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JANUARY 1964 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

EIGHTY-EIGHTH CONGRESS

SECOND SESSION

JANUARY 23, 27, 28, and 29, 1964

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JANUARY 1964 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 23, 1964

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

The joint committee met, pursuant to notice, at 10 a.m., in room 1114, New Senate Office Building, Hon. Paul H. Douglas (chairman) presiding.

Present: Senators Douglas, Sparkman, Proxmire, Pell, Javits, Miller, and Jordan; and Representatives Reuss, Griffiths, Curtis, and Kilburn.

Also present: James W. Knowles, executive director; Hamilton D. Gewehr, administrative clerk; and Donald A. Webster, minority economist.

Chairman DOUGLAS. It is now 10 o'clock. The committee will come to order.

We begin this morning the committee's consideration of the Economic Report of the President, which was transmitted to the Congress on the 20th of January, by hearing from the Council of Economic Advisers, Walter W. Heller, Chairman, accompanied by Gardner Ackley and John P. Lewis, members of the Council.

Members of the Joint Economic Committee who are always concerned with, and by law must consider the Economic Report, are particularly interested in the report this year since it contains two chapters which emphasize matters that have long been of interest to the Joint Economic Committee.

One of these relates to the chapter entitled "The Problem of Poverty in America," and, second, the chapter entitled "The Promise and Problems of Technological Change."

In order that the committee may have before it a reminder of its previous deliberations and reports, I want to include in the record at this point a list of the relevant past committee publications on these two subjects.

(The exhibits referred to follow:)

LOW-INCOME FAMILIES

The following studies, hearings, etc., have been conducted by the Joint Economic Committee:

"Selected Government Programs Which Aid the Unemployed and Low-Income Families" (materials assembled by the staffs of the Subcommittee on Unemployment and the Subcommittee on Low-Income Families), committee print, November 1949.

"Low-Income Families and Economic Stability" (materials on the problem of low-income families assembled by the staff of the Subcommittee on Low-Income Families), Senate Document 231, September 1950; reprinted from committee print of November 1949.

"Low-Income Families," hearings, Subcommittee on Low-Income Families (December 12, 13, 14, 15, 16, 17, 19, 20, 21, and 22, 1949.)

"Low-Income Families and Economic Stability" (final report of the Subcommittee on Low-Income Families), Senate Document 146, March 1950.

"Underemployment of Rural Families," materials prepared for the Joint Committee on the Economic Report, committee print, February 1951.

"Making Ends Meet on Less Than $2,000 a Year, Case Studies of 100 Low-Income Families" (communication to the Joint Committee on the Economic Report from the conference group of nine national voluntary organizations convened by the National Social Welfare Assembly), committee print, July 1951.

"Characteristics of the Low-Income Population and Related Programs" (materials prepared by the staff of the Subcommittee on Low-Income Families), committee print October 1955.

"Low-Income Families," hearings, Subcommittee on Low-Income Families (November 18, 19, 21, 22, and 23, 1955) December 1955.

"A Program for the Low-Income Population at Substandard Levels of Living" (report of the Subcommittee on Low-Income Families), committee print, December 1955 became Senate Report 1311, January 1956.

"The Low-Income Population and Economic Growth," by Robert J. Lampman (Study Paper No. 12, "Study of Employment, Growth, and Price Levels"), December 1959.

AUTOMATION

The following studies, hearings, etc., have been conducted by the Joint Economic Committee:

"Automation and Technological Change," hearings, Subcommittee on Economic Stabilization (October 14, 15, 17, 18, 24, 25, 26, 27, and 28, 1955).

"Automation and Technological Change" (report of the Subcommittee on Economic Stabilization), committee print, November 1955 became Senate Report 1308, January 1956.

"Instrumentation and Automation," hearings, Subcommittee on Economic Stabilization (December 12, 13, and 14, 1956).

"Automation and Recent Trends," hearings, Subcommittee on Economic Stabilization (November 14 and 15, 1957).

"New Views on Automation" (papers submitted to the Subcommittee on Automation and Energy Resources), committee print, October 1960.

Chairman DOUGLAS. Unfortunately these items are all out of print except for a quite limited supply of the reports to which I am about to refer.

Two of the items on this list represent subcommittee reports which were approved by the full committee for transmission to the Congress. I believe that the recommendations of these two subcommittees, transmitted through the full committee, afford a good summary of the breadth and depth of the committee's consideration and its early recognition of these problems emphasized more recently in the current Economic Report of the President.

First, there is the report of January 5, 1956, to the 84th Congress, Senate Report 1308, prepared by the Subcommittee on Economic Stabilization under the chairmanship of our colleague, Representative Wright Patman of Texas. The report entitled, "Automation and Technological Change," contains a number of findings which I commend to all interested in this problem, and I especially call attention to the recommendations reproduced in an accompanying annex.

(The report referred to is as follows:)

RECOMMENDATIONS CONTAINED IN AUTOMATION AND TECHNOLOGICAL CHANGE

(Senate Rept. 1308, 84th Cong., Jan. 5, 1956)

1. The best and by far the most important single recommendation which the subcommittee can give is that the private and public sectors of the Nation do everything possible to assure the maintenance of a good, healthy, dynamic, and prospering economy, so that those who lose out at one place as a consequence of progressive technology will have no difficulty in finding a demand for their services elsewhere in the economy.

2. At this stage of the investigation, no specific broad-gage economic legislation appears to be called for, and the very good reason for this is that we already have on our statute books the Employment Act of 1946. The subcommittee can only recommend that the spirit and objectives of that act continue to be given active instrumentation and support by the executive agencies, the Congress, and the people as a whole.

3. The subcommittee recommends and strongly urges that the Federal executive agencies, the appropriate committees of the Congress, the State and local governments, and all others involved take very seriously to heart the need for a specific and broad program to promote secondary and higher education, to the largest extent possible.

4. The subcommittee similarly recommends that the Federal executive agencies, the Congress, and especially the local areas themselves develop comprehensive and concrete programs to ease the problems and eliminate local pockets of chronic or shortrun unemployment, whatever the cause or causes of distress may be.

5. While Government presents a special situation it too must be alert to secure the benefits of advancing technology and increasing productivity. At the same time, in the interests of making the Government a model employer, the subcommittee suggests that the executive departments and agencies and the respective committees of the Senate and House dealing with civil service administration would do well to keep especial watch over the problems of personnel administration involved in the displacement of employees by machines and improved techniques.

6. In the interests of labor mobility and facilitating the shifts involved in automation, the subcommittee recommends that consideration be given by the executive departments and, if need be, by the Congress to measures which will make for greater effectiveness and increased usefulness of the U.S. Employment Service, especially in dealing with the problem of the middle-aged worker and the placement of those of higher skills and degree of specialization.

7. From its own experience with such data, this subcommittee joins in what is certain to be a primary interest of the Statistics Subcommittee of the Joint Economic Committee; namely, the improvement of economic statistics, especially those relating to productivity and occupational shifts, and an increased alertness on the part of the executive agencies to the responsibility of providing statistics for policymaking in business as well as in Government.

8. The subcommittee recommends that industry, and management for its part, must be prepared to accept the human costs of displacement and retraining as charges against the savings from the introduction of automation. In saying this, the subcommittee is not unmindful of—and was, indeed, gratified by—the extent to which enlightened management is already aware of and accepting responsibility in this respect. Nevertheless, by careful planning and scheduling, the adjustments of workers and the stoppage of employment can be minimized and due recognition should be given to the timing of investment and technological changes with an eye on the state of general business and the needs of increased employment.

9. Organized labor should continue to recognize that an improved level of living for all cannot be achieved by a blind defense of the status quo. The education of its members, of management, community leaders, and Government officials, such as has been provided by these hearings, is an important function of union responsibility.

10. Throughout these hearings many witnesses have presented thoughtful and thought-provoking recommendations upon which the subcommittee has not had

an opportunity to formulate definitive conclusions. In addition to the above recommendations, we commend to industry, labor, Government agencies, and State legislatures alike the study of this record and these individual suggestions, in order that the benefits of automation may be maximized and its hardships minimized.

11. Finally, the subcommittee's investigation convinced it that the problems of automation are by no means negligible nor settled. This prompts the subcommittee to the view and the urgent recommendation that all interested parties should make this a subject of continuing or recurrent study. The Subcommittee on Economic Stabilization considers it to be its responsibility and intends to review regularly the progress of technological change and the statistical evidence of occupational shifts. This is being done for the purpose of keeping informed and of being in a position to recommend further legislation if it should be needed.

The second area which is stressed in the Economic Report of the President; namely, the problem of poverty, was first considered by this committee through its Subcommittee on Low-Income Families of which our colleague, Senator John Sparkman, was the chairman. This subcommittee's report to the 81st Congress, Senate Document 146, was carried out pursuant to Senate Concurrent Resolution 26 and transmitted to the Congress on February 23, 1950.

Another landmark in the committee's long concern with this problem of low-income families is the report to the 84th Congress, Senate Report 1311, by the Subcommittee on Low-Income Families, again under the chairmanship of Senator John Sparkman. This report was dated January 5, 1956. As in the case of the report on automation, I commend the entire brief report to the attention of those interested but, in summary, include here only a brief statement of the explicit recommendations.

(The statement referred to is as follows:)

RECOMMENDATIONS CONTAINED IN A PROGRAM FOR THE LOW-INCOME POPULATION AT SUBSTANDARD LEVELS OF LIVING

(S. Rept. 1311, 84th Cong., Jan. 5, 1956)

We recommend:

I. INCOME SECURITY, PUBLIC WELFARE, AND HEALTH CARE

(1) The Congress consider legislation to establish social-insurance programs covering the risks of temporary and permanent total disability. (Senator Ralph E. Flanders said: "This undertaking must be approached with great caution. Many insurance companies have had to discontinue disability benefits owing to the difficulty in defining 'disability,' whether temporary or permanent, in any given case.")

(2) The appropriate congressional committees study the desirability and feasibility of dovetailing such programs, if established, with the workmen's compensation acts of the various States; such study will necessarily entail a review and evaluation of the adequacy of the existing workmen's compensation programs.

(3) That the Federal Government, in cooperation with the States and private groups, develop a comprehensive health program covering the following:

(*a*) Stimulation of means whereby families in rural areas may secure adequate health care;

(*b*) Provision of additional funds to provide for adequate recruiting and training of professional workers in the field of health care;

(*c*) Reduction in the cost to the individual of comprehensive health protection. This may necessitate contributing part or all of the cost of approved insurance programs for low-income families. The Congress may wish to consider whether it may be necessary, in order that voluntary health plans reach all of the population, to provide Federal financial aid to those in the low-income groups who are unable to purchase such protection; additional funds alone, however, would be useless to millions of our people in rural areas where there is a lack of doctors, nurses, and hospital beds;

(*d*) Extension of the school-lunch and milk programs, and the distribution of surplus commodities to needy families; and

(*e*) Expansion of Federal participation in public-assistance payments for medical care.

(4) That the following changes be considered in the Federal grant-in-aid program of public assistance:

(*a*) Establishing a single, unified system of Federal grants for general public assistance in place of the current and separate programs which, according to evidence presented to the subcommittee, tend to restrict unnecessarily the types of need for which Federal funds are available;

(*b*) Basing Federal grants-in-aid for general public assistance on an equalization formula which takes into account the relative financial needs of the various States and State differences in per capita income;

(*c*) Lowering the maximum residence requirements which the States can impose on public-assistance applicants; and

(*d*) Making the Federal grants for child-welfare services available to all areas rather than limited as they now are to specially designated areas.

(5) Including in the federally aided public-assistance programs provision for services designed to encourage individuals to attain self-support and self-care and to preserve and strengthen family life.

(6) That the Federal Government consider providing additional grants-in-aid to the States for the purpose of increasing the supply of trained professional workers needed to carry out the recommendations we present in this report.

II. INCREASING EDUCATIONAL AND TRAINING OPPORTUNITIES FOR THE LOW-INCOME POPULATION

(1) Direct Federal grants-in-aid to the States, initially for construction of school plant and equipment, based on an equalization formula which takes account of the relative economic need among the States.

(2) That the Federal Government, through grant-in-aid programs, assist the States to expand guidance services and vocational counseling provided within the school systems.

(3) The establishment of a national scholarship fund to aid those who could profit from additional education but who lack the necessary financial resources.

(4) Expansion of adult education programs through Federal financial assistance extended to such institutions as the recognized and accredited colleges and universities; and, encouragement of vocational training and retraining programs sponsored by nongovernmental groups in our economy.

III. AID TO ECONOMICALLY DEPRESSED RURAL AND INDUSTRIAL AREAS

A. Depressed agricultural areas and aid to low-income rural families

(1) Expansion of the credit programs now available to farmers, with increased emphasis on loans extended to low-income farmers.

(2) In combination with expansion of credit programs for low-income farmers, a corresponding increase in the provision of technical assistance to the individual farm families receiving loans, such assistance to include development of an appropriate farm plan for the individual family and extending the technical guidance and leadership required to help the family carry out the plan proposed.

(3) Consideration be given to the development of farm extension services to meet the needs of low income farm families in particular, and to greater utilization of trained workers to assist the family improve all aspects of its family life. As a first step toward a better life it should be possible to help the family get improved subsistence from the land on which they are now living.

(4) Consideration of the following program designed to meet these particular needs:

(*a*) By means of technical assistance and Federal loan guarantees, aid recognized and approved local groups engaged in attracting new industry into the area, and develop other ways of providing off-farm employment. These programs (which also are recommended for extension to depressed industrial areas) should provide maximum stimulus to private investment in areas now depressed but which possess advantages of location or resources that, in combination with such investment, make economic growth practical and feasible;

(*b*) Assist in the development of a program for financing approved cases of out-migration of individual families;

(*c*) Expand vocational counseling and job placement services in depressed agricultural areas; and

(*d*) Expand in rural areas the federally aided nonfarm vocational training programs.

B. Depressed industrial areas and aid to low-income families

(1) Substantial expansion of existing programs of technical assistance to depressed industrial areas and to small producers within the area.

(2) Credit aids be extended, when such assistance is economically desirable to existing local industries, and to approved local groups engaged in planning and constructing "ever-available" plants for the purpose of attracting diversified and expanding industries. Credit aid may possibly take the form of loan guarantees designed to promote maximum stimulus to private investment.

(3) That the Federal Government share in planning and conducting appropriate economic surveys to determine the scope of current and potential local resources.

(4) Expansion of the small-business program, with particular emphasis on aid to depressed areas, and coordinated with a strengthened program of decentralization of defense contracts.

(5) Extension of vocational counseling, job information, and placement services of the Federal-State employment services so that workers in depressed areas will be aware of job opportunities in other communities. In addition, these agencies should expand their function of alerting employers outside of depressed areas, as well as within, to the types of skills currently available in depressed areas.

(6) That financial assistance should be provided to unemployed workers willing to undertake the approved retraining programs, and to those willing to migrate to areas of labor shortage.

IV. FINDINGS AND RECOMMENDATIONS IN REGARD TO ADMINISTRATIVE AND RESEARCH NEEDS

A. Depressed rural and industrial areas

(1) That there be established in the executive branch of the Federal Government a central group charged with the responsibility of preparing a coordinated, comprehensive program aiding currently depressed industrial and rural areas and so designed as not to affect adversely other areas. Such a program must assist in maintaining the economic climate necessary to promote maximum economic growth of the economy as a whole.

(2) Increased research along the following lines:

(*a*) A continuing program of study is needed to analyze regional and technological shifts so that trouble spots can be detected early enough to make for practical preventive action, such as encouragement of new enterprises in an expanding industry in areas where a major enterprise in a declining industry is expected to close down;

(*b*) An inventory of labor skills and economic assets should be compiled for each area now marked by concentrations of low incomes and chronic unemployment, to make it possible for public and private groups to match the available local resources with the needs of expanding industries so that new enterprises could be attracted to these depressed areas;

(*c*) For each distressed area, improved and more detailed reports on unemployment, labor force, percent unemployed, and number of new jobs to be created;

(*d*) Regular reporting of work stoppages by areas with some suitable measure of its relative importance in each area; and

(*e*) More information on differences in costs of living and in wage rates between areas and communities.

