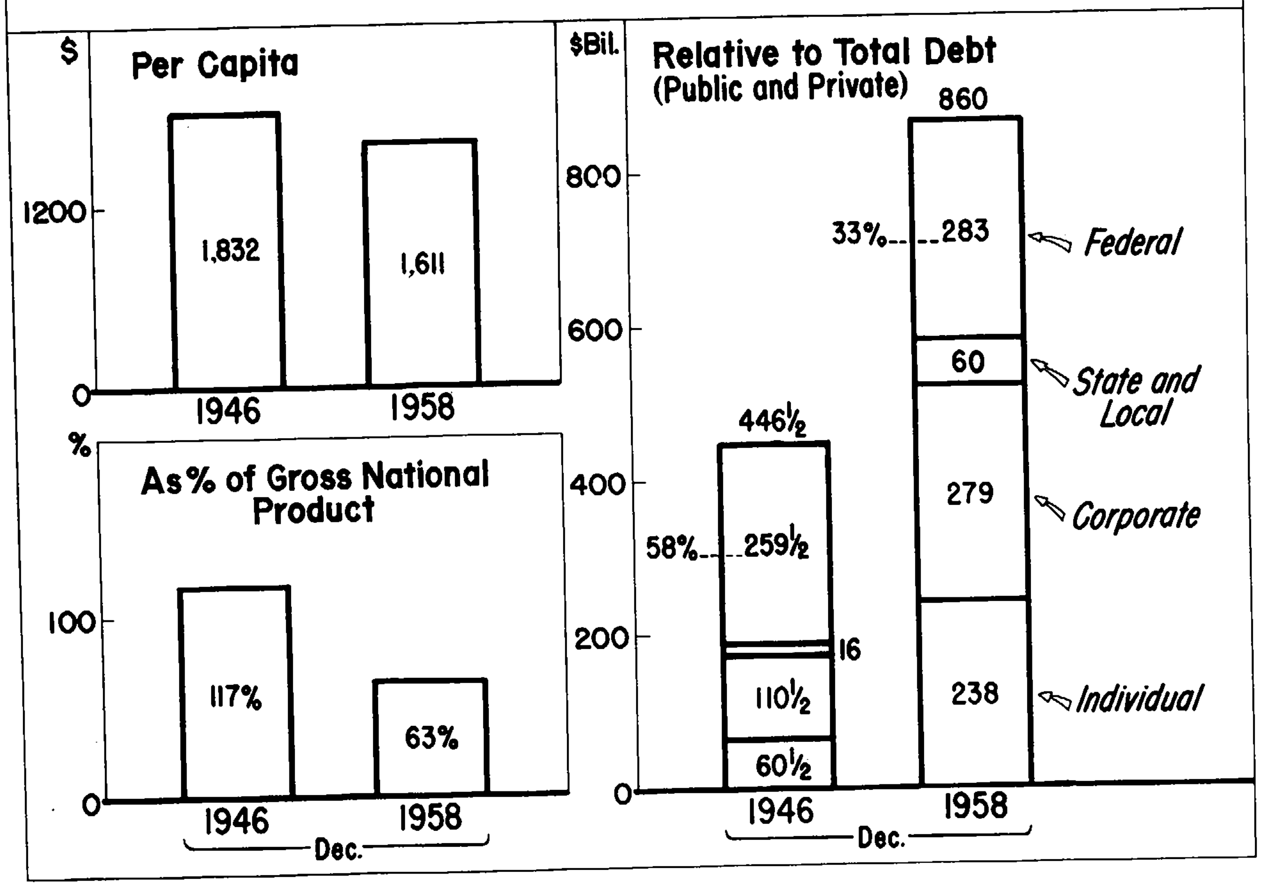
Now, our whole push, our whole attempt, in financing is not only to get longer-range securities out and keep the interest rates down, but to get as much of the investment as possible over into the hands of nonbank investors.

Chart 11, page 23.--This chart gives you a picture of the public debt in a growing economy. It shows the relationship of the public debt to the population--how much it is per capita. It has come down per capita somewhat since 1946, although it is growing in total. It shows you also the percentage of our gross national product that the debt represents. It shows the amount of the debt that was created by the Federal Government, State, local, corporate, individuals and compares it to 1946.

Gentlemen, this of necessity has had to be a very rapid view of some of our problems. I hope that it gives you some feeling of the tremendous problem that we face. We will have to refinance about $72 to $73 billion during this year. That is a tremendous task. We need to have as satisfactory a market as possible to take that.

CHART 11

THE PUBLIC DEBT IN A GROWING ECONOMY



Office of the Secretary of the Treasury

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What do we think about as we face the market in doing our financing? Well, we have five things that we check on and try to be sure are there. If you have all five of these worked out properly, the answer is easy. You could do it.

In the first place, we have to be sure that we get our money. We have to be sure that we get our money because we need it very promptly after the financing date. In the last six weeks we have been running with free-callable funds--that's money on deposit in the bank that we can call in--equal to about two weeks of expenditures. That's a pretty short operation to be running when you're spending some $80 billion a year. I can assure you that no private corporation would want to run that closely.

Also, if we project an issue and put it out and it doesn't do as well as some people expect, that has a bad effect. It starts off a lot of rumors that have no basis. It also starts off a lot of considerations in the private financing field. So we must be sure that we put out an issue of the right size, at the right time, and with the right interest rate, so that we will get it all taken up, and produce the necessary money.

Secondly, we want to borrow our money as cheaply as possible. We are paying some $8 billion a year now in interest. We don't want to pay a cent more than we have to pay. It's quite a job to estimate just whether you need to put it out at 2-1/2 percent or 3-1/4 or 4 percent. We don't want to pay too much. If we make a mistake there, the public is going to know it very very quickly. If we agree to pay too much, the bond or security will begin to sell at a premium very rapidly. Of course, if we don't pay enough, it's going to be sold at a discount very rapidly. The frequent issuance of Government securities which immediately go to a discount is not helpful either.

Third, we want to extend the maturity. We want to estimate as reasonably as we can how long a bond the markets will take, and then put that bond out. If they are ready to take a 20-year bond, we don't want to put out a 5-year bond. If they're ready to take a 3-year note we don't want to put out a 60-day bill.

Fourth, we want to do the maximum amount of borrowing outside of the banking system. We want to tailor the offering in such a way that it will appeal to the nonbank investors.

And, finally, we want to go to the market as seldom as possible. If we go into the market every 30 days, we are an upsetting influence. As I have indicated to you, in the two financing periods which we had on the screen our borrowing was more than double the amount of securities issued by private business during that same period of time. We also have the State and municipal borrowing to consider. We very frequently have had it happen that after we have announced an issue, the mayor of a city or the treasurer of a State would call and complain bitterly that they had their financing all ready to close; that they were going to secure their financing at, we'll say, 3-1/8 and we just put a security out at 3-1/4. The minute that happens, of course, the people who were going to buy the State or the municipal security will say, "Well, the Federal Government is paying more. We won't take yours." So now we are trying to go to the market for new borrowings not more than four times a year.

These are the five things which we try to do. If we guess right on all of them, we make the right choice. If we make a mistake somewhere along the way, then that financing, while it won't fail, will not be as successful as we would have hoped to have it.

You are interested here in the total defense picture. You are here because we as a nation have a two-pronged job to do. I know you realize that. One of these tasks, which is one of our responsibilities, is to provide an adequate defense establishment to discourage any threat to this country from any outside source. Our other job is to make sure that our economy here at home is strong enough now and remains strong enough to support that defense establishment and at the same time to maintain here at home the kind of a country which we want, with the freedoms which have brought us where we are today. I am sure none of us want to defend this country for the sole purpose of defending some real estate and some people who might be living in it at a particular time. We want to defend the United States with the rights and the privileges and the freedoms which we have had in the past and still possess today.

During the past two decades the value of the dollar fell by more than one-half; but there is certainly little general understanding of the inflationary dangers resulting from continuing large Government deficits. When the Government lives beyond its means, going into debt to pay for part of its requirements, as you have seen we have been doing, we create heavy pressures for an inflationary price rise. Inflation weakens the whole economy. It brings serious hardship to those of our citizens who are least able to protect themselves against a rising cost of living.