B. Low income resulting from causes associated with the individual

(1) Intensive studies to identify the population at substandard levels of living and the causes of their low economic status.

(2) That the Federal-State employment services place greater emphasis on job-placement services for the older worker.

(3) That, in all ways possible, government—Federal, State, and local—encourage industry to employ older workers willing and able to work and to make more jobs available to this group by redesigning work to fit their capacity.

(4) That the appropriate departments and agencies of the executive branch prepare a report on the current status and size of the low-income population and the progress made in the alleviation of poverty and elimination of its causes, such report to be submitted to the Joint Economic Committee during the 85th Congress, and periodically thereafter.

Chairman DOUGLAS. I think the reader of each of these reports will find these thought-provoking recommendations still extremely timely. For the record, we have not changed them, although an occasional interesting, dated flavor may be found in them.

Of course, we do not know whether in the light of changing time the committee would make the same or different recommendations upon reconsideration today.

Gentlemen, we are very happy to have you with us. We are all very much interested in the report of the President. Is Congressman Curtis here? I understand he has a statement that he wishes to submit. I will either give it to the gentleman representing the minority party to read, or it can be printed in the record.

Senator MILLER. Mr. Chairman, in the interest of time, I would move that we have it placed in the record.

Chairman Douglas. The Congressman is coming in the door.

Representative CURTIS. Thank you, Mr. Chairman, and I welcome the witnesses again.

I would like to read this statement I have prepared.

The administration says that its economic program will pack a greater net fiscal stimulus in 1964 than in any other peacetime year in the Nation's history. Not only will Federal purchases of goods and services increase by $2.5 billion, but taxes would be cut, the withholding rate would be lowered immediately to 14 percent and, if the administration has its way, money would be kept easy. All of this is being offered while the economy is already expanding vigorously and experiencing inflationary danger signs which the President himself has noted.

This is not a program of balanced and sustainable growth, but one which gambles with the Nation's economic stability and well-being in order to get maximum expansion in 1964. I believe that the administration's program could seriously overheat the economy this year and lead to renewed inflation that would offset the beneficial effects of the tax cut and create more serious balance-of-payments problems and more unemployment.

Because of the excesses caused by policies proposed for 1964, the result in 1965 could well be a leveling off of economic activity, or even a decline. If this happens, we can be certain that the administration will sharply increase its spending and thus abandon its original expenditure estimates under the argument of economic necessity.

These are critical issues before the Nation and I earnestly hope that our committee, the Joint Economic Committee, will explore them thoroughly during these important hearings.

Chairman DOUGLAS. Mr. Heller, we are very glad indeed to have you with us. And we will be happy to have your statement.

STATEMENT OF DR. WALTER W. HELLER, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; ACCOMPANIED BY GARDNER ACKLEY AND JOHN P. LEWIS, MEMBERS

Dr. HELLER. Mr. Chairman and members of the Joint Economic Committee, these annual appearances of ours before the congressional Joint Economic Committee always are landmarks for the Council of Economic Advisers.

The committee and the Council are twin progeny of the Employment Act of 1946—not identical twins, perhaps, but we have a close fraternal relationship. And these annual opportunities for a comprehensive, on-the-record exchange between us are occasions to which we always look forward.

We also look forward, I confess, to the annual terminal significance of this hearing, for it means that the Economic Report of the President and our own annual report to the President have been completed and are between covers.

You have both of these reports, and there is no need in this opening statement, I am sure, for me to review at length what they say. Rather, as background for discussion, let me simply sketch in barest outline what seem to us to be some of their key points. I shall indicate 11 of these.

1. We find the current economic situation strong. The economy fully completed its first $100 billion of expansion from the recession trough of early 1961 in just 2¾ years. The expansion, which was admirably maintained throughout 1963, compares favorably, as to both size and duration, with its predecessors. The bulk of the $100 billion increase has represented an expansion of physical output. Thanks to our very good overall price record, the real gain has been 16 percent. And the benefits of this gain have been broadly shared.

2. We find the outlook for 1964 even stronger than the recent record, given an early tax cut. If the tax cut is effective by February 1, the Nation can anticipate a calendar 1964 GNP of $623 billion viewed at the midpoint of a $10 billion range. (A delay to March 1 would lower this estimate by about $2 billion.) This would be a year-to-year rise in real output of about 5 percent. With this gain, we will renew our inroads on the unemployment problem which, in the President's words, casts "a long shadow over our pride" in the achievements of the past 3 years. The unemployment rate declined from 7 percent in early 1961 to about 5½ percent in the spring of 1962, while real GNP was advancing at an average annual rate of 7.3 percent. In other words, taking the advance for first quarter 1961 to second quarter of 1962, we were advancing at an annual pace of 7.3 percent which dropped our unemployment from 7 to 5½ percent. Unemployment has hovered around 5½ percent ever since, while real GNP was advancing at an average annual rate of only 3.9 percent. In other words, from the second quarter of 1962 to the fourth quarter of 1963, the average rate of growth, average rate of expansion, was only about 4 percent, and during that time, the rate of unemployment essentially did not change. Given the tax-stimulated speedup in GNP growth, we expect to see unemployment decline this year, reach about 5 percent by yearend, and, with appropriate policies, keep on declining thereafter.

3. Both the President's report and our own emphasize the critical importance of the earliest possible enactment of the tax program contained in H.R. 8363 as modified by two changes recommended by the President and approved by the Senate Finance Committee: One, the immediate reduction of the withholding rate on taxable wage and salary payments from 18 to 14 percent, instead of 15 percent; and, two, the elimination of the provisions of the House bill which reduce the rate of tax on capital gains.

With respect to tax reduction, let me make three subpoints:

(*a*) The fiscal stimulus that the economy receives from the tax reduction program this year will indeed be massive. The best method of gaging the net fiscal stimulus provided by the Federal budget, by the receipts side and the expenditures side in combination, is to measure the change in the so-called full-employment surplus. This is the year-to-year change in the surplus (or deficit) that the national income accounts budget would show if the economy were operating consistently at full employment. And as a very modest definition of "full employment," we have used our interim goal of 4 percent unemployment for these calculations.

When the full-employment surplus falls, there is a net fiscal stimulus. When the full-employment surplus rises, there is a net fiscal restraint. Viewed in these terms, the net fiscal stimulus that the tax reduction program and the President's fiscal 1965 budget jointly will supply to the economy in calendar 1964 will be the greatest provided during any calendar year in our peacetime history.

(*b*) Under the President's austere budget, together with the budget for fiscal 1964, of course, there will be only a moderate rise in Federal purchases of goods and services from calendar 1963 to calendar 1964. The rate of advance in Federal purchases will slow down substantially. The sharply rising fiscal stimulus will arise primarily from the $8.8 billion cut in individual income tax collections and $1.4 billion cut in corporate liabilities for 1964.

(*c*) The one-step drop in the withholding rate to 14 percent will play an important role in reconciling the desired budgetary economy on one hand and the needed fiscal stimulus on the other.

Without the one-step drop to 14 percent, the net fiscal stimulus to the economy this year would be about $2 billion less, and the GNP at the end of 1964 would be several billions below our current projections.

4. A general theme of the Council's report is the persistent, though, of course, not unvarying, need for an expansionary fiscal policy in a growing economy. The Nation has been slow in learning this lesson. Time and again we have observed the tendency of our tax system to yield rapidly rising tax collections as income grows. Twice since the last major tax reduction in 1954, this restrictive trait in our fiscal framework has helped push us into recession. And in 1962 and 1963 it restrained adequate expansion. The current year will establish a high water mark in the effective use of fiscal policy—this year, we will be making a bold, expansion-promoting adjustment in our fiscal framework before, not after, recession overtakes us. The tax cut will powerfully serve the basic purpose of generating the demand and incentives that are essential for full employment and faster growth. But it will also serve as valuable near-term insurance against recession.

5. It would be self-defeating to offset, through a tight money policy, the stimulus that the tax cut will give the economy. As the President said:

> Monetary and debt policy should be directed toward maintaining interest rates and credit conditions that encourage private investment.

If the recent sharp improvement in our balance of payments is maintained, no further tightening in monetary policy will be needed to restrain capital outflows. Of course, monetary policy must remain flexible to meet unforeseen contingencies, and it gains some room for maneuver as budgetary policy becomes more expansionary.

6. In an important sense, the enactment of the tax reduction bill will clear the decks for a determined assault on other problems that for the most part have been with us for a long time but have had to yield precedence to what has been the No. 1 economic problem of the past 3 years: the need to step up our expansion enough to eliminate the wholly unnecessary unemployment and underproduction that have persistently plagued us. Thus, both the President in his report and we in ours were in a better position this year than a year ago to look beyond the tax cut to several other key problems that must be solved in the years ahead.

These other issues occupy the balance of this summary.

7. In spite of the increasing prosperity of most Americans, one-fifth of the Nation's families still live on annual money incomes of $3,000 or less. In his state of the Union message, the President declared an "unconditional war on poverty in America." The second chapter of our report to the President supplies a factual analysis of the adversary in this campaign. It examines the incidence, characteristics, and roots of poverty.

I might say, Mr. Chairman, in expressing some pride in having worked on this poverty program and having begun to discuss it with President Kennedy as early as last June, we readily yield to the Joint Economic Committee in having anticipated not only the problem but the general approaches to a solution many years ago. We have made extremely good use in our analysis of the various studies that have been made for the Joint Economic Committee and, indeed, have used some of the same people who worked on some of your studies.

Chairman DOUGLAS. Thank you very much. The credit for the two studies goes to Senator Sparkman and the committee.

Dr. HELLER. Apart from the creation of job and income opportunities through policies for full employment and faster economic growth, a long-range attack on poverty must have two prongs.

First, and primarily, it must be concerned to raise the earning power of the poor, and thereby provide them, and especially their children, with escapes from poverty. This can be done both by raising the productivity of the disadvantaged through education, training, and health measures, and by attacks on discrimination and local economic blight. Second, such an attack must offer assistance to the aged, the disabled, and others in special circumstances that prevent them from holding jobs.

The President's new initiative will combine Federal with State local efforts in a program that challenges and engages community leadership.

8. In the third chapter of its report, the Council undertakes a fairly extensive analysis of technological change and its economic con-

sequences. There again, Mr. Chairman, we have made very good use of earlier studies by the committee. We were particularly impressed with your 1956 report, which noted that strong overall economic conditions tend to hold to a minimum the problem of worker displacement by automation.

Representative CURTIS. Were you referring to the committee's report or the President's report?

Dr. HELLER. That is the Joint Economic Committee's report entitled "Automation and Technological Change."

Representative CURTIS. I see. I understand.

Dr. HELLER. On the one hand, since technological improvement is one of the prime movers of economic growth, this discussion may be thought of as a sequel to the extended analysis in the Council's 1962 report, and I might add also the 1963 report, of means for increasing the economy's longrun growth rate. On the other hand, the present report also strongly emphasizes our need to make adequate provision for the job displacement and other human problems that are the inevitable byproduct of technological progress.

9. Both reports—the President's and the Council's—emphasize the importance of maintaining stability of prices and unit labor costs at high employment. This issue will become increasingly important in 1964 and succeeding years as, with the help of the tax cut, the underproduction and unemployment gaps are narrowed. In terms of the present "balance among wages, prices, and profits," it is our view that "the economy is in a good position, as it enters 1964, to avoid inflationary price and wage decisions." Substantial productivity increases in 1961–63 have permitted labor earnings and profits to rise sharply within the framework of a generally stable price level.

But we have no grounds for complacency. Price stability is essential—on equity grounds, on balance-of-payments grounds, and in order to avoid compromising our pursuit of rapid expansion. And the possibility that discretionary price and wage decisions could touch off a renewed price-wage spiral must always be faced in a vigorous expansion. This is not a prediction that this will be so, but simply a caution that we be vigilant on the front of price-wage inflation. In the face of record and rising profits and labor earnings, responsible private decisionmaking that accords with the reaffirmed price-wage guideposts can be one of our main lines of defense against resumption of inflation.

10. The Council is happy to note the marked improvement in the Nation's balance of payments in the last half of 1963. The short-run measures taken or proposed in President Kennedy's July program have contributed to these gains. We look forward to the day when greater competitiveness of our products and attractiveness of our domestic investment opportunities will eliminate the need for these temporary measures.

However, this very success, which by eliminating U.S. payments deficits will dry up what is, under present arrangements, the principal source of additional liquidity for the rest of the world, will raise a broader and different problem. I hope you will not misunderstand. We are not saying the balance-of-payments problem is solved, but only that, when it is, there may be a problem of international liquidity. That issue, the longer run adequacy of our international monetary system, is one that is being studied this year by the so-called Group of Ten leading industrial countries and by the International Monetary Fund. The second part of chapter 5 of our report identifies the objectives to be served by the international monetary system, outlines the emergence of the present system, including its actual or potential shortcomings, and sketches some of the alternative proposals now being made for strengthening or reforming it.

11. The role of and continuing need for U.S. development assistance to the less developed countries of Latin America, Asia, and Africa is a subject, heavily economic in its content, that congressional debate over the foreign aid program has brought to the fore in recent months. We have thought it useful in the final chapter of our report to provide a brief analysis of the U.S. development assistance effort that places it in historical context; examines its rationale and the relationship of American efforts to those of other donors; and considers the manner in which, country by country, the need for development assistance can be constructively ended as the developing countries achieve self-support.

As the President remarks in his report:

> Our development assistance effort must and will be more sharply focused and rigorously administered. We shall encourage others to share more of its burden and seek a larger role for private investment. But a strong development assistance program continues to be vital to our pursuit of peace and stability in the free world.

With the help of the tax cut, the year 1964 promises to become a year of major economic achievement for the United States; not merely because it will set new records for GNP, income, employment, and industrial production; and not merely because it will be a rare fourth consecutive year of uninterrupted economic gains. The more significant reasons are these:

First: 1964 will be the first year in seven in which our annual rate of unemployment will fall below 5½ percent of the civilian labor force. It should be a year in which the unemployment rate will be trending downward toward the lower levels common during our earlier postwar history and implied by the phrase "maximum employment."

Second: The tax reduction that assures this result will represent a deliberate fiscal policy choice, guided by the considerations formulated in the Employment Act, and enacted after a full and intensive public discussion. This committee has long pioneered enlightened discussion of such issues, but now, for the first time, the debate has been conducted on a truly national scale.

Finally, it will be a notable year because, having begun to make real headway on our aggregative problems of unemployment, underinvestment, underutilization, and balance-of-payments deficit, we can now give a higher and higher priority in Federal policy to the economic problems of particular groups and regions. We can place more and more at the center of our national concern such problems as those of individuals dislocated by technological change, of low-paid workers who could improve their earnings and their contribution to production by learning new skills, of regional depression in Appalachia, of retired workers unable to pay for hospital care, of the family without an able-bodied earner, and, above all, of the unfortunate fifth of our families whose poverty blights our prosperity.

Representative REUSS (presiding). Thank you very much, Chairman Heller. We will proceed with our questioning under the 10-minute rule.

I note your statement, and the statement of President Johnson in the report, that, and I quote:

It would be self-defeating to offset through a tight-money policy the stimulus that the tax cut will give the economy.

Yesterday before the House Committee on Banking and Currency I had a chance to question Chairman Martin of the Federal Reserve Board of Governors on that point. Particularly, I asked him, assuming a continuation of unemployment over 5 percent and a lack of use of industrial capacity along the present lines of around 13 percent, whether he would feel called upon this year, 1964, to tighten money, and his answer was that he might. And then I asked him whether he didn't think it unlikely that he would have to tighten money supply, and he couldn't give me any satisfaction on that, either; he couldn't say it was unlikely. In this connection I read——

Representative KILBURN. Would the gentleman yield? I thought his answer was that if there was any indication of inflation, that it might——

Representative REUSS. Well, on page 167 of yesterday's transcript, it says:

Mr. REUSS. Getting back to 1964, would you agree with me that with as high an unemployment rate as 5 percent or more and with as great an unused industrial capacity, however modern it may be, as presently exists, it is unlikely that you will be called upon, in exercising your good judgment, to tighten money?