When the Government spends more than it takes in, it must borrow the difference in order to pay its bills. To the extent that these funds can be obtained only by resorting to borrowing from the commercial banking system, there is real inflationary pressure, as I have already pointed out. Heavy competition from private borrowers for available savings usually means that a large part of our deficit will have to be financed through issuing securities to the banking system. This results in an equivalent increase in bank deposits. It increases the money supply. To add to the supply of money more than is added to the amount of goods and services tends to decrease the value of our money. In that way deficit financing generates inflationary pressures sooner or later.

The other major area in which we are generating inflationary pressures is, of course, in the wage-price spiral. This is a difficult area in which to move, because the minute you begin to talk about it, particularly if you are in an area where you are subject to being quoted, it is said that you are trying to indicate that labor shouldn't have its fair share.

Now, you gentlemen know that that's not the point at all. The point, again, is that if you increase the supply of money without adding to the amount of goods and services available, you are going to decrease the value of our money. And when you give a wage increase with no increase in production, when you are getting no more labor for the higher wages than you got for the smaller amount, when you are producing no more goods than you did for the smaller amount, you are creating the same kind of inflationary pressures that you create when you have a deficit in Federal financing and go to the commercial banking system to help to carry it.

I'm sure it's clear to you--if not, it should be--that we in the Treasury Department have not followed or urged, and will not follow or urge, policies which are in any way inimical to our national defense, or try to impose our judgment upon those responsible for our national safety. However, military strength is necessarily based upon a strong and a dynamic economy. If we're going to continue to carry the heavy load in the military field which we have, we need to have an economy which will grow and which is dynamic. Weakening our economy will play into the hands of those who threaten our way of life just as surely as weakening our military position.

Some people will tell you, I'm sure, and perhaps have here, that all the Government needs to do is to spend more money; that the economy will then grow faster, and we will have more resources for everything--for defense, for housing, for personal consumption. Frankly, in my opinion this is a short-sighted doctrine, because it will inevitably lead the inflationary spiral.

To argue that with a larger output, costs tend to fall overlooks the simple fact that a rising demand for labor and raw materials drives up costs. An economy running under forced draft, like a war economy, is bound to be inflationary. For a short while people will enjoy the illusion of good times that the inflationary boom will bring. This is an attraction on which this doctrine has been sold time after time in this world. It was sold in Germany. It was sold in France. You know the answer.

What happens a year or two later, after you have started off on this inflationary spiral and sort of relaxed and started to enjoy it? Well, the exhilaration passes off, and the hangover begins. An inflationary society is necessarily a disorganized and an inefficient one. It is a very poor base from which to conduct a long-term worldwide struggle against those who would destroy us if they could. It's a particularly poor base from which to meet the strain of a sudden emergency. We would have a hard time, gentlemen, taking the additional strain of even a minor emergency if we were to go into one already overextended.

We have a clear responsibility as a nation to adhere to prudent programs which will contribute to sustained growth in our economy over the long term. One of the most important of these is the maintenance of fiscal soundness. Imprudent spending and a complacent attitude toward deficit financing could in time destroy the very basis of our economic growth--the confidence of Americans in the future of this country.

I've been asked to touch--and I'll have to do it very briefly--on two other subjects. One is our tax policy as it affects our economy, as it affects the strength of our Nation; and the other is something about what we would do in the fiscal area in case of a serious nuclear attack or a serious attack of some other kind, which destroys part of the productive capacity of this Nation.

As to the first subject, there has been some talk about a tax reduction. I think it's obvious to you from the charts that you have seen here, and from the emphasis that we've placed on the desire to combat inflation through fighting deficit financing, that we don't have a picture at the present time which is particularly conducive to a tax reduction.

There is no question that our tax system is one that has just sort of grown up. For example, we still have a tax on the transportation of persons. Part of the reason for putting that on during the wartime period was to discourage unnecessary traveling. It's still on. It's on because, frankly, we need the revenue.

We do have a very heavy dependence on the personal income tax. There are many economists who think that this is helpful; that in this last recession the fact that we collected a large percentage of our income from personal income taxes and that this tax fell off quite quickly and in a sense quite sharply when the economy went down, therefore relieving the individual from that much of his tax burden, was helpful in getting things back on the road.