Mr. MARTIN. Oh, I would not go even that far.

Mr. REUSS. You would not even agree with me on this.

Mr. MARTIN. I won't even go that far because those things can change so rapidly, and I do not want to tie it to five. Whether it is 5½, 3, or 2 percent unemployment depends on conditions at a given time and also has to do with world markets. We are facing inflation abroad today.

That was the answer, and I think that it perhaps can speak for itself.

I also read with interest the material in the Economic Report on Federal Policy about the expansions of 1954–57, and 1958–60, in which the Council sets forth the history of those times, I think correctly, and points out that premature tightening of money and credit conditions frustrated and thwarted a rising economic condition on both those occasions.

I asked Mr. Martin about that, and it is his view that his action in tightening money in those earlier periods had nothing to do with the unfortunate recession that followed.

How do you square this attitude on the part of the monetary authorities with the position taken by you and the President, that it would be "self-defeating to offset through a tight-money policy the stimulus that the tax cut will give the economy"?

Dr. HELLER. Mr. Reuss, I think that the statements that have been made by Mr. Martin have been couched in rather careful and qualified terms. That is to say, he has not suggested, as I read it, that he intends to offset the expansionary impact of the tax cut through tightening of money. What he has said is that he is keeping his powder dry, so to speak, so that if there should be signs of inflationary overheating which might bring about difficulties in the balance-of-payments sphere or in the domestic economy itself, he would be ready to act.

Representative REUSS. His idea of keeping his powder dry, however, is to keep it so dry that it may explode prematurely as happened in 1957 and in 1960, and what I put to you is that in the total light of Mr. Martin's testimony and his steadfast refusal to accept the idea that maybe he kept his powder too dry in 1957, 1958, and in 1960, is it not likely that the same Board which has erred twice in the last 7 years in the opinion of the Council of Economic Advisers might err a third time, a power to err which is given to it under our independent Federal system?

Dr. HELLER. You use the word "likely." I should say it is always possible. I should also say, by the way, apropos of metaphors, that this one exploded in my face. But I think it is also fair to say that there has been a very considerable degree of cooperation and coordination and understanding among responsible financial and economic authorities, both those who are and who are not in the administration. There are continual discussions among the Chairman of the Board of Governors of the Federal Reserve System, the Secretary of the Treasury, the Director of the Bureau of the Budget, and the Chairman of the Council. These discussions are sometimes with the President, and sometimes without. I have a good deal of confidence that out of these discussions and the understanding that exists among the responsible authorities—not only as to the problems of inflation but also as to the problems of full employment and growth—that there is a very good chance for a continuation of a cooperative policy, in which monetary expansion will be maintained consistent with stable expansion of the economy.

As one looks at the record, for example, in 1963, it is true that long-term rates did begin to move up. But when one compares long-term rates at the end of 1963 with the beginning of 1961, they have, of course, moved up far less than in either of the previous two periods of expansion, which we criticized in terms of the recessions that followed. I might say that, particularly in the case of the 1958–60 expansion, this criticism is based on economic analysis, which is widely shared by economists regardless of their particular party of preference. My predecessor but one, Arthur Burns, has pointed to the same problem at that period.

Representative REUSS. I am glad to hear about the close cooperation which does exist between you and the Federal Reserve Board. This is entirely proper and I know that it has in the past produced some results which I think are good. I would remind you of the function of this committee, the Joint Economic Committee, which, as you said in your paper this morning, is very like your own. We have to keep rather a continuing surveillance over the Nation's efforts to attain maximum employment, production, and purchasing power.

Accordingly, I would like to ask of you the following: You are familiar with my views and you have heard them restated this morning, that with the current rate of unemployment in this country, we don't want, as the President says, to vitiate the effect of a tax cut by tightening the money supply except under extraordinarycircumstances. That language is always in there.

My question is this: During this upcoming year of 1964, if at any time you discover or have reasonable grounds to suspect that the monetary authorities are about to take decisive action to tighten money, would you inform this committee through its chairman so that you and your associates on the Council may sit down with us in successive meetings and discuss the proposed or effectuated change in the direction on monetary policy, so that we can have the benefit of your views on the state of our balance of payments, the state of inflationary pressures, and above all, the state of unemployment? Would that not be a useful early warning system to set up so that this committee can better discharge its functions?

Dr. HELLER. Let me note in connection with that suggestion that the Board of Governors of the Federal Reserve System is a direct creature of Congress and that it might be more appropriate for them to inform you than for us to do so.

Representative REUSS. It would be indeed, but as I read their report they are—one can use words ranging from unwilling to contumacious, depending on your view of their statutory function. They aren't going to tell us. As Mr. Martin said yesterday, if they choose tomorrow to alter the monetary policy of this country, we can read about it in March 1965, 15 months later, when we get their report. Now, as the Chairman of our Council of Economic Advisers, you are in a position to ride closer herd on our monetary authorities, consistently with their independence, than we are, and what I would ask, therefore, and I would hope that you would be willing to do it, is that you notify us so that we may have a hearing, executive or public as is deemed best, with you and your associates at any time this year when it appears that the monetary authorities are changing direction.

In making this request, I want to make it clear that you are not constitutionally endowed with a sure-fire method of determining whether such a change is taking place. All I am asking is that if you get a whiff of something like this, tell us, and we will sit down and talk about it. Can we do that?

Dr. HELLER. This is, as you yourself suggest, somewhat of a difficult request to carry out. But certainly, to the extent that it is possible, we will always cooperate with this committee and try to be as helpful as we can.

Representative REUSS. Thank you very much. We will expect to hear from you if something along these lines comes to your attention that you feel we should know.

Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

First, I would like to ask that we of the minority be permitted to submit in writing a series of questions to the Council of Economic Advisers, as we have in the past. We have prepared a list of questions and, of course, we wouldn't have the opportunity here, in this kind of format, to go into them all. I think this technique has served a useful purpose in the past.

I think it probably would be helpful, too, if we made these questions and your answers a little more public. Would you be willing to undergo that ordeal again, Dr. Heller?

Dr. HELLER. Well, Mr. Curtis, you do correctly describe it as an ordeal. I take back anything I said about the terminal significance of these hearings.

Representative CURTIS. I think you recognize that in these studies, the combination of more reasoned questions and your opportunity to answer them more fully is quite fruitful and becomes a source of reference in the published hearings. So if I may, Mr. Chairman, I would like unanimous consent to submit this series of questions.

Representative REUSS. Without objection, so ordered.

(Subsequently, Representative Curtis submitted 24 questions to the Council of Economic Advisers. The questions and the answers thereto follow:)

Question 1. The administration has said the fiscal stimulus which the economy will receive from the Federal Government this year will be three times greater than the stimulus received in any of the 3 previous years. In the face of a vigorous expansion that is continuing without signs of abatement, how do you justify such a policy? Couldn't it lead to an inflationary boom in 1964 and a bust in a later year?

Answer. Even the sustained, strong expansion of the past 3 years has not yet brought the U.S. economy close to the full potential of either its manpower or its industrial capacity. With 5½ percent of our labor force still idle, with a million or more potential workers who have dropped out of the labor force and are ready to return as jobs become available, and with our factories operating, on the average, at about 87 percent of capacity, it is clear that the economy needs a strong stimulus to demand and incentives.

The Council estimates that our idle labor and idle plant capacity could today produce without excess strain on our productive system or on price levels, another $30 billion a year of extra output.

Moreover, our productive capacity is growing rapidly. Normal labor force growth in the next 2 or 3 years will average 1.3 million new workers per year, as compared with an average increase of 800,000 per year during the 1950's. Labor productivity will continue to rise. Total capacity to produce grows about $30 billion a year in current prices.

Since early 1962, our expansion of output has barely kept up with the expansion of capacity, and unemployment has remained a disappointing 5½ percent of our labor force. It will require a powerful fiscal stimulus to let us catch up with our present excess capacity, and let us keep up with the current and future growth of our capacity.

Without such a fiscal stimulus, the prospects for continued advance in 1964 are uncertain. Surveys made when the tax cut was still uncertain show only modest planned increases in plant and equipment investment; housing construction has been at a level so high that further increases cannot now safely be expected; inventories will not be built up materially unless total sales grow more rapidly than they have been growing; and there is no evidence of any incipient consumer spending boom. Thus without a strong fiscal stimulus in 1964, the 3-year expansion—already unusually long by historical standards—would be very likely to terminate in 1964.

The suggestion that the President's fiscal program is inflationary appears not only to underrate the existing and prospective capacity of our great economy, but to overestimate the speed with which the demand stimulus of the tax cut will take effect. Consumers will not all at once begin spending on the basis of their $8 billion higher after-tax incomes. Production will not expand all at once in the face of larger consumer buying. Investment will not respond instantaneously to a higher utilization of existing capacity.

Rather, the stimulus from the 1964 tax cuts will gradually cumulate and gather strength, and will not approach its maximum impact until well into 1965, by which time modest additional tax reductions will have become effective.

The very gradualness of taking effect is why it is so important that the tax bill be passed quickly, and that the withholding rate be immediately reduced to 14 percent. Only in this way will the economy feel a strong enough stimulus in 1964 to bring the unemployment rate down significantly by the end of the year.

In the light of the above—and particularly if unions and business firms continue to practice the kind of responsible wage and price policies that they have followed in recent years—there is no reason why prices should rise in 1964 any more than in 1963.

Question 2. The Council said in its 1962 report that inflation is more difficult to avoid the smaller the full employment budget surplus. Since you expect to wipe out the full employment budget surplus this year, doesn't that increase the chances of inflation?

Answer. Although the temptation to raise wages and prices contrary to the public interest may be increased as economic expansion accelerates, the magnitude of our unemployed resources will avoid any general shortage of labor or plant capacity. As operating rates increase toward the point of optimum efficiency, unit costs will tend to decrease. The tax cut will mean higher take-home, pay, lower costs, increased after-tax profits. In the light of the anticipated gains to labor and industry, and the substantial unused resources that will remain, there is no occasion for inflationary price or wage behavior in 1964.

The administration will continue to pursue policies to preserve price stability. These include the preservation of actively competitive domestic markets, stimulation of price competition in world markets, expansion of programs to improve the functioning of labor markets, stimulation of productivity advances and lower costs, and frugality and efficiency in Government purchases of goods and services. The administration has restated its noninflationary price-wage guideposts. Wage and price developments will be followed closely, and the administration will not hesitate to draw public attention to price or wage decisions that flout the public interest.

We believe that inflation can and will be avoided in 1964.

Question 3. The request for reducing the withholding rate immediately from 18 percent to 14 percent moves some of the stimulus from the second stage of of the tax cut from 1965 to 1964. The drop in the withholding rate to 14 percent would reduce lump-sum refunds next spring to individuals by about $2 billion. How is this likely to affect consumer spending and the general economy at that time?

Answer. The reduction in lump-sum refunds next spring is not due wholly to the drop of the withholding rate to 14 percent as against 15 percent. Going from 18 percent to 15 percent on January 1, 1964, would itself have reduced 1965 refunds by about $1 billion. If, for example, the withholding rate were reduced to 14 percent on March 1, the further reduction in refunds would be about $0.8 billion.

The reduction in withholding during 1964 is, of course, the primary channel through which the tax cut stimulus reaches markets and creates jobs. To be sure, refunds in spring 1965 will be less than if the withholding rate had not been lowered—or had been lowered by less. But, on the other hand, the cumulative response to the 1964 cuts will be greater than would be the case with a 15-percent withholding rate, and, as explained in our answer to question 1, this cumulative impact will grow well into 1965, and even beyond.

Question 4. The budget also shows that individual tax collections next year (other than that withheld) will increase by $1.8 billion, or to $16.7 billion from the $14.6 billion average of the previous 3 years. Presumably this will be a result of the immediate application of the 14-percent withholding rate. Won't this be a restrictive factor on the economy next spring?

Answer. It is estimated that the application of the 14-percent withholding rate will account for less than $0.5 billion of the $1.8 billion increase in other-than-withheld tax collections. The phrase "the $14.6 billion average of the previous 3 years" might suggest that nonwithheld tax collections are reasonably stable. But they are not. Such receipts change with changes in personal income. When personal income showed large gains—as in calendar years 1955, 1956, and 1959—nonwithheld receipts in the fiscal years following showed rises varying from $900 million to $1.5 billion.

Because of the record gain in personal income expected in calendar year 1964, and the increase in nonwithheld receipts arising from the revenue-increasing provisions of the tax bill, a substantial rise in fiscal year 1965 receipts is expected quite apart from the reduced withholding.

Question 5. Federal purchases of goods and services are expected to increase in 1964. By how much? Do you consider this a stimulative factor? What will be the trend of such spending in calendar 1965? Do you consider this stimulative or restrictive?

Answer. Federal expenditures on goods and services are now estimated to rise by $3.4 billion in fiscal 1964 and $1.3 billion in fiscal 1965. The calendar 1964 increase in spending is estimated to be $2.5 billion, compared with an estimated increase of $4 billion in calendar 1963. It is not possible to give an estimate of spending in calendar 1965 since the last half of that year falls within the fiscal 1966 budget period; before budget plans are made for that period the administration will, of course, review the priorities of spending programs and the progress of the economy.

The 3.8-percent planned increase in Federal spending on goods and services in calendar 1964 is considerably smaller than the 1963 increase either in Federal spending (6.4 percent) or gross national product (5.4 percent); and it is also substantially smaller than the expansion in GNP projected for 1964 (6.5 percent). Consequently the spending side of the Federal budget can hardly be considered stimulative, in 1964. Federal spending will be expanding little, if at all during the first half of 1965; however, the tax cut stimulus is expected to provide for an acceleration in economic expansion not only throughout 1964, but well beyond.

Question 6. The administration argues that inflation is not likely to occur because there are idle resources of men and equipment available for absorption in a new wave of expansion. Do you have any estimate of how much of our excess capacity is actually obsolete or which is capacity to produce goods no longer in demand? Is it not likely that too sharp an expansion could bring into operation inefficient, high-cost plant which would tend to put pressure on prices?

Answer. According to a McGraw-Hill survey, as of December 1962 an estimated 20 percent of the stock of plant and equipment for all industries was technologically outmoded. For manufacturing the figure was 22 percent. There are of course conceptual difficulties in attempting to derive such an estimate from surveys, because each firm interprets the cutoff between "technologically outmoded" and "not technologically outmoded" differently. But even these rough approximations are useful.

According to that same survey, manufacturing firms—on the average—would prefer to be operating at 92 percent of capacity, whereas they are currently operating at about 87 percent of capacity according to a measure of capacity utilization compiled at the Federal Reserve Board, based on the McGraw-Hill surveys. This gap is consistent with the administration's estimate of a GNP gap of 5 percent, or $30 billion, for the entire economy. Unless manufacturing firms prefer to make less rather than more profits, we can conclude that average unit costs of production will be lower—or at least not perceptibly higher—as manufacturing operating rates are increased from 87 percent to 92 percent.

This finding is not inconsistent with recognition that an estimated 22 percent of plant and equipment in manufacturing is technologically outmoded. Since technological advances are continually occurring, every firm has some technologically outmoded plant and equipment, unless its entire stock of equipment is brand new. One analysis recently undertaken by the Department of Commerce estimated that private nonfarm equipment stocks were on the average 7 years old, while nonfarm structures averaged about twice that age. Technological, organizational, and managerial improvements—large and small—are constantly taking place. The overall costs of production at a given point in time reflect, not the latest technology, but the average technology in an industry—i.e., existing prices already reflect much obsolete plant and equipment. As operating rates are increased, the additional plant and equipment brought into use may be older and less efficient, but the overall impact on average efficiency in the industry should be slight, and may be offset, or more than offset, by economies due to the spreading of overhead labor and capital costs.