I think that if anybody was making a study of our tax system, he would look pretty hard at the question as to whether or not he might relieve some of the dependence which we now have on personal income taxes, because from the Government income side, at the very time when we may need all of the income we can get, such as in a recession, when we may need money to finance things on the Federal level, our income is going to fall off.

You've seen the dependence on excise taxes in the magnitude of $15 billion a year. The largest part of those taxes comes at the present time from the tax on alcohol and the tax on tobacco. There are some other excise taxes which many characterize as nuisance taxes, but they do add substantially to the total revenue that we take in.

Of course, we have a very heavy tax burden on our corporations. Except for those with relatively small profits, the rate is 52 percent. There is great complaint that this prevents them from piling up the capital which they need to rebuild their plant, as well as to do the research which they believe is necessary to remain competitive. They have not only to meet competition in this country but also competition in other countries.

There are many who feel that if we could get the corporate rate down below 50 percent, we could get over a psychological hump which is at present harmful. They say that at the present time many corporate policies are dictated on the basis: "Well, Uncle Sam is going to pay more than one-half of this; so any time I can get something for less than 50 cents on the dollar, I as a corporate executive will take it." They argue that if we could turn that around and let the corporations pay, we will say 49 percent, we might change their policies and it might result in a total tax take which will be greater from the corporations than at the present time. No one would ever know the wisdom of this contention until you could actually make the test.

On the question of tax reform as opposed to tax reduction, there are areas where we think we ought to have some reform. The whole area of depreciation is one which we are studying very carefully in the Treasury. We'd like to give some relief. We know some of the things that could be done. One of the things we have to look at though, frankly, is how much additional revenue we might lose through changes in the law.

If you are talking about a tax reform which merely erodes the base, which allows somebody else to escape paying taxes, then we're going to be against it. But if you're talking about a tax reform which adds to the base, and then lets everybody pay lower rates, then that's something in which we have a very great interest.

Now, what do I mean by adding to the base? Well, we have built into our tax system, because of the heavy rates, a lot of escape areas. If you're over 65, you get a double deduction. We allow a certain tax credit for people over 65 to sort of offset certain pension operations. We allow a special deduction for medical expenses. We allow now a special limited deduction for dividend credit.

The form is complicated. I've been asked many times: "Why don't you simplify the form?" Well, in that respect we do have a very simple form now. It's postcard size. People whose income is almost entirely from wages and salaries can fill out this card in a matter of four or five minutes. The only difficulty is getting the money to send in with it.

We took the longer form and we went over it line by line. There isn't a line in there that isn't required by some statute that has been passed by the Congress.

Now, the reason for many of the exemptions and credits is that we have such high individual rates, particularly in the top brackets, that they do create inequities. You have to allow deductions to correct the inequities. I'm not using this term accurately. These are not loopholes. None of exemptions or credits are loopholes in the sense that they slipped in and did something that the tax writers didn't intend for them to do. These were all items which were authorized by the Congress intentionally, because they felt that some relief was needed in these areas. They came into the system, however, because the rates, particularly in the upper levels are so high.

There's a good body of thought in favor of eliminating some of these escape areas. As a matter of fact, I think that the House Ways and Means Committee and the Treasury will begin shortly some intensive and extensive studies as to whether it may not be possible to eliminate some of these areas which I have talked about and at the same time reduce the rate all along, so that everybody will pay less taxes because the base will be broader.

Let me turn now just for a moment from these specific items in our tax policy to taxation generally as it relates to the broader question of fiscal policy.

You will all recall, I am sure, the very strong pressures that we had just a year ago for a tax cut. It was contended--and I think that we in the Treasury stood pretty much alone against it--that we needed a tax cut to insure early recovery. Dire predictions were made as to what the effect of Government inaction would be.

We resisted those demands, and I think that the events justified that decision. The turning point in the recession came in April--very much earlier than most prophets expected. The recovery, which some had said would be slow and halting, was in fact vigorous and sustained. I don't believe a tax cut would have brought a quicker turnabout, and I'm sure it would have multiplied our problems of insuring fiscal soundness during this current period of economic growth.