Little direct information is available on manufacturing capacity to produce goods no longer in demand. However, such capacity would be in addition to—not part of—estimates of excess capacity which the Council has used.

The speed with which operations can be efficiently expanded and the flexibility with which firms can meet changing product demands are aided by the fact that investment is taking place at the same time that outmoded plant and equipment are being retired from the capital stock. Data on expansion of capacity greatly understate the turnover of capacity. It is estimated that the annual change in the stock of private nonfarm capital during recent years has been about one-third of gross investment. This means that when the stock of plant and equipment increases by 3 percent from one year to the next—which is roughly the rate of increase in recent years—about 9 percent of the total capital stock is new.

It would certainly be a mistake to understate the competitive pressures on business to introduce technological improvements, or to minimize their ability to innovate quickly when economic conditions so warrant. The real significance of the estimate that one-fifth of our plant and equipment is technologically outmoded is not the one implied by the question—namely, that this fact will interfere with expansion of output. Rather, its importance lies in suggesting the scope for cost-reducing investment in an economy operating close to capacity and with strong investment incentives.

Question 7. Do you have a breakdown of industries which are operating at or near their preferred operating rate? Is it not true that too sharp an expansion would cause price pressures in these industries which would tend to "spill over" into other sectors of the economy?

Answer. The following table presents a breakdown of actual operating rates, preferred operating rates, and expected increase in physical volume of output, 1964 over 1963, for 15 manufacturing industries, as of September 1963. These data are taken from the November 1963 McGraw-Hill survey and represent the latest information of this type available.

As can be seen from the table, every one of the 15 manufacturing industries reported actual operating rates below preferred rates. Excess capacity is particularly concentrated in the durable goods sector including stone, clay, and glass, and chemicals. These are the industries which would be most affected by an accelerated rate of investment. Thus, the industries most likely to experience a sharp expansion of demand under the stimulus of the tax cut are the very ones most in need of, and best able to handle, a substantial increase in capacity utilization. Even the automobile industry, which has enjoyed exceptionally strong demand, could expand operating rates by 6 percentage points without exceeding preferred rates.

Actual and preferred rates of operation and output expectations in 15 manufacturing industries

Industry	Actual operating rate September 1963 [1] (percent)	Preferred operating rate [2] (percent)	Preferred less actual (percentage points)	Expected percent change in physical volume of output 1963–64 [1]
Iron and steel	69	91	22	1
Nonferrous metals	88	95	7	5
Machinery	79	91	12	6
Electrical machinery	82	93	11	7
Autos, trucks, and parts	90	96	6	2
Transportation equipment (aircraft, ships, railroad equipment)	76	88	12	2
Fabricated metals and instruments	81	92	11	5
Chemicals	81	90	9	6
Paper and pulp	94	97	3	4
Rubber	89	94	5	4
Stone, clay, and glass	78	88	10	5
Petroleum and coal products	93	95	2	2
Food and beverages	80	86	6	5
Textiles	95	96	1	4
Miscellaneous manufacturing	89	94	5	6

[1] Source: McGraw-Hill Survey, November 1963. Actual operating rate of iron and steel is average for year, estimated by Council of Economic Advisers.

[2] Source: McGraw-Hill Survey, April 1963. Preferred operating rate for iron and steel based on McGraw-Hill Survey, November 1962.

If we suppose that demand for output increases from 1963 to 1964 by the same percentage that manufacturing firms in different industries expect, then, assuming that no industry increases its productive capacity, actual operating rates would exceed preferred rates in only three industries—paper and pulp, textile, and miscellaneous manufacturing. Price increases in these industries would have little feedback on other business sectors. If manufacturing capacity increased by just 1 percent in each industry, only textiles would be operating at higher than preferred rates, given expected increases in manufacturing sales. If, in 1964, manufacturing capacity should expand in each industry by the same amount that capacity expanded for manufacturing as a whole in 1963—4 percent—then at its expected output in 1964 every industry would be operating below preferred rates.

Of course, output expectations held by manufacturing firms in September may have been unduly pessimistic. If we suppose that the actual output increase in 1964 is twice the expected increase for each and every industry, then with a 4-percent expansion of capacity across the board, only the same three industries—paper and pulp, textile, and miscellaneous manufacturing—would be operating above preferred rates. Clearly there is no plausible rate of increase of output in 1964 which would result in significant price pressures due to insufficient capacity.

Question 8. The unemployment rate in December for all married men was 3.4 percent. It was 4.4 percent for all men over 20. The rate for women over 20 was 5.2 percent, and for teenagers, it was 14.8 percent. Is it possible that a new wave of expansion would increase demand for married men, for whom the unemployment rate is already far below the administration's interim full employment target of 4 percent? If this occurred, would it not be likely to create serious labor and skill bottlenecks and put upward pressure on wages?

Answer. If demand quickens, causing employers to seek additional employees, they will naturally look to the unemployed as a source of new workers—and it is very unlikely that employers will confine their search to married men alone. Married men, because they are usually in the prime working ages and also possess a considerable accumulation of skills, training, and seniority, are always less likely to be unemployed. Their unemployment rate is usually well below the average rate for all males. Thus in December 1955, for example, when the average unemployment rate for the total civilian labor force was 4 percent, the rate for married men was only 2.1 percent—well below their 3.4 percent rate in December 1963. And in December 1956, when the overall rate was 4.1 percent, the rate for married men was 2.5 percent.

Thus there is no real conflict. Expansion of demand will lower more rapidly the unemployment rates of groups most prone to unemployment when demand is slack. But it also will effect significant further reductions in the present rate of married men—something that past experience has shown is perfectly normal and feasible in high employment periods.

Although there are always some skill shortages of one kind or another, there is little reason to fear any general upward pressure on wages as unemployment drops. Instead, whatever tightening of the labor market does occur will bring pressures to bear on employers to upgrade the skills of the new people they hire. Since many of these will be younger men, the effect will be to move them up the skill ladder and thereby make them less prone to unemployment in the future.

Question 9. News stories indicate that organized labor plans to press for increased wages this year in contrast to its efforts of recent years to increase fringe benefits and improve job security. Does this indicate to you that labor feels it is in a better bargaining position because of a tighter labor market for experienced workers in 1964?

Answer. No, it does not, since unemployment still remains well over 5 percent. It is possible, however, that organized labor is anticipating some labor market tightening that may be generated by the stimulus to demand resulting from the tax cut. But since this stimulus is unlikely to reduce unemployment much below 5 percent within the coming year, one can hardly characterize the 1964 labor market for experienced workers as a "tight" one.

At the same time, it is true, as we said in our report, that rank-and-file labor is currently "restive" in the face of recent money wage gains that have been smaller, on average, than those of earlier years. It is particularly important, therefore, (*a*) to emphasize the advantages—to labor and to the economy generally—of achieving gains in real wages in a manner that does not force price increases; and (*b*) to emphasize the advantages—to business and to the economy generally—of avoiding unnecessary price increases that, besides raising average prices directly, incite intensified wage demands.

Noninflationary wage and price decisions in the coming year will permit labor and management to share the gains of continued expansion without the risks and costs of a renewed inflation.

Question 10. What would be the administration's policy in 1965 should the sharp expansion which it seeks result in a leveling off or a decline in the high level of economic activity attained in 1964? Do you think you would hold to the 1965 budget estimates or would spending be likely to increase substantially?

Answer. As pointed out in response to questions 3, 4, and 5, the Council's best judgment at this time is that, with the pending tax cut enacted, there will not be a leveling off or a decline in 1965 from the high level of economic activity attained in 1964. On the contrary, it is our view that the improvement in activity in 1964 will still fall substantially short of reflecting the full impact of the fiscal stimulus provided by the tax program. With the effects of the fiscal stimulus more pronounced in 1965, we expect a continued vigorous expansion. The expenditure budget for fiscal year 1966 can, of course, take account both of program needs and fiscal needs as they appear at the end of 1964.

Question 11. Anything which causes productivity to increase also causes our economic potential to increase and makes it that much harder to close the so-called gap between actual and potential production. While it is not an argument against the tax cut. doesn't the tax cut have this effect, since it is expected to increase our productivity?

Answer. Since various aspects of this question are covered in extensive detail in chapter 3 of the 1964 Economic Report, the answer given will simply summarize the relevant considerations.

The tax cut will work to improve productivity in two main ways.

1. The tax cut stimulus to demand will mean that employed manpower and existing capacity are utilized more effectively.

2. By stepping up demand, by sharpening profit incentives, and by providing a substantially increased flow of investment funds, the tax cut will encourage investment and innovation. An accelerated rate of investment hastens the replacement of obsolete plant and equipment with capital embodying the latest technology, thus stepping up the rate of overall improvement in the quality and productivity of the capital stock. Moreover, with markets favorable and risk capital more readily available, technological innovations are more likely to occur, and once proved successful, will more easily spread throughout an industry.

But simply because the impact of the tax cut on output per man-hour is expected to be positive does not suggest that it will be greater than the effect on output. The most immediate and most tangible result of the tax cut stimulus to demand will be increased employment. This is particularly true in the case of production workers.

Put another way, reducing the employment gap can be viewed as a necessary condition to achieving the beneficial effects on productivity. Thus, the Council, in its estimates of the gap between actual and potential output, includes the increase in productivity owing to greater utilization, as well as the reduction in the unemployment rate. To this extent the effects on productivity of closing the gap via the tax cut have already been taken into account.

The longer run investment effects on productivity have not been included in the gap calculations, but, as has been pointed out, their achievement depends on an accelerated rate of investment, which implies a faster rate of economic growth. Thus, policies designed to increase the rate of growth can be expected to produce additional productivity increases which would not have been available in their absence. This means that standards of living can rise more rapidly than otherwise. Only if demand could not keep pace—and the historical evidence and economic analysis are both very much to the contrary—would the additional productivity increases be unwelcome.

Question 12. The Economic Report frequently refers to the large recent increases in the absolute level of corporate profits. In order to be meaningful, shouldn't this be related to stockholders' equity or to the return on the invested dollar? Looked at in this way, aren't corporate profits still considerably below their pre-1957 level?

Answer. Official statistics of stockholders' equity are available only for manufacturing industries. Based on data for the first three quarters of 1963, the after-tax return on stockholders' equity for manufacturing corporations, as estimated by the FTC–SEC, averaged close to 10 percent for the year as a whole. This is a marked improvement from the 8.8 percent annual average in 1961, paralleling the improvement shown by absolute figures on corporate profits in the national income accounts (covering all industries, not just manufacturing). It also betters the 9.8-percent average rate of return during 1959–60. The rate of return on stockholders' equity in 1963 was still somewhat lower, however, than in the 1955-57 period of relatively full capacity production. This reflects the need—also stressed in the report—for accelerated expansion which will bring economic activity up to full capacity.

Although the tax changes of 1962—the investment tax credit and the revised depreciation guidelines—did not, in the aggregate, appreciably raise profits after taxes, they did increase capital consumption allowances and reduce tax liabilities, thus adding materially to corporate cash flow.

Question 13. Please describe the "early warning system" being set up in the agencies to warn of impending price increases. How do you intend to differentiate between increases that are inflationary and those that are not? In what fashion will the President bring to the attention of the public increases which he considers inflationary? How will you avoid a repetition of the disastrous reaction to the steel-pricing crisis in 1962? Since price changes serve a vital economic function of allocating resources, how will you avoid the harmful effects which would follow from any tendency to freeze price relationships?

Answer. Industry specialists in the Department of Commerce and collective-bargaining specialists in the Department of Labor have arranged regularly to supply the administration with current information on impending and already announced price changes of significance. Staff-level technical task forces from these agencies and the Council of Economic Advisers also will assemble a variety of economic data on industries where critical price and/or wage changes are anticipated. Making use of this information, senior officials of the same agencies will identify, and keep the President informed of, industry situations that threaten to overstep the bounds of responsible price and wage making. Such situations, if serious enough, would become candidates for further administration consideration. The specific means by which the President might wish to focus public attention on particular situations, and otherwise convey his interest and concern to the parties involved, would, of course, be up to the President.

In the most fundamental terms, the distinction between price and wage increases that are inflationary and those that are not is the distinction between increases that fall within the administration price and wage guideposts and those that do not. These guideposts have been publicly set forth in the 1962, 1963, and 1964 Economic Reports. The data being assembled by the Department of Labor and the Department of Commerce will facilitate the evaluation of price trends in various industries—rising, stable, and falling—in the light of the guideposts.

It is not the purpose of the guideposts to freeze price relationships and therefore to prevent prices from performing their allocative function. Quite the contrary. Price and wage decisions which adhere to the guideposts are consistent with the tendencies of competitive labor and product markets, and therefore with efficient allocation of resources. Under the guideposts relative price movements depend—as they should—on relative productivity movements. In general, prices would be expected to increase in industries experiencing less than average trend productivity increases, and prices would be expected to decrease in industries with greater than average trend productivity increases. Individual price rigidity is therefore the exception rather than the rule. A stable price level for a product where quality is unchanged but where productivity is rapidly advancing is clearly a violation of the guideposts.

It is not anticipated that a repetition of the 1962 steel episode will occur. There is greater recognition on the part of major private groups today than there was even 2 years ago that the exercise of private power carries with it the need to exercise private responsibility. In 1964 any firm, industry, or union that openly flouts the public interest in noninflationary price and wage behavior is likely to incur the censure, not only of an alert public, but of the (predominantly responsible) leaders of its own interest group. The purpose of the administration will be to promote responsible behavior, self-administered.

Question 14. The administration plans to ask for an extension of the coverage of the minimum wage and overtime provisions of the Fair Labor Standards Act. Do you have any studies of whether extension of minimum wage might tend to reduce job opportunities for teenagers and other unskilled or inexperienced personnel? In the long run might there be a tendency to introduce labor-saving machinery or procedures as a result of the minimum wage?

Answer. We are not aware of any studies of the effects of extension of minimum wages on job opportunities for particular groups of workers such as teenagers. However, the Labor Department has completed several studies of the general effects of establishing or raising minimum wage rates. In the January 1963 report submitted to the Congress in accordance with the requirements of Section 4(d) of the Fair Labor Standards Act, the Secretary of Labor concluded that "the 1961 minimum wage increases had no discernible effect on the nation-wide level of employment in the industries affected."

However, he noted that, "the studies of employment changes in nonmetropolitan areas of the South suggest that in 1962 there was more effective use of time of employees in covered retail stores, and an 11 percent decline in the number of workers employed. Employment increased in noncovered retail trade in these areas."

"A Study of Changes in Wage Structure of a Matched Sample of Retail Establishments, 1961–62," published by the Labor Department in November 1963, showed that" employment declined between June 1961 and June 1962 about 1.5 percent in covered establishments and about 0.5 percent in noncovered establishments." In limited-price variety stores the decline was about 10 percent in covered stores and about 4 percent in noncovered stores.

The evidence from these and other studies is that in a period of economic expansion job opportunities are created which more than offset any localized displacement effects of minimum wage extension. It is probably true that the labor force adjustments created by minimum wage extension will be concentrated among unskilled and inexperienced workers, including teenagers. This impact calls attention to the need for better basic education, for improved retraining programs, and for other efforts to improve the productivity of all members of the labor force.

The continuing improvement of our standard of living depends on the rate of growth of productivity. The introduction of more productive labor-saving machinery in industries affected by minimum wage extension will enable such industries to maintain profitable production and employment at wages that meet society's standards for an acceptable minimum. The contribution of such improvements to average productivity will help raise the productive potential of the economy. At the same time, however, there must be sufficient expansion of total demand so that jobs are provided for the workers displaced by technological change.

Question 15. If the minimum wage and overtime provisions of the Fair Labor Standards Act are extended to new workers, how do you intend to make certain that the increases in labor costs do not exceed the administration's own noninflationary guidelines?