I personally am sure of another thing. We have had a very dramatic economic turnaround. It really was dramatic, as you have seen in the charts. We were using the term "saucering out" to describe what was going to happen. The economy didn't saucer out at all. It contracted sharply and it expanded sharply. If we had had a tax cut, followed by this dramatic turnabout, you would have a great body of opinion at the present time saying: "See, it was the tax cut that brought this result." We would have had built into our economic thinking for some time to come the idea that the immediate remedy, whenever business begins to fall off a little bit, is to have a tax cut. I think that what actually happened has established that you can recover from a recession without immediately rushing in and putting into effect a tax cut.

Our economy gave a very impressive demonstration of its resiliency and powers of recuperation. These are due to the inherent confidence and good sense of our people, to the solidarity and strength of our economic organization and of our financial institutions, and to the automatic stabilizers which have been built into our private enterprise economy through unemployment compensation and through the automatic adjustment of our tax burdens which I have spoken about. We can have confidence, I believe, in the strength of our economy. We don't need to resort to hasty, drastic measures each time that there may be a temporary falling off in economic activity.

I want to make it clear, however, that I hope, as we progress in our fiscal affairs, that we can eventually have a tax cut. Our economy does carry a heavy fiscal burden, and steps to reduce the pressures against incentives and the pressures against saving and capital formation would help the economy.

I don't mean to say that the economy can't bear the burden which we have now. It can. It can bear a heavier burden, in fact, for a reasonable period of time if our people are convinced that that heavier burden is really necessary and is not due to poor judgment in the selection of the places where you spend the money, or to just lack of economy in trying to reach necessary goals.

As we constantly evaluate our economic growth, however, certain conditions should be met before we consider any tax cut.

First, we should be sure that by reducing taxes we do not contribute to inflationary pressures. These pressures, now mostly in abeyance, could revive. In that case we should aim for a surplus in our budget. We should not eliminate the surplus through a tax reduction unless our whole economic posture warrants it.

Second, we must give thought to reducing the public debt. If in bad times we allow ourselves to run a deficit in order to stimulate the recovery, we must pay that debt off in good times. Otherwise we're going to engage in periodic increases in the public debt without any countervailing reductions.

A few years ago I think there was a sound body, or at least a large body, of economic thought which held that you paid off your debt in good times but might have to add to your debt in bad times to take care of the situation. We seem to continue with the thought of adding to the debt, but somewhere along the line we have dropped out the idea that we ever pay any of it off.

Finally, and I believe most importantly, the prospect for a tax cut depends upon our success in holding down public expenditures. You know the efforts that are being made in the Treasury, and you know the efforts that are being made, and with success, in the Armed Forces.

It's very easy indeed for everybody to suggest that public expenditures should be cut down. I say sometimes to my congressional friends, when they come down to talk to us about some project, that every Congressman is for economy except in his own district. In like fashion, every individual is for economy unless it happens to affect some pet project that he has--his own business or his own particular area.

We've got to be prepared to accept some economies that will hit us. We've got to be prepared to give up something on the Federal level that perhaps we would like to have. When the realization gains ground that holding down expenditures means holding down everybody's expenditures, when everybody accepts that for a fact, then we will have established fiscal discipline; and the budget, I believe, will be under control.

Now, just a very brief reference to what we might do within the banking system, the fiscal system, if we have a nuclear disaster brought about here in this country in time of war. I'm sure you have all studied what the possibilities are. We're not talking now about a limited destruction spread all over the country, or a very substantial destruction but limited to a very small area of the country. We're talking about a wide, massive nuclear blow that would kill millions of our people and that would tie up our economy throughout all sections of the country. What, if anything, is being done about that?

My understanding is that future speakers in this course will go into some detail in that area. Suffice it for me to say that a good deal of planning and thinking is going on in this area both in the Federal Reserve System and in the Treasury Department. At such a time we would work very closely together. The Federal Reserve System would be our instrument or agency for carrying out many of our policies.

We have had splendid cooperation from the banking institutions. One of the important things, of course, if we are going to continue to work through our present banking system, which has been built up over many years and which has had built into it many things which we couldn't overnight recreate, is that we need to have as many of the banking personnel available after a major nuclear blow as possible. We need to have their records available, so that they will at least know where they stand, so the banks will have some knowledgeable people to pick up the pieces and so that you will have an area of material and manpower with which to work.