Answer. Extension of the provisions of the Fair Labor Standards Act generally affects relatively small numbers of workers and introduces changes over a considerable period of time. As a result, it is unlikely that the changes that are in prospect will exert discernible upward pressure on prices. The January 1963 report of the Secretary of Labor stated that, "The 1961 minimum wage increases had no discernible effects on average wages in the economy generally. There is no indication that these increases produced any general upward pressure on the wage structure." In general, only a small proportion of total employees in any establishment or industry will be affected by minimum wage changes. As a result, the increase in total labor compensation per employee man-hour will be only a fraction of the increase in the wages of affected employees.

The guideposts provide that wage rate increases may appropriately exceed the general economy-wide increase in productivity in an industry in which "wage rates are exceptionally low compared with the range of wages earned elsewhere by similar labor, because the bargaining position of workers has been weak in particular local labor markets." The extension of minimum wage coverage thus does not constitute a violation of the noninflationary wage-price guideposts.

Question 16. While income for the rest of the Nation was increasing, total agricultural income between 1962 and 1963 declined from $17.6 billion to $17.3 billion. In December the seasonally adjusted annual rate was down to $16.8 billion. How does the administration intend to stop the slide of farm income?[1]

Answer. In 1961 national income produced in agriculture was $17.2 billion, in 1962 it was $17.7 billion and for 1963 it was $17.4 billion. The average for the period 1961–63 was $17.4 billion. In the previous 8 years, 1953–60, national income produced in agriculture average only $15.9 billion, or 9 percent lower. Indeed, in only 1 year during this latter period, 1958, did it ever rise as high as $17 billion.

However, neither the personal income produced in agriculture (the numbers used in the question) nor national income produced in agriculture are fully appropriate measures of welfare in agriculture. Both of these measures include such expenses of farming as rent paid nonfarm landlords, interest payments, and other money flows going to individuals who are never normally considered part of agriculture.

Even a measure of the total income flows going to those directly involved in agriculture is not an appropriate measure of welfare. Agriculture is a dynamic industry in which many changes have occurred in the past and continue now to take place. The most striking of these are the sustained high rates of increasing productivity in agriculture (far higher than in industry), and the accompanying major organizational changes—including the decline in the number of farmers necessary to produce the food and fiber that we need.

Thus, the appropriate measures of welfare in agriculture must be expressed in per farm or per capita terms. These figures for recent years are seen below.

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[1] The income measure of the question appears to have been produced by subtracting "nonagricultural personal income" (p. 225 of Economic Report) from "total personal income" (p. 224 of Economic Report). It is thus a measure of "personal income produced in agriculture."

Years	Operators' realized net income per farm	Per capita personal income of farm population	
		From farming	From all sources
1953–60 average	$2,710	$708	$1,078
1961–63 average	3,369	931	1,425
1961	3,269	882	1,358
1962	3,414	940	1,436
1963 [1]	3,425	970	1,480

[1] Preliminary.

As can be seen in the table the welfare of American agriculture has continued to improve since 1960. The farm operator's realized net income per farm over the period 1961–63 is 24 percent higher than the average over the previous 8 years. In fact, during the years 1953–60, in no year did operator's net income reach the levels of either 1961, 1962, or 1963.

The same pattern prevails in all of the series on per capita income for the farm population, whether it is income from farming or from all sources. The per capita income of the farm population averaged 32 percent higher in the 1961–63 years than it did over the period 1953–60.

Even with this improvement, of course, the per capita income of the farm population is now only about 60 percent of the average for the nonfarm population. Much remains to be done though we have been making slow but steady improvement. In 1953 per capita farm income was 53 percent of nonfarm. By 1960 it had increased to 54 percent.

Question 17. A sharp change has taken place in the proportion of GNP increase contributed by the Federal Government and the private sector in the three most recent recoveries. In the current recovery, 11 percent of the GNP increase came from Federal Government purchases, compared to declines of 10.9 and 1.2 percent in the two previous recoveries. At the same time, personal consumption expenditures accounted for only 48.9 percent of the GNP increase in this recovery, compared to 70.5 and 60 percent in the two previous recoveries. Explain the significance of the shift.

Answer. The proportion of personal consumption expenditures in the total increase of gross national product may vary for any one or more of several reasons. As shown in the accompanying table such variations may be due to changes in (1) capital consumption allowances, (2) indirect business taxes, (3) the share of corporate profits, (4) contributions for social insurance, (5) transfer payments, (6) personal tax and nontax payments, and (7) the rate of spending or saving out of personal disposable income. Further, the change in consumption expenditures relative to a change in GNP when both are measured in constant prices depends upon the relative change in prices of consumer goods and services compared to the change in prices for investment and Government goods and services.

In brief, during the 1954–57 expansion the change in consumption relative to the change in GNP, in current prices, was affected favorably by the reduction of taxes in January 1954. In the 1958–60 expansion, an increase in consumer spending in excess of the increase of personal disposable income was largely responsible for the favorable change in consumption relative to the change in GNP. (On a yearly average basis the consumer spending rate has stayed within the range of 92 to 94 percent of disposable income. Marginal changes of spending relative to disposable income do, however, show a larger range of variation, as the table indicates.) In the present expansion, the reduction in national income relative to the change in GNP and the decline in the rate of spending relative to the change in personal disposable income have, thus far, reduced the share of consumption relative to the change in GNP.

The reduction in the consumption share, as is clear from the table, is not to be explained by the increased share of Federal expenditures relative to the change in GNP. The connection between Federal expenditures and consumption expenditures is that the rise in Federal expenditures during the current expansion made possible larger consumer expenditures than would otherwise have been the case.

The foregoing analysis is in terms of relative changes, as suggested by the question. It may also be useful to compare actual consumption in absolute terms. In the first expansion consumer expenditures in current prices increased at an average annual rate of $16.1 billion; in the second, $18.8 billion; and in the present expansion, thus far, by $17.9 billion.

Change in consumption and other items as percentage of change in GNP, national, and personal income

[In percent; current prices except where indicated]

	2d quarter 1954 to 3d quarter 1957	1st quarter 1958 to 2d quarter 1960	1st quarter 1961 to 4th quarter 1963
Distribution of change in gross national product:			
Gross national product	100.0	100.0	100.0
Less:			
Capital consumption allowances	10.4	6.7	9.2
Indirect business taxes	9.3	11.5	11.1
Other	-.5	-1.3	.5
Equals national income	80.8	83.1	[1] 79.2
Distribution of change in relation of national income and personal income:			
National income	100.0	100.0	100.0
Less:			
Corporate profits plus IVA	12.7	21.5	19.0
Contributions for social insurance	7.1	10.1	8.7
Excess of wage accruals over disbursements	0	-1.0	0
Plus transfers, dividends, and interest	13.9	13.4	11.9
Equals personal income	94.2	82.6	84.2
Change in personal income relative to change in GNP	76.1	68.7	66.7
Change in disposable personal income relative to change in personal income	85.1	79.6	84.3
Change in consumption relative to change in disposable personal income	90.2	108.7	88.0
Change in consumption relative to change in personal income	76.8	86.5	74.3
Change in consumption relative to change in GNP	58.4	59.4	49.5
In constant 1963 prices: Change in consumption relative to change in GNP	70.5	60.5	48.9

[1] Preliminary CEA estimate.

NOTE.—Detail will not necessarily add to totals because of rounding.

Question 18. Total Federal expenditures increased 20 percent in the current recovery. How does this compare with increases in previous recoveries? Has this recovery been more dependent than others on increases in Federal spending? What are the implications of this?

Answer. The question clearly refers to data in current prices, as opposed to the comparisons in constant prices shown in table 1 of the Council's 1964 report, page 34.

The percentage rises in total Federal expenditures in current prices in the present expansion and in the 1954–57 and 1958–60 expansions are shown in the following tabulation, along with the changes in Federal receipts and GNP over the same periods. The change in Federal purchases of goods and services relative to the change in GNP is shown in the last line of the table. All data are as defined in the national income accounts.

	2d quarter 1954 to 3d quarter 1957	1st quarter 1958 to 2d quarter 1960	1st quarter 1961 to 4th quarter 1963
	Percentage change		
Federal expenditures	16.3	11.0	19.6
Federal receipts	30.3	29.8	25.5
GNP	24.9	16.4	19.9
	Percent		
Absolute change in Federal purchases of goods and services as percent of absolute change in GNP	3.2	3.2	11.6

As shown by these data and those in table 1 of the report, Federal expenditures did contribute more to the current expansion than was the case in the preceding two expansions. The contrasting, and more salutary, performance of Federal fiscal practice in the current expansion is described in pages 44–46 of the Council's report. The experience of the past decade confirms the economic analysis which holds that Federal fiscal practice can have a powerful impact, good or bad, on private economic activity. As stated in the Council's report, page 39—

"To comply with the mandate of the Employment Act of 1946 'to promote maximum employment, production, and purchasing power,' the Federal Government must adjust its programs to complement private demand. Given the magnitude of its expenditure commitments, its revenue collections, its public debt management obligations, and its money and credit responsibilities, the Government inevitably exerts a powerful impact on demand. It is, therefore, a first principle of responsible Federal economic policy to try, insofar as possible, to adjust this impact in a way that promotes expansion and price stability."

Question 19. It has often been said that Federal employment will increase as the population increases in order to meet growing demands for Government services. Isn't it true, however, that productivity of Government workers is increasing and that this largely offsets the need for the total to grow as the population grows? Do you have any estimate of the annual increase in the productivity of Government workers?

Answer. Although it is clear that productivity in Government is increasing, no overall measures of Government productivity or changes in it now exist. To fill this gap, the Bureau of the Budget more than a year ago initiated a study to assess the feasibility of productivity measures for the Federal Establishment, using five Federal organizations as pilot cases. While the full report on the study will not go to the printer for another month, the Bureau reports that special efforts have been required to develop meaningful productivity measures, because outputs (1) are not easily defined, (2) change rapidly in both quantity and quality, and (3) do not carry market prices. Despite these difficulties, the experience from this study will be carried over into other governmental operations to help expand our knowledge about Federal productivity.

Rough indicators of output now available on the basis of workload measures for a number of Government activities (more than 160 such cases are set forth in the appendix to the 1965 budget) form at least a partial basis for the Bureau of the Budget's assumption that Government employee productivity will continue to increase. Estimates of appropriations and employment in the 1965 budget reflect this assumption.

The suggestion that growing productivity in Government can completely offset the need for adding employees as the population grows is not entirely correct, however. Many major Federal activities are almost wholly unrelated to population size; for example, the size of our defense, foreign aid, and space programs. Likewise, new programs and new legislation may expand Government employment more rapidly than population increases; for example, new drug legislation, increased concern with mental illness, the Manpower Development and Training Act, and the President's program to attack poverty. All of these have resulted in an expansion of Federal employment not related to population increases and not offset by productivity increases.

In addition, a variety of other factors affect requirements for Government services. For example, changes in the age distribution of the population will increase the number of beneficiaries under old-age and survivors insurance by 5 percent next year; the number of veterans and their survivors receiving pensions is estimated to rise by 4 percent; and the number of children participating in the school lunch program is expected to increase by 5.3 percent. Rising per capita incomes are expected to give rise to more growth in travel than population increases might suggest. Passport visas will be up 10 percent over 1964, national park visits are expected to be up 9 percent over 1963, and so on. Whether rising productivity will in the long run fully offset the necessary expansion of Government services in each of these areas is something we still do not know. And yet it is clear that through rising productivity an expanded level of services is already being provided by many agencies without expanded employment. Most notable among these is the Post Office which estimates that in 1963, despite substantially higher mail volume, 9,000 fewer people were hired than would have been required without increased productivity.

Question 20. The budget document says that the annual net outflow of dollars overseas as a result of Federal Government programs is estimated to drop by $800 million between 1963 and 1964. What is the estimated change between 1964 and 1965?

Answer. Page 446 of the budget shows that net Federal payments abroad are estimated to decline by $200 million between fiscal 1963 and 1964 and by an additional $600 million in 1965, producing a total decline of $800 million over the 2-year period.

Question 21. The Council's report says that the administration will call public attention to decisions that seriously overstep noninflationary price and wage standards. How do you decide what is a noninflationary price? By the level of profits in a particular industry or company? What is the standard that you use?

Answer. That is the purpose of the administration's price and wage guideposts. In an industry in which trend productivity is growing less rapidly than the national trend, the noninflationary price guidepost would be met if prices were raised to accommodate the labor cost increases indicated by the general wage guidepost. In an industry whose trend productivity is growing more rapidly than the national average, the noninflationary standard would be met if prices were lowered enough to distribute to the industry's customers the labor cost savings it would make under the general wage guidepost. In industries whose trend productivity equaled the national trend prices would remain stable. The appropriate noninflationary price policy for a particular industry would depend on its trend productivity growth rate. Profits by themselves would not indicate whether or not an industry had followed the noninflationary guideposts.

Question 22. The budget document comes out after the Economic Report. This particular Economic Report seems to point up the difficulities of describing economic policy without specifically referring to the budget figures. Wouldn't it be preferable if the budget document were released first, thus permitting the Economic Report to discuss fiscal policy with specific reference to the budget figures?

Answer. The budget document has usually come out before the Economic Report. This year has been unusual because of the long session of Congress and the short period of time available for the President to screen budget proposals. With the lateness in printing the Budget and the legal requirement that the Economic Report be presented by January 20, the report had to precede the budget.

In any event, the overall budget figures were presented by the President in his state of the Union message, and the details were available to the Council while the report was written. The report does not usually deal at any length with the details of the administrative budget as such but rather with the broad policy aspects and the related revenue and expenditure figures on a national income accounts basis. In drafting the Economic Report, therefore, the Council was not hampered by the fact that the release of the report preceded the release of the budget. One will find references in the report to the character of the fiscal policy embodied in the budget program and its markedly stimulative impact on the economy; references to the effects of the budget program on the full-employment surplus; and references to estimates of expenditures, on a national income basis, in 1964.

Question 23. The Council of Economic Advisers each year issues a forecast of gross national product for the year. Is there a tendency for this forecast to become a target? Does Government fiscal and monetary policy, in other words, tend to be shaped in such a way that the Council's forecast will be realized.

Answer. There is no tendency for the Council's forecast to become a target. Nor does government fiscal and monetary policy tend to be shaped in such a way that the Council's forecast will be realized. The target of fiscal and monetary policy, as mentioned in the answer to question 18, is the promotion of expansion and price stability, not the realization of a forecast.

It is worth restating, in this connection, the observation made in the Economic Report (p. 39):

"These fiscal policy tools, while powerful, can at present be used by the Executive with only limited flexibility. Major expenditure programs must be related to a variety of domestic and international objectives as well as to the requirements of economic efficiency. They are therefore sometimes difficult to reconcile with income and employment goals in the annual budgetary process. Moreover, under our constitutional system, legislation needed to implement fiscal policies is the prerogative of the Congress. The Congress has demonstrated its ability to enact tax and expenditure legislation quickly in time of emergency, and the executive branch does have some flexibility in the timing of expenditures. This limited flexibility was used to good advantage in 1961. But without legislation to establish in advance specific rules designed to facilitate flexible fiscal policy—such as those requested by President Kennedy in 1962—tax and expenditure policies cannot be adjusted with sufficient speed to cope with the swift changes in private demand that bring recession or inflation. Greater flexibility would be desirable. However, the main function of fiscal policy must continue to be the provision of a good supporting framework for expansion."

Question 24. Dr. Heller before the Senate Finance Committee on November 12, 1963, said:

"I have a strong conviction, however, that if, on the one hand, we stimulate the economy by increasing private demand and, on the other hand, we cancel that out by reducing public demand, the total effect would be self-defeating because we would be canceling out with one action what we were undertaking with the other."

Judging by your report this year, you no longer have this opinion. Would you care to explain how you reconcile these positions?

Answer. There is nothing in the report to indicate any deviation from the quoted statement. If the expenditure cuts in the 1965 budget were as large as $10 billion, they certainly would defeat the fiscal stimulus of the tax cut, no matter how defensible they might be on efficiency grounds. However, we are contemplating not a $10 billion cut in budget expenditures but a one-half billion dollar cut. This could not possibly cancel the stimulus of the tax cut. Indeed, the Federal fiscal stimulus in 1964 will be the greatest of any peacetime year in history.