Now, many of the banks, under Federal Reserve leadership, have paid much more attention to this than most areas of our economy. A series of very helpful booklets have been produced by a group in which the Treasury participates. These booklets have been sent out through the country. Many banks have made microfilm pictures of all of their necessary records and have placed them in positions away from their present banking houses, in places which they believe to be reasonably safe. They are doing a great deal to instruct their personnel not only in their own protection, but in the protection of necessary records.

I would like to indicate just one phase of the manner in which we have been working on this in Operation Alert. In the last exercise, which we played under OCDM direction, Treasury Department was advised that State banks in many States had been closed by the governors acting under their emergency powers and that in numerous cases throughout the country, other banks had closed by their own decision. Also, that some States had issued script to facilitate the exchange of survival goods, in view of the sudden stoppage of credit and the scarcity of currency in their areas.

Then they asked several questions such as the steps we would recommend to underwrite the solvency and liquidity of the Nation's monetary and credit system in accordance with standards of the exercise.

Well, it would take longer than the time I have available today to go into all of this in detail, but the word went out that in general we would ask those banks that could get back into some kind of shape to open in accordance with Treasury's emergency regulations with Federal bank supervisory authorities giving advice and direction to banking institutions. Federal supervisory authorities have preliminary directions now as to the type of loans which banking institutions could make, including limited loans to help individuals and larger loans for certain productive purposes. We have indicated that the Federal Government would guarantee throughout the country certain types of loans in order to get some movement.

I don't want to indicate that I personally think this is necessarily the first thing that is going to be looked to or that is going to happen if a serious nuclear strike should occur. I think myself that we need to study it.

I have tried to figure out where you could find a situation to study that would perhaps be similar to this. I think the experience in Germany, particularly in Berlin, right after the collapse and death of Hitler, with the Russians moving in, is about as good an area in recent times as you can get to study. That study has been made.

As a matter of fact, there the people went pretty much under a barter system for some time. The banks were for all practical purposes closed, or were under very, very restrictive operation, for almost three years. During that time some parts of the economy did begin to revive.

But the point is that we wouldn't know until we actually went through one of these attacks--which we all hope and expect will never happen--at just exactly what stage the economy would be after the attack. So we are trying to plan to be ready, whatever the stage may be, to make whatever contribution can best be made through the fiscal system and through having whatever banks are left actually function.

Debt management, fiscal policy, central banks, planning for the future, and heavy taxation are all important. I'm afraid they're going to be part of our picture for some time. But they are no substitute for a real sense of dedication, for a willingness to sacrifice for prime objectives, for hard work, for savings.

The problem which you are studying and with which we are all concerned is not an easy one. There's only one thing of which we can be certain and that is that there is no painless solution.

CAPTAIN SCHOENI: The Secretary is ready for your questions.

QUESTION: Mr. Secretary, I am not clear on something with reference to this new tax reform that you made reference to. You said that by enlarging the base, we might be able to lower taxes on each individual. I am a little puzzled about this, because it occurs to me that practically everybody who is a wage earner is already paying taxes. What is this base that is broadened? I am not quite sure I understand.

MR. SCRIBNER: Perhaps I was not as clear as I should have been. I did not intend by that to indicate that we would necessarily take more individuals in. I intended to indicate that the base on which the tax would be measured, that is, the amount of dollars that the individual had which would be subject to tax, would be increased.

If you take the figures that the Commerce Department issues, which show the total gross income of individuals, they show well over a hundred billion dollars of personal income which is not subject to tax at all. It is not reached for taxation. Some of this amount of course, is in the $600 exemption which is given each taxpayer. Much of it is in the amount that you are permitted to deduct for various reasons--because you give to charitable organizations, because of medical expenses, interest and taxes paid, and so forth.

The extremist would say: "Don't give any deductions at all. Put the whole amount of personal income into the tax base. Broaden it by bringing it all in." If you did that, instead of starting our taxes at 20 percent, you might be able to start at 10 percent or 12 percent. You broaden the base not by bringing more individuals in, but by making more of the money which individuals receive, subject to tax.