Representative Curtis. Secondly, Dr. Heller, I was a little bit disturbed by the fact that a good deal of attention was directed in the Economic Report not on the future, but in picking at the past, especially the economic policies in the 1958 and 1960 period. Dr. Saulnier, who was Chairman of the Council of Economic Advisers at that time, made a speech at Miami University, April 29, 1963, in which he took up criticisms on this period which are largely the same that are repeated here in the Economic Report. I would like unanimous consent to insert Dr. Saulnier's speech in the record of the hearings to serve as a rebuttal to the Council's critical comments.

Representative Reuss. That is entirely proper and without objection, so ordered.

(The speech referred to follows:)

[From the Congressional Record, May 8, 1963]

THE DIALOG ON GROWTH CONTINUED

(The W. A. Hammond lecture at Miami University, Oxford, Ohio, Monday, Apr. 29, 1963, by Dr. Raymond J. Saulnier, professor of economics, Barnard College, Columbia University, New York City)

Speaking a little less than a year ago at Yale University, President Kennedy invited discussion, a serious dialog he termed it, on ways and means for promoting a higher rate of growth. He called in particular for a "cleaning up" of the area of discourse having to do with the impact of Federal expenditures on the growth performance of our economy and for discussion of budgetary questions in general.

It is hard for me to believe that the President could be greatly disappointed in the results of his Yale initiative. The dialog he wisely called for has gone forward at a fair pace. And it has been no mere academic discussion, to use an expression about which, as a longtime academician myself, I have personal reservations. On the contrary, public debate on the matters in which he expressed special interest has taken a very practical turn as a result of his having put forward a highly controversial budget plan for the fiscal year 1964.

The administration's fiscal plan may be summarized as follows: with official estimates as of January 1963 stating that the administrative budget will show a deficit of close to $9 billion in fiscal 1963, the plan calls for (i) an increase in Federal spending of $4.5 billion in fiscal 1964, following a $6.5 billion increase the year before and bringing the total to $98.8 billion; (ii) an increase in spending authority (new obligational authority) of $4.7 billion in fiscal 1964, following a $10.3 billion increase the year before and bringing the total to $107.9 billion; (iii) a reduction of taxes which, over a period of 3 years, and net of the direct revenue effects of asked-for structural reforms, would come to $10.3 billion; and (iv) a planned deficit of $11.9 billion in fiscal 1964.

Few budgets in recent years, perhaps in the entire history of our country, have been of a nature more likely to raise controversy and it is not surprising that public discussion of it has been spirited. And I think it is correct to say that the discussion has been conducted on a fairly respectable level of sophistication. There has been recourse to a certain amount of what has been called mythology but it would be a mistake to believe that this has been exclusively on one side of the argument. We were warned at Yale last June against "traditional labels" "wornout slogans" "ancient cliches" and "myths." These are things to be avoided, to be sure, but we must remember that the expression "ancient cliche" for example, can become a cliche, too. And the amount of mischief that such a cliche can do as an obstacle to our being able to discuss policy problems logically and objectively and to our ability to learn what there is to learn from experience is not one bit less for the fact that it is a modern rather than an ancient substitute for thought.

Indeed, we must be careful that the debate doesn't result in the construction of a new mythology. But I think there is precisely such a danger. The new mythology would run something like this: it would be a grave mistake and a threat to our economic security to cut Federal expenditures, or even to prevent their increase, because this would be followed inevitably by a reduction in employment, by a rise in unemployment, and by an assortment of other economic ills. Conversely, the new mythology would tell us that an increase in Federal expenditures will increase employment as nothing else will, and has a capability that is absolutely unique for the promotion of the Nation's prosperity.

The launching of a new mythology of this type is no fancied danger. Indeed, I must say, most respectfully, that I believe President Kennedy came very close to doing so when, in speaking on April 19 last to the American Society of Newspaper Editors in Washington, D.C., he asserted that "a cut of $5 billion now from the proposed Federal budget * * * would cause 1 million fewer jobs by the end of the fiscal year." In the same address, and by way of illustrating this same fiscal point of view, the President assigned a great part of the responsibility for the 1957–58 recession to what he described as the "tremendous drop" in 1957 in Federal purchases, in the defense area particularly, and credited it with having added to the miseries caused by what he apparently believes to have been a generally mistaken fiscal and monetary policy; namely, "a $12.5 billion deficit in 1959, the largest outflow in a period of 3 years of gold and dollars amounting to nearly $12 billion and a recession in 1960."

These are important questions. We want to be quite sure that we have a balanced picture in mind of what happened in 1957. In particular, we want to be sure that we don't attribute an undue role in the 1957–58 recession to changes in the level of Federal expenditures. This is not just a question of keeping our history straight. It is also a question of drawing the right conclusions from history. And right conclusions in these matters are important not only for guidance in current policy matters but for our understanding of the proper and most constructive role of Government in our economic life.

We may begin by asking what actually did happen to Federal expenditures in 1957? There was a small and short-lived decline that can be seen in quarterly data only but the fact is that on an annual basis Federal spending did not decline at all. On the contrary, Federal spending went up by several billion dollars in 1957. And it went up again in 1958. This is true whether we measure spending by the administrative (conventional) budget, by the consolidated cash statement of the Federal Government, or by the national income accounts. And it is true whether we speak of calendar years or fiscal years.

It would burden these remarks unduly to cite the figures for each of these accounts but to use the administrative budget as an example; spending was $4.4 billion higher in 1957 (calendar) than in 1956. It went up by another $4.1 billion in 1958, and by another $4.5 billion in 1959. There was a drop in 1960, but only in the administrative and cash budgets; in the national income accounts, a style of budget accounting which the President singled out at Yale for special commendation, there was an increase in Federal spending in 1960, also.

The same is true of Federal purchases of goods and services, as registered in the gross national product accounts, a measure of Federal spending activity to which special attention was given in the President's address to the editors. Total Federal purchases (in current prices) rose by $4 billion in 1957 and by another $2.9 billion in 1958. In constant (1954) prices the year-to-year increases were $1.5 and $1.3 billion, respectively.

What about Federal purchases of goods and services for national defense, on which the President's major interest was concentrated? These rose by $4 billion in 1957, after having risen by $1.3 billion in 1956, and then went up by another $400 million in 1958.

In short, the expenditure declines to which the President refers were so short lived they can't be found in annual figures. They can be found only in quarterly data. And when you find them, as you will see, they are small in amount.

Let us look at these quarterly data first in terms of the amounts spent by the Federal Government in the purchase of goods and services. The expenditure reduction is greatest when purchases are expressed in constant prices, so let me cite these figures first. What we find is that the 1957 expenditure decline lasted for only two quarters and involved a drop from an annual rate of $44 billion (1954 prices) in the second quarter of 1957 to $42.3 billion in the fourth quarter. Purchases rose again, by nearly a billion dollars on an annual rate base, in the first quarter of 1958.

In current prices the decline in Federal purchases was smaller and shorter lived, lasting only 3 months. There was a drop from an annual rate of $50 billion in the third quarter of 1957 (the amount had held steady between the second and third quarters) to $49.4 billion in the fourth quarter.

What about expenditures on defense goods? Again, one has to use quarterly data to find a decline. And again, it was short lived and was small in amount. On a current price basis, which is the only basis for which data are readily available for quarterly analysis, there was a decline from a seasonally adjusted annual rate of $45 billion in the third quarter of 1957 to $44 billion in the fourth quarter. The figure was back to $44.4 billion in the first quarter of 1958.

Now, purchases of goods and services constitute a large part of the Federal Government's spending activity, but not all of it. In fact, figures on purchases miss about one-third of the budget total in the period we are discussing. In order to get a complete picture of the Federal Government's spending in 1957 we should, therefore, look not just at purchases of goods and services but at all Federal Government expenditures. If we do this, again using the income and product accounts, we see that the decline lasted for 3 months only, in this case from the second to the third quarter of 1957, that the drop was from an annual rate of $80.3 billion (current prices) to $79.9 billion, only $400 million on a seasonally adjusted annual rate basis, and that there was an increase to $80.6 billion in the fourth quarter.

The President's argument was concisely summarized in the label of the chart used on the occasion of his talk to the newspaper editors. It read: "Growing Unemployment Followed Budget Cuts in 1957." Now if this is read to mean that unemployment in 1958, and subsequently, was caused by budget cuts in 1957, which is not an unlikely reading, then we must load onto small, short-lived declines in Federal expenditures or in Federal purchases of goods and services a responsibility that is far heavier than I believe we have any ground for expecting them to carry. And I believe it would be a great mistake to conclude from this experience that any effort at expenditure control in 1963 should be ruled out of bounds. All the more so, incidentally, when the 1963 question is not whether expenditures should be cut or not over the previous year, but whether expenditures should go up by $4.5 billion or not.

Let us pursue this matter a bit further. As we have seen, Federal expenditure reductions in 1957 were not large and did not last long. Indeed, the more closely you look at them the smaller they become. Clearly, one must take a good many other factors into consideration to reach a correct understanding of the 1957–58 recession. Accordingly, let me enumerate, with a minimum of comment, some major factors antecedent to the 1957–58 downturn that, in my judgment, had an important bearing on it.

First, 1955 and 1956 were years of very rapid increase in the production and sale of consumer goods, especially consumer durable goods, reflecting in good part the release of demands that had been built up, and pent up, in the Korean conflict period. These were unusually heavy and urgent demands and it is very unlikely that they could have been extended without diminution much beyond 1956 or mid-1957. Specifically, there was an exceptionally heavy surge of automobile production and sales in 1955; and high levels of auto sales continued in 1956 and 1957.

By and large, these increases in demand reflected economic considerations such as employment income and price. But it would be a mistake to ignore, for one thing, the effect of changes in automobile styling in this period. For reasons you must not ask me to explain, the American people rushed to the dealers' showrooms to buy the multicolored cars with wraparound windshields and modest tailfins that became available in the fall of 1954. Their enthusiasm reached an unprecedented pitch in 1955. It continued in 1956 and in 1957, too, but by that time the cars had evolved in design to an unbelievable length, width, and weight. And the modest little tailfins of the 1955 model had become very large, indeed, and to me, and I believe to a great many others, were by this time not very attractive at all. To some people they were the sign of an irretrievable national decadence, though happily this was mainly a case of some people's ability to write getting the better of them. In any case, auto dealers' showrooms in 1958 were shunned by vast numbers of Americans and sales of domestically produced cars dropped in 1958 by nearly 2 million, or to very little more than 50 percent of what they had been in 1955. If you are looking for shocks to our economy in this period, this was certainly a leading one. And the rate of Federal spending had very little to do with it. The drop in sales could not have been due entirely to a disenchantment with automobiles per se or to consumer income because at the same time that the demand for domestically produced cars was collapsing we were importing more and more of the smaller, more compact, and less expensive cars produced abroad. To remind ourselves of the extent of this shift in demand, let me recall that new passenger car imports rose from a value of $69 million in 1955 to a value of $735 million in 1959.

Another factor contributed to the essentially unsustainable increase in car sales that began in 1955 and for which we paid heavily in 1958. Consumer installment credit terms were greatly liberalized, both as regards the minimum downpayments required and the number of months allowed for repayment. Indeed, the liberalization of terms was so notorious that there was widespread advocacy in 1956 and in 1957 for the enactment of standby authority which would permit the Federal Government, presumably acting through the Federal Reserve System, to reimpose controls on the use of consumer installment credit. To all intents and purposes this expansionary factor had spent its force by 1957.

Second, we reached by mid-1957 the climax of a boom in business fixed investment expenditures that had lifted spending by American business on plant and equipment from a seasonally adjusted annual rate of about $26 billion in early 1955 to a rate of about $37 billion in mid-1957, an increase of 50 percent in 2½ years. Obviously, this was too sharp a rate of increase to be continued for very long, and it wasn't. A sharp decline in plant and equipment expenditures began in mid-1957 and continued for a year; at its low point, in mid-1958, it had reduced activity in the investment goods sector of our economy by about 25 percent.

Third, homebuilding had spurted in 1954 to levels that, unless some future revision of housing statistics tells us otherwise, have never since been exceeded. Then, in 1955, long before the short-lived and small 1957 reduction in the rate of Federal expenditures occurred, a decline in housing starts began which lasted for about 2 years, exerting a more or less continuously deflationary effect on the economy.

Fourth, and on a point to which I will refer again in a moment, the years immediately preceding 1957 were marked by sharp increases in labor compensation rates, far in excess of the productivity improvements achieved in those years. The facts on this point are by now reasonably well known and acknowledged. As was pointed out in the President's Economic Report for January 1962, average hourly compensation in manufacturing industries rose by 6 percent or more in 1955 and again in 1956, very much in excess of normal productivity gains. And over the period, 1953–57 as a whole, average hourly compensation rates in all private nonagricultural industries rose twice as fast as output per man-hour.

As reflected in data on manufacturing industries, the result of this inflation of labor costs, along with other cost factors having a similar effect, was a decline in the ratio of profits per dollar of sales in 1956 and 1957. And in data covering all corporate enterprise in the United States we see that there was a parallel decline in the volume of corporate profits after taxes. I am sure there is no need at this point in the dialog to say that this steady attrition of corporate profits had a deflationary effect on the investment expenditures of business and that this, in turn, had a deflationary effect on economic activity generally.

Fifth, inventories were being accumulated in 1955 at rates that were exceeded in the immediately preceding years only during the Korean conflict period, and the buildup was almost as high in 1956 as in 1955. This, also, was an invitation to downturn at a later date, and come it did. The buildup dropped from a rate of $4.7 billion in 1956 to $1.6 billion in 1957. Starting well before and far exceeding in size the drop in Federal expenditures to which such a long list of mischievous results has been attributed.

Sixth, our merchandise trade balance, which reflects the balance between goods exported to the rest of the world and goods imported from other countries, and which then as now showed an excess of exports over imports, rose sharply in 1956 and experienced an exceptional spurt in the winter of 1956–57 when the Suez crisis disrupted world trade.

The effect of this unfortunate international incident on the foreign trade of the United States was greatly to increase the demand for our exports; notably oil, and thus to give a powerfully accelerating impulse to our economy. But the stimulus did not last, and no one would have wanted it to. When the letdown came, as it did in the second quarter of 1957, it inevitably exerted a deflationary pressure on our economy. Indeed, the drop in net exports between the first quarter of 1957 and the first quarter of 1958, measured in current prices, came to $4.3 billion, on an annual rate basis. As an influence on the economy, therefore, net exports antedated and far outweighed changes in Federal expenditures or purchases. Indeed, even between the second and fourth quarters of 1957, which is the particular period to which the President has referred, the decline in net exports was actually greater than in the decline in Federal purchases of goods and services.

So, you see, there were many factors conspiring together in 1957 to complicate the task of holding our economy stable and achieving the measure of sustainable growth of which our economy was capable. What a setback to our understanding of the business cycle it would be if we were to fall into the error of thinking that the whole experience was due to a cut in expenditures by the Federal Government. Even more serious, what a misfortune it would be if, based on an analysis of the 1957–58 recession that is oversimplified to say the least, any resistance to the continuous rise of Federal spending were to be discredited as ancient thinking and rooted in mythology.

While I am on this subject of the 1957–58 recession I should like to comment on the interpretation of this event, and of the period 1957–62 as a whole, expounded by the Council of Economic Advisers in its January 1963 Economic Report to the President.

The Council's interpretation may be summarized as follows: In its view, the U.S. economy has lagged continuously since 1957 and this lag, which by exerting itself again in the second half of 1962 seriously upset the Council's forecasts for that year, has been due to a "suspicion," to use the Council's word, on the part of American businessmen that "underutilization was to be the normal state of the American economy." In an interesting venture in lay psychoanalysis, the Council concludes that the downcast spirits of businessmen derive from "(the) unemployment of manpower and machines (that has) persisted for nearly 5 years." Not unexpectedly, the Council finds this unhappy state of affairs to be due to the needlessly restrictive monetary and fiscal policy pursued by the Eisenhower administration in the years 1957–60.