QUESTION: Mr. Scribner, this week's "U.S. News and World Report" states that the Secretary of the Treasury is reported to have made up his mind that the inflation has been brought under control for the time being. Now, if the factors that you mentioned that lead to inflation--deficit spending and a wage spiral--still exist, what other factors would bring about a situation such as has been reported here?

MR. SCRIBNER: I think there is a feeling that inflationary pressures have subsided somewhat. One of the tests that you look at is the cost of living index. Since last May the cost of living has stayed pretty level. As you know, there was a very small increase in the last figures that were reported, but it was a relatively small increase.

Nevertheless, the factors that would cause inflation, or that make for inflationary pressures, are right there, ready to be loosed very easily. For example, you have seen in these charts all of the background as to the Federal debt. You know what the pressures are. You know about all of the demands that are being made at the present time by special groups who want more Federal spending.

It's pretty generally predicted that it's going to be very difficult to hold the budget at the present level. We may not be able to hold it. If we aren't, to the extent that we go into debt, there would be added inflationary pressures.

Also there is the question of what labor may do, or what labor and management may do, for that matter. You can get another spiral set

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off through wage increases that have no relationship to productivity. That would have an even more serious effect, in my opinion, on the inflationary pressures, if it was very widespread, than an increase in the Federal debt.

It was my privilege to visit a number of the central banks in Europe last November and December and to talk with the governors of those banks and with some of their chief officers.

At that time there was some feeling abroad that perhaps we in the United States had given up on our fight against inflation; that the stock market reflected this surrender. There was belief that if we had to spend $80 billion a year--which is what we are spending in this fiscal year--we couldn't hope to raise that much out of any tax increases that could be put through the Congress. They thought we were headed for further large deficits. They also thought that labor and management were not really aware of the inflationary threat which we faced. They felt, of course that if we were going to surrender to inflation here, it was going to sweep the rest of the world.

The stiffness which we have shown here in resisting inflation has, in my opinion, been very helpful all over the world. It has been particularly helpful, I think, to the French. When they decided that they had to make some tough economic decisions, our example was helpful. Tough decisions were made by the French. They are going to be difficult ones for them to make work. They are doing some of the things now which they should have been doing long ago. It gave them strength to see the position taken by the President, the Secretary of the Treasury, and others that we were not going to give in to inflationary pressures and say, "Yes, we've got to have a little inflation or perhaps a lot of it."

To answer your question in a capsule, which I haven't done, the possibility of a wage and price spiral and the possibility of further deficit financing are the factors which are being carefully watched.

QUESTION: A local columnist Monday night made this quotation from "News Letter:" "The flight from Government bonds is more ominous than most Washington officials care to admit publicly. Several recent Treasury financing operations have failed badly." My question, sir, is, Have there been any recent bad failures in financing operations? Is the situation ominous? Or is this an unduly pessimistic report, as it may well be?

MR. SCRIBNER: Well, I think that it's always easier to get readers if you use words like "ominous" or "imminent." I personally would not say that there have been any bad failures. The one that gave some concern was in this very large refinancing which we had about a month ago, when new securities were offered with a pretty good interest rate and a short term and where there was a very large attrition, a much larger attrition than some had forecast. It was necessary then to go into the market immediately with another general offering. That offering went for the most part into the banks.

We can sell the securities that we have to sell. It's a question, though, whether we can sell them in the places where we would like to sell them. I pointed this out before. It is a question whether you can get individuals to take them and whether you can get longer terms.

Of course, as you have concern about inflation, which means that people don't want a fixed obligation that extends any distance into the future, you are going to have difficulty in putting out anything that is due in over five years and in getting your interest rate down. I think we always will be able to sell securities enough to finance the Government; but we may not be able to do it in the way that we would like to do it and in a way which would contribute most to the soundness of our economy.

QUESTION: Mr. Secretary, it has been my observation that the more knowledgeable people become about handling their personal affairs, the less interested they become in buying Government bonds. During the intermission I personally spoke to 24 people out there and found that only two of them have a program for buying bonds. At the same time there's a picture in this morning's "Washington Post" indicating that the President is appealing to the populace to buy bonds. It strikes me, if you follow this thing, that he's appealing to the less knowledgeable and the more ignorant. Would you comment on that?