There is by no means enough time at my disposal tonight to address myself as fully as I should like to this interpretation of the 1957–61 period, which I believe to be mistaken. But that opportunity may present itself at some other time. Let me say only that the Council's interpretation ignores major forces that were at work in the economy in 1957–60 in favor of a fascination with fiscal and montary policy. It gives no attention at all to the 1957 and pre-1957 developments which I have just sketched. And among the post-1957 developments which it ignores is the steel strike of 1959, which completely blocked the normal course of recovery and growth in that year and in 1960 and had the impact on our economy of a minor recession.

And I reject the Council's criticism of fiscal and monetary policy in the 1957–60 episode as having been needlessly restrictive. I believe that their point of view is based on an underestimation of the inflationary developments, actual as well as threatened, that featured that period. We must not forget that those were years of considerable price and cost inflation. I have already commented on the cost and particularly on the wage inflation that was occurring especially in 1955 and 1956. Beginning in 1956, after 4 years of comparative stability, the index of consumer prices began a rise which lasted for about 2½ years and which averaged about 3¼ percent a year. This is a rate of price increase sufficient to cut the purchasing power of the dollar by over 25 percent in just about one decade. There was a sharp rise, also, in common stock prices and in land values. Is there anyone who would seriously maintain that this was a situation that a responsible government should have ignored?

It was no accident that this was the age, fortunately not a long one, of articles on "The Age of Inflation." I would maintain that it is a serious deficiency in any interpretation of the period, and certainly of any interpretation that is intended to clarify policy problems, to overlook the inflation psychology which these writings commented on month after month and which did indeed take hold in those years and spread through the economy and through financial markets especially. The spread of this psychology would have been all the greater and would have left marks on the economy all the deeper if it had not been resisted by fiscal and monetary policy. Under the circumstances, any deviation from monetary and fiscal restraint would have aggravated the inflationary psychology which already existed and would have given encouragement to every inflationary force, whether from the side of cost or of demand, that was then active in our economy. And it would have complicated today's problems of achieving growth and stability and of holding prices reasonably steady. If you will forgive a semifacetious remark, let us say that although I would not claim that the monetary and fiscal policies pursued in the years prior to 1961 were intended to ease the path of my friends on the present Council of Economic Advisers, I hope that some day these policies will receive at least part of the credit due them for having had some such effect.

As I have said in talking about these matters on another occasion, we are not speaking here of an imaginary inflation problem but a very real one with which we had a major encounter. Currently, it is fashionable to disparage the policies which were adopted to meet it, but I assure that if we ever encounter it again we will find ourselves in the position of having to do precisely the same thing over again. And let us not think that this is a total impossibility. Indeed, it was envisaged by the President in his remarks to the Society of Newspaper Editors on April 19 when he said, "If we get again in this country strong inflationary pressure there are obvious monetary restraints which * * * would prevent us from going into an abnormal period."

So much for the business cycle theory implied in the caption "Unemployment Followed Budget Cuts in 1957" that topped the President's statistical exhibit when he spoke to the news editors and for the more elaborate excursion into business cycle history by the Council of Economic Advisers. Let me invite you to consider from another angle the relationship between budget cuts and budget ncreases, on the one hand, and employment and unemployment, on the other. We can throw some light, I think, on this relationship by comparing what happened to jobs in 1953–55, when Federal spending was reduced sharply, with a roughly comparable reduction in taxes, with what happened in 1960–62, when Federal expenditures were increased by an even larger amount, with no significant change in taxes. Both periods were marked by recession: 1953–54, when the Korean conflict was being ended; and 1960–61, which was much less severe and which can be accounted for entirely by inventory adjustment. But for purposes of testing relationships between budget changes and changes in employment and unemployment it is changes between the terminal years of the two periods which we would compare.

The salient facts are these. Between 1953 and 1955, incident to the liquidation of the Korean conflict, Federal administrative budget expenditures were reduced by $6.9 billion and Federal purchases of national defense goods and services in the GNP accounts, on which the President places particular emphasis, was reduced by $10.2 billion. These figures are in current prices and refer to calendar years. Between 1960 and 1962, on the other hand, Federal budget expenditures rose by $14.3 billion and defense purchases increased by $7.7 billion. One could hardly ask for two more sharply contrasting periods on the basis of which to test a theory that employment will fall if the budget is cut, with or without a reduction in taxes.

What does the comparison show? The fact is that employment increased between 1953 and 1955 while the budget and taxes were being reduced by almost as much as it increased between 1960 and 1962 when expenditures were being raised. The civilian employment increase in the first period was 1 million; in the second period it was 1,318,000.

If one examines the employment figures, however, it will be seen that the increase that took place between 1960 and 1962 consisted in the main of a rise in government jobs, Federal, State and local. Government employment increased by 665,000 and accounted for more than 50 percent of the total employment increase. There was an increase in government jobs between 1953 and 1955, too, again counting Federal, State and local employment, but it was much smaller, amounting to 269,000 or only about 25 percent of the total gain.

And what about unemployment in these two periods? The fact is that it increased in both periods: just over 1 million between 1953 and 1955, and 76,000 between 1960 and 1962. But two factors were at work in the economy in these years that together more than account for this difference.

In the first place, our Armed Forces were reduced by 500,000 between 1953 and 1955, as we demobilized following the Korean conflict, whereas they were increased by 314,000 between 1960 and 1962 as our military commitments and involvements around the world tended to become more numerous and to deepen.

Second, labor force participation rates were rising between 1953 and 1955 (from 58.5 to 58.7 percent) which made the task of preventing a rise in unemployment in that period more difficult; they were declining between 1960 and 1962 (from 58.3 to 57.4 percent), which simplified the task of holding unemployment down. We may ask what would have been the result as regards changes in unemployment if these rates had remained unchanged over the two periods. Interestingly enough, if this had been the case unemployment would have increased by half again as much in 1960–62, when Federal expenditures were being increased by nearly $15 billion, as it did in 1953–55, when Federal expenditures were being reduced by around $7 billion. In short, the apparently better unemployment record of 1960–62 was due not to a difference in Federal expenditure policy, but to the simple fact that in those years there was an appreciable drop in the percentage of American people going into the labor market in search of work.

I am sure you understand that the dialog on the relation of budget cuts to employment and to unemployment and on the causes and consequences of the 1957–58 recession are inspired by more than an academic interest in clarifying a few points in business cycle theory or annals, though we may hope for some byproducts of this character.

On the contrary, the dialog is inspired by a very practical policy question. But if I may say so, quite respectfully, the question is not, as the President suggested in his speech to the newspaper editors, whether we shall at this time have wholesale budget cuts of $5, $10, or $15 million. The question is whether with the economy rising at a good rate, and I would judge at a good bit faster rate than was officially expected when the budget was put together, but with a large budgetary deficit in prospect, it is sound fiscal policy to increase Federal spending by $5 billion at the same time that we are reducing taxes, over a 3-year period by some $10 billion. The question is whether in this context of economic conditions and with our long-term interests prominently in mind we would not be better advised to exercise a closer control over Federal spending increases and possibly to hold spending levels unchanged as between fiscal 1963 and fiscal 1964.

This is the practical question, and the purpose of this paper is to show that as we seek an answer to it efforts at expenditure control should not be blocked by a general proposition to the effect that "unemployment follows budget cuts" or by assertions that there is a necessary connection between budget cuts (if we were in fact talking about budget cuts) and unemployment such that a $5 billion cut, which the President has cited, would necessarily produce a loss of 1 million jobs. Nor should we be dissuaded from a sensible program of expenditure containment and control, and by this I do not mean just turning down preliminary agency and department requests from the inflated figures which they normally put forward, but by holding actual budget expenditures to a level which, consistent with our wish to reduce taxes, is within our fiscal capability, by a theory to the effect that a reduction in the rate of Federal purchases of defense goods and services in 1957 which occurred within the limits of a single quarter, and which came to $1 billion on a seasonally adjusted annual rate basis but followed an annual rate increase of $1.3 billion in the first 6 months of the year and was followed by a $400 million increase in the first quarter of 1958, should be assigned major responsibility for two recessions, a $12½ billion budget deficit and a very large outflow of gold.

If we accept this version of history and this line of argument we will have committed ourselves to a policy that is not only inflationary in its direct effects, even if we have to wait a bit for the inflationary effects to show themselves, but which will support and amplify all independent inflationary forces at work in our economy.

What is more, we will have committed ourselves to a fiscal policy which implies the steady growth of government, and in particular of the Federal Government, relative to the private sector of the economy. And we will have invited a basic restructuring of our traditional institutions.

The fact is, however, that there are checks and balances in our economy and in our political system that can prevent such processes from getting out of hand. As a practical matter, you can't cut taxes and raise expenditures simultaneously without at some point getting into a frightful fiscal mess and I expect this fact of life to be recognized before too long. Rightly or wrongly we are going to cut taxes and cut them substantially. All the best people are for it, though there must be at least a dozen different formulas on how it should be done. Even those who not so long ago were complaining of "public squalor and private affluence" are now vying with one another to reduce our revenue gathering capability. You can be assured that this frame of mind will not last long because it supports a strategy which is essentially nonviable.

I like to say that I do not make many forecasts, and actually I do not. But I am prepared to make one for you tonight. My forecast is that you will hear a lot more about Federal expenditure control before you hear less. And there is more than an even chance that the idea, ancient as it is, will win a new respectability when it is adopted, as I expect it will be, by the President's own administration, an event to which I look forward eagerly.

And when this piece of ancient thinking has been lifted, as the saying goes, into the 20th century, and put into practical effect, I do not expect it to be followed by unemployment. Nor do I expect it to cause a recession, let alone two recessions. And I do not expect it to promote an accelerated outflow of gold. On the contrary, I would expect it to bring benefits not just to us but to all our friends around the world who look to us, more than to anyone else, to maintain a sturdy, unimpeachable fiscal position and a free society.

Representative CURTIS. Thirdly, I was very pleased that you gave credit to the Joint Economic Committee for some of its studies in this area of poverty. Indeed, I think that tribute is appropriate. But I would also like to call attention to the President's Economic Report of 1956, chapter 3, entitled "Broadening the Scope of Prosperity." This chapter, which is devoted to the problems of agricultural poverty, pockets of unemployment, low-income families, and the special needs of elderly persons, is an excellent source of material for those interested in the question of poverty and its elimination. I think it might be well to repeat that in the record at this point.

Representative REUSS. Without objection, so ordered.

(The excerpt referred to follows:)

CHAPTER 3. BROADENING THE SCOPE OF PROSPERITY

[Excerpt from the Economic Report of the President, January 1956, pp 51–71.]

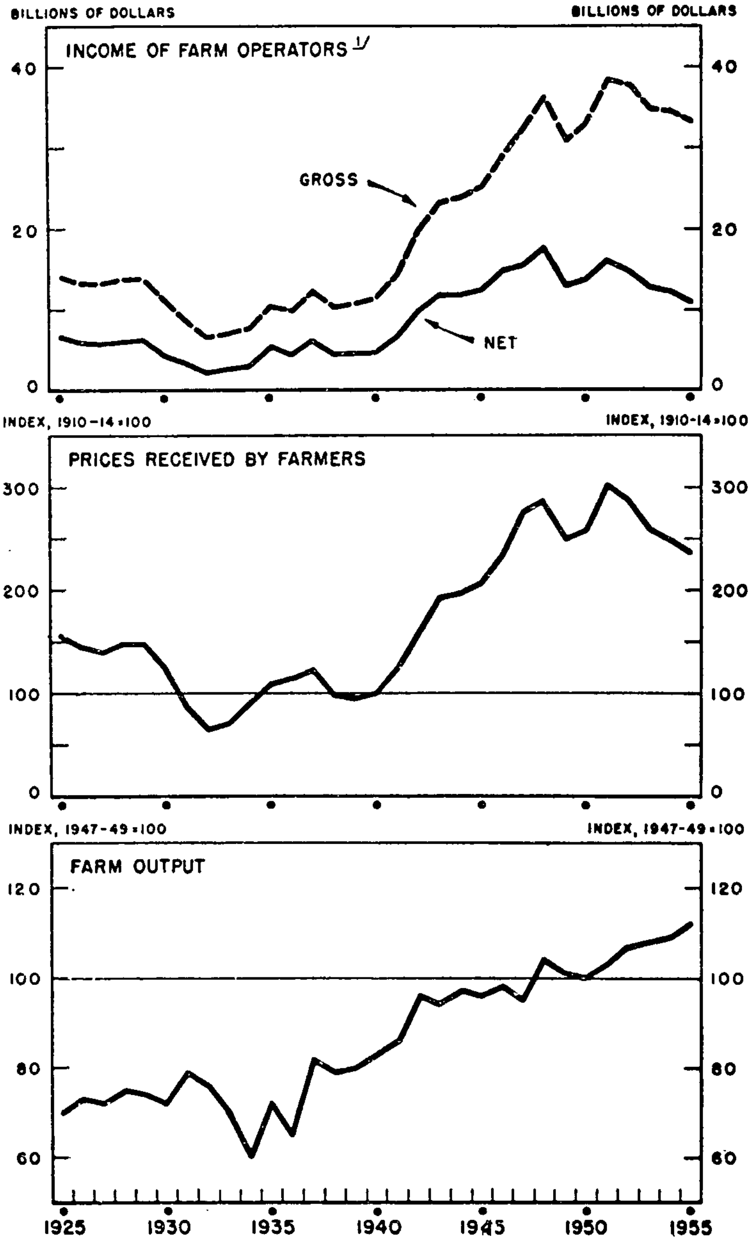
The preceding chapter has focused on the Nation's success in attaining general prosperity without price inflation during the year just ended. But the economic life of a dynamic people is full of cross-currents. No matter how rapidly the economy as a whole may be advancing, there are always some industries and areas that are standing still or even declining. Progress of technology is by its nature uneven; new products and new firms continually disrupt economic routine; shifts of demand keep occurring and recurring; foreign developments have widely divergent effects on domestic industry; and the weather itself is sometimes the arbiter over the lives and fortunes of people. These factors and many others like them diversify the economic life of a nation. If our economy is to continue growing, it will have to remain fluid and resilient, and broadly responsive to market forces. The general welfare may, however, be greatly enhanced by fostering conditions under which adjustments can be accomplished with a minimum of hardships or difficulty.

It is precisely because good times have spread so widely among the American people that we should give serious thought to ways and means of extending prosperity to the less flourishing sectors of our economy. Many branches of agriculture have failed to participate fully in the Nation's prosperity. Unemployment has persisted in some urban communities despite the attainment of full employment, in a practical sense, in the Nation at large. Even in these highly prosperous times a relatively small yet significant number of American families have, for one reason or another, incomes that are much too low. We must try to extend the magnificent performance of our economy. The first and most pressing problem requiring the attention of the Congress is the continued decline of agricultural incomes.

I. PROMOTING AGRICULTURAL READJUSTMENTS

American agriculture is a highly varied part of the national economy. The commercial farms—where the income of the operator's family depends primarily on the sale of farm products—vary greatly in size, in degree of specialization, in productive efficiency, and in financial return. In addition, there are many part-time and residential farms. The Nation has a stake in the welfare of all agriculture and all farm people. National programs must take account of the divergent problems of the different groups.

Farm Income, Prices, and Output



1/ INCLUDES GOVERNMENT PAYMENTS AND NET CHANGE IN FARM INVENTORIES.

SOURCE: DEPARTMENT OF AGRICULTURE.

The commercial farmers who produce the bulk of our farm output are ingenious, adaptive, and progressive. They take advantage of the rich flow of technical knowledge, materials, and machinery made available by research and industrial development. Their farms are better equipped and better managed than they have ever been. Operator-owned family farms continue to predominate, and the acreage and capital per farm are increasing. Farm wage rates have risen as the high level of industrial activity in the postwar decade has drawn into more remunerative nonfarm occupations many low income farmers, sharecroppers, and hired hands. Farm people are taking advantage of opportunities for off-farm employment, full time or part time, which yields important supplements to their income; and their living has improved far above prewar levels. Since January 1955, farmers have participated in our national system of old-age and survivors insurance. Continuing large increases in population, coupled with high and rising levels of national income and employment, have maintained a strong domestic demand for farm products in recent years.