MR. SCRIBNER: Let me say first that perhaps you've characterized me. I am buying the bonds.

This is a question that I don't want to treat at all lightly and which ought to be answered at some length.

There is a fixed interest rate that we are able to pay on these bonds. It is now 3.25 percent. These bonds are not negotiable and therefore they are not tradable as easily in the market as some of the reasonably short-term securities which we are now putting out and that are due in three years or even less than that. So you might say that these people are being urged to buy something that pays them less return than some other securities that they could buy.

But there are some factors that are overlooked here. In the first place, one of the things which has disturbed me very much in the Treasury has been letters--frankly rather pathetic letters--that we have received from retired people--I don't mean a great rush of them, but a few letters a week--saying: "I was advised by my broker to buy Government securities; that they were the safest securities in the world. I bought some bonds and now I have sickness or I've had a death and we have got to cash our bonds. I find that I can get only $900 for a bond that I paid $1,000 for," or "I can get only $850 for a bond that I paid such and such amount for."

Now, you see, they bought the marketable bond, which is not supported and which trades in the open market. Had they bought an E bond, they could turn it in at any time to their bank and get the amount that they put in it, plus whatever interest had accrued on it. The E bond is a demand obligation. It's something, as a matter of fact, that everybody ought to own in some amount. He ought to have them just as he ought to have a savings account. It's the same type of investment.

Further than that, this bond produces compound interest. A lot of people, even your more knowledgeable people, if they receive a coupon don't get that money reinvested immediately. They put it aside somewhere; and it may be two months, three months, or six months, because it may be a small amount, before the income goes to work. So that for the fellow who doesn't know much about securities an E bond is something that reinvests his money for him immediately.

In addition, it's the safest security in the world. We have a most complex and frankly, very expensive, system of registering every bondholder; so that if your bond is lost, you can come in and with relatively simple proof of the loss of your security, get a new one issued to you. We're doing it all the time for people whose houses burned down, and who lost their bonds in the fire, or they have lost the bonds or have had them stolen. I know of no other security that will give you better protection.

There's another angle to this thing. This type of security is sold in large measure through the payroll deduction plan. I know many, many people who for some reason are not able to save on their own. If you give them the money, it's gone. But because there is a built-in system through which the money can be deducted from their pay and put aside for them, they are saving. At the end of the year they have a few bonds--bonds that are guaranteed to return every cent they put into them, bonds that earn compound interest, bonds that are registered.

Finally, there is one other thing--and if this is a selling pitch, I'm willing to make it. We need to have the people of this country make an investment in the United States. We need to have the people in this country own some Government securities, so that when anything happens, it's happening to part of their own investment. Everyone interested in private enterprise says: "Get people to buy stock. Get them to know something about the private enterprise system." By the same token we ought to urge everyone if possible, to own a small interest in this country of theirs. And I don't know of a security, on balance, that is a better place for the great rank and file of people, and most people are not sophisticated in investment matters, to put their money than in "E" bonds.

Incidentally, I'm going to contract the savings bond program people, and tell them that here's a field where they really should go to work.

CAPTAIN SCHOENI: I know there are many more questions that we all would like to ask the Secretary, but I believe he has a very important engagement at the Treasury this afternoon, probably talking about bonds.

Mr. Secretary, on behalf of the Commandant and the student body, I wish to thank you for a very illuminating lecture on the problems of the Treasury Department and your very frank discussion.

MR. SCRIBNER: May I say that I have been delighted to be here. The facts are the facts. You can find them in the form we've given them; you can find them in other forms--that is, what's happened in the past, what we owe now, and where it's placed.

What should be done in the future in the tax field, in the general fiscal field, is an uncertain road. You can secure all sorts of advice. I assure you that we welcome advice from groups such as this, that are looking at and studying this problem, I trust, with an open mind. It is our hope that from all such resources throughout the United States we're going to receive some suggestions, perhaps for doing some things differently, perhaps for changing some things, that will help us all to move toward the goals that we all want to achieve.

(11 June 1959--4, 150)B/en/pc