Nevertheless, the economic condition of agriculture is not satisfactory, and the position of farmers in our dynamic economy has aroused deep concern. Experience varies widely from year to year in different farming sections and enterprises, and from farm to farm. Yet gross and net incomes from farming have been declining since 1951, in sharp contrast to improving rewards in industry, commerce, and finance. Readjustment to peacetime conditions of demand and production has not been fully achieved. It is imperative that we strengthen farm programs on the basis of a realistic appraisal of the present situation.

Farmers responded magnificently to wartime and postwar challenges to produce abundantly, and generally enjoyed great prosperity in the 1940's. Farm incomes rose to new highs after World War II as a result of price inflation, high domestic demand, and extraordinary exports largely financed by grants and loans from the Government. Substantial declines in farm prices and incomes in 1948 and 1949 were due mainly to subsidence of this abnormal export demand, record crop production in 1948, and some contraction in the domestic economy. The outbreak of the Korean conflict and fears of a return of wartime shortages stimulated increases in both the domestic and foreign demand for agricultural products. This, coupled with renewed inflation, raised farm prices and gross incomes to new peaks in 1951. The containment of hostilities led to a fall in abnormal demands for stocks, and there was a sharp decline of agricultural exports in 1952–53. Enlarged supplies of meats and dairy products in 1953, as well as temporarily reduced consumer demand for the latter, also contributed to the decline in farm prices and incomes from their exceptional 1951 peaks. The further declines in 1954 and 1955 were associated with a general enlargement of production and stocks.

The decline in gross farm income since 1951 has been accompanied by an even sharper decline in net income. Farm production expenses in increasing degree consist of machinery, fertilizer, and other items purchased from the nonfarm economy. Prices of these items have declined little in recent years, and in many cases have risen as nonfarm demands for steel, gasoline, and other products continued to increase. Thus, farmers have been subjected to a cost-price squeeze. Although the market conditions that prevailed during and immediately after the war could not be expected to continue indefinitely, the protracted decline and current low levels of income, in a period of generally good times, are of increasing concern.

On certain points the evidence is clear. Commercial farmers have been producing and are geared to produce more than could be commercially disposed of at supported prices. Government restrictions on acreage of several crops, notably wheat and cotton, have insufficiently curtailed production of these crops and have led to expansion of others. Huge carryovers have piled up, far beyond liberal estimates of desirable reserves. Government holdings acquired under price-support programs have kept rising, in spite of intensive and effective efforts to dispose of surpluses.

The persisting decline in farm prices and incomes reflects a continuing imbalance between farm output and its ultimate disposition. The imbalance is to be traced largely to the technological revolution in American agriculture, changing domestic demands for farm products, the expansion of agricultural production abroad, and the repeated extension of wartime price-support levels long after the end of World War II.

The most recent upsurge in our agricultural technology began in the late 1930's. It has taken many forms, such as better varieties of seeds, improved breeds of livestock, more and better machinery, increasing use of fertilizer, improved feeding practices, extension of electrification, and more effective controls of weeds, insects, and plant and animal diseases. Favorable prices, higher incomes, and the steadily improving asset position of farmers during the war made it possible to adopt the new technology at a rapid pace between 1940 and 1945. After the war the broad uptrend in farm output continued, and there is no sign that the current phase of the technological revolution has run its course. The index of total farm output rose 20 percent during 1939–45, 4 percent in 1945–50, and 12 percent in 1950–55; new records were set in each of the past 5 years. The latest increases have far exceeded the expectations of competent specialists. In output per acre, per livestock unit, per farmworker, and per man-hour, remarkable advances have been registered.

Demand has not risen enough to absorb all of the enlarged farm output. Indeed, technological developments on and off farms have of themselves reduced the demand for several important farm products. Notable examples are the nearly complete replacement of horses and mules by automotive equipment in farm and nonfarm uses, and of horsefeed by motor fuel; inroads of synthetic fibers, paper, and other products on the consumption of cotton and wool; and the adverse effect on the demand for fats and oils from increasing displacement of soap by detergents. Apart from such changes, as incomes rise the demand for farm products tends to increase at a rate below the rate of increase in disposable personal income. Per capita consumption of food in 1955 was only 3 percent higher than in 1947–49, whereas per capita disposable income in constant dollars was 15 percent higher. Retail food sales have risen with population and incomes, but much of the increase in consumer expenditure has gone for additional services associated with processing and distribution rather than to enlarge the per capita demand for raw foodstuffs. For some products, such as wheat and potatoes, rising personal incomes entail a decrease in demand as consumers shift to more highly preferred foods. And per capita consumption of meat, poultry, and most dairy products has of late been so high that further increases encounter greater competition from other desired goods and services.

Notable gains by the economies of Western Europe and many other parts of the world since 1948 might have been expected to enlarge normal export markets for American farm products. Several factors have severely limited the extent to which this has occurred. Agriculture abroad gradually recovered from wartime destruction and disorganization. Under the stimulus of national measures aimed at self-sufficiency, enlarged exports, and protection to farmers, the output of major crops—wheat, cotton, rice, sugar, and others—has sharply increased. Even several of the low-income countries have greatly expanded their production of foodstuffs and fibers. As increased supplies have brought world prices down, the levels of price supports in this country have tended to price our products out of world markets.

The tendency to surplus production in the United States was strongly reinforced by legislative and administrative actions in 1952. An act of July 17, 1952, extended price supports on the six basic crops at 90 percent of parity through 1954–55, and postponed until 1956 the application of modernized parity formulas. By administrative decisions in 1952, acreage allotments and marketing quotas were not applied to wheat for harvest in the following year, price supports for dairy products were maintained, and the support prices of many nonbasic commodities were raised. These measures imposed heavy burdens on this administration. Farm output rose to a new high in the very year when the abnormal demands arising from the Korean conflict disappeared. Large portions of the 1953 output of supported crops and dairy products, including one-third of the farm marketings of basic crops, had to be acquired by the Commodity Credit Corporation (CCC). The stimulus to overproduction of basic crops continued in 1954–55. From mid-1952 to mid-1955, when prices of all six basic crops were supported at 90 percent of old parities, CCC inventories and commitments for these commodities rose from $1.2 to $6 billion.

As soon as previous regulations could be terminated, this administration took steps to cope with the growing surpluses, under discretion permitted by the Agricultural Act of 1949. The price-support level for dairy products was reduced on April 1, 1954, to 75 percent of parity, with the aim of reducing surplus stocks, encouraging consumption, and thus improving the position of dairy farmers. Price supports were lowered for flaxseed, soybeans, and dry beans harvested in 1954 and for feed grains and cottonseed harvested in 1955, so that these products might compete more effectively in the markets for which they are produced. Acreage allotments and marketing quotas were authorized for 1954 crops of wheat, cotton, tobacco, and peanuts. To avoid extreme acreage reductions in 1 year, the

Congress determined that the full reductions should not be applied to cotton and wheat until 1955.

The Congress incorporated major administration proposals in the Agricultural Act of 1954, which was designed to strengthen the foundations of agriculture and to yield beneficial results over the years. This act authorized the first departure from price supports on basic crops at 90 percent of parity, which had been inaugurated in 1942 to stimulate production to meet war needs. It provided for flexibility in these price supports, eventually within the range of 90 to 75 percent of modernized parities. Thus far, however, 90 percent supports have continued to apply on cotton, tobacco, and peanuts; and despite the adjustment in price supports on wheat and rice for harvest in 1955, these products have not moved freely into domestic use or export. The attainment of a balance between production and market demand has been severely handicapped by the huge stocks accumulated under provisions of earlier legislation, and also by the failure of acreage allotments to bring about corresponding reductions in farm output.

Cotton acreage allotments in 1954 and 1955 were set at the minimums permitted by law, with the object of reducing production to 10 million bales in 1955. Actually, because of remarkably increased yields, the 1954 crop exceeded the production goal by 15 percent, and the 1955 crop by nearly 50 percent. Wheat yields have not risen as rapidly, but the amounts produced on the minimum acreage allotment permitted by law (55 million acres) have continued to exceed domestic and export needs. Similar results have been experienced with other basic commodities. Hence carryovers of these commodities and feed grains have risen in 1952–55. For most commodities, moreover, the proportion of total carryovers held by the CCC has been increasing; on June 30, 1955, about 97 percent of the wheat carryover was in its hands.

The production control programs that have been operated for basic commodities, which account for about one-fourth of the total income from farm marketings, have indirectly contributed to lower incomes for the producers of other important commodities. Farmers with acreage diverted from basic crops have deemed it more profitable to produce feed grains or other crops, even at lowered support prices, than to let this part of their land lie idle. Many have expanded their hog and beef cattle numbers to use the additional feed thus produced, adding further to the expansion induced by relatively favorable livestock prices in earlier years. Dairy feeding rates have also been increased. These factors have been largely responsible for lower prices of beef cattle and sharply lower prices of hogs in 1955, and a continued increase in production of dairy products.

Unrealistic supports have not merely overstimulated production of several basic farm products in this country and abroad; they have also impeded normal flow into feed use and export. Feed use of wheat is no larger than in former periods of scarcity, while food use has been virtually constant for many years, and seed use has dropped as acreage has been restricted. Practically all our wheat and flour exports now move only under direct subsidy or under special export programs. In fiscal year 1955 the average subsidy on wheat exported under the International Wheat Agreement was about 75 cents per bushel. In December 1955 American wheats were selling on domestic markers around 65 cents per bushel above equivalent export prices.

Our cotton is steadily losing ground in competition with synthetic fibers and paper, and is rapidly losing export markets to foreign producers who have stepped up their production at prices made remunerative by American price supports. In 1954–55 over 40 percent of our cotton exports were moved under special programs, including Export-Import Bank loans. In the current marketing year the disparity between prices of American and foreign cottons is much wider than hitherto, and commercial exports are running extremely low. In short, cotton-growers now face the threat of a drastic, permanent shrinkage of their commercial markets. Tobacco exports are holding up well, despite expansion of foreign production, but increasing proportions are moved under special export programs. Since 1953 commercial exports of American rice have declined radically, and outlets for surplus rice in CCC hands are found with great difficulty either at home or abroad.

With additional authority granted by the Congress during the past 2 years, the administration has made great efforts to dispose of surplus accumulations at home and abroad, as well as to enlarge the domestic use of livestock products that tend to be in surplus. The Agricultural Act of 1954 authorized the CCC to use $50 million annually to increase the consumption of milk by schoolchildren, and to make available to the armed services dairy products acquired in price support operations. The Agricultural Trade Development and Assistance Act of 1954 gave the CCC additional authority to use surplus agricultural commodities in barter transactions, and for famine relief or other emergencies in friendly countries. It also authorized in title I the sale of these products to friendly nations for foreign currencies. In mid-1955 the authorization to reimburse the CCC for losses on sales under title I was increased from the original $700 to $1,500 million for the 3 fiscal years 1955–57. In fiscal 1955, exports sold for foreign currencies totaled $345 million; exports bartered for strategic and other materials amounted to $125 million; and shipments under grant programs of the International Cooperation Administration totaled $381 million. The moderate rise in our total agricultural exports from the low of 1952–53 is more than accounted for by subsidized sales, sales for foreign currencies, sacrifice sales, and donations.

Recent administrative actions have helped in other ways to alleviate temporary market surpluses and to reduce CCC stocks. Examples are: (1) Liberal donations for school lunch programs, to charitable institutions, and—with the aid of private philanthropic organizations—to needy people overseas; (2) payment of export subsidies on certain citrus fruits; (3) in view of the large 1955 crops, payments to divert white potatoes to starch and feed use, and the purchase of sweetpotatoes for use in school lunches; (4) inauguration in the fall of 1955 of a program of purchase of pork products and lard; and (5) gradual sale of CCC holdings of wool on competitive bids beginning in November 1955.

The administration is intensifying its efforts in these directions. Yet experience shows that there are limits to expanding the noncommercial disposal of farm products. Beyond some point, commercial sales are merely displaced, without increasing total consumption. At home, the displacement may be of the same or competing commodities; abroad, our own commercial exports or those of friendly nations may be displaced. Moreover, domestic producers in an importing country even if its people are ill fed and ill clothed, may feel adversely affected. The difficulties are greatest with our largest surpluses, those of cotton and wheat. Extreme care is necessary to avoid disrupting world markets and damaging the delicate fabric of our foreign relations.

Increasingly vigorous surplus disposals have achieved substantial reductions in CCC stocks of some commodities and retarded the increase of others. Surplus disposals of agricultural commodities by the CCC have risen from $520 million in fiscal year 1953 to $1,424 million in fiscal 1954, and $2,115 million in fiscal 1955. The realized losses on such disposals account for much of the increase in total costs of programs primarily for stabilization of farm prices and income which were $330 million in fiscal 1953, $963 million in fiscal 1954, and about $1,300 million in fiscal 1955. Meanwhile, total CCC inventories and commitments rose from $1.4 billion in mid-1952 to over $7 billion in mid-1955. Chiefly because of huge feed grain supplies and extraordinarily high cotton yields, CCC stocks in 1956 will probably be still higher.

The Federal Government has thus assumed heavy financial burdens on behalf of agriculture during the past 3 years. Increasing proportions of gross and net farm income have come from the public Treasury. In spite of this, farm income has declined and many farmers have continued to be subject to tight restrictions. In considerable part, these are consequences of price supports that are out of line with market conditions, and of production restraints that do not work well.

It is clear that price supports at 90 percent of parity for basic commodities, after thorough test, have failed in recent years to maintain farm prices and farm income. They have delayed realistic adjustment of farm output to altered domestic and export demands. They have indeed cushioned declines of prices for producers of supported commodities; but, contrary to intentions, they have prolonged the period and extended the scope of declines in farm prices and incomes. To go back to high, rigid price supports, as some have urged, would only make the situation worse.

The position we have reached clearly requires further revision in agricultural programs that will lead toward the goals of a stable and prosperous agriculture, with production in balance with market demand, at costs and prices that permit good farmers to earn remunerative returns with substantial freedom in managing their enterprises. In view of the size of stocks accumulated, and the persistent tendency to annual additions, these high goals cannot be reached at once, but we must move energetically toward them.

Present agricultural conditions call for an attack on several fronts. Surplus stocks must be reduced. Annual surpluses of important products must be cut at their source, and soil conservation must be extended on land now contributing to such surpluses. Additional voluntary reductions in crop acreage must be induced by payments to offset the consequent loss of income from farming.

Various modifications in commodity programs and a relaxation of present restrictions on farmers, where feasible, are required. Stress should be laid on enlarging outlets for farm products, on means of reducing production costs, and on ways of helping farm people to earn more income.

The special message on agriculture of January 9, 1956, therefore, recommended a number of measures to promote economic readjustments in agriculture. Chief among these is the two-part soil bank program designed to reduce current output of farm products, particularly of those commodities in greatest surplus. Also included are proposals to speed surplus disposal, broaden outlets for farm products, reduce farm production costs, improve farm credit facilities, and expand agricultural research.

The message recommended that the Congress consider a program for stimulating voluntary additional reductions in the acreage planted to wheat, cotton, corn, and rice. Under the proposed acreage reserve program, growers of these crops will be asked to reduce plantings below their allotments in return for negotiable certificates entitling them to cash or to specified quantities of the commodity from CCC stocks. Thus, surplus stocks can be used to meet portions of current market demand without reducing the net farm income of the growers. Under existing conditions special problems arise in connection with corn. If, therefore, the Congress should choose not to authorize the acreage reserve program for corn, an alternative might be considered; namely, to eliminate acreage allotments and put corn price supports on a discretionary basis comparable with other feed grains. This course might also be considered with respect to rice, on which both acreage and marketing controls are in effect.

The proposed conservation reserve program—the second part of the soil bank—is designed to alleviate the declines in income of producers of cultivated crops and livestock that have resulted from the increased supplies of feed grains and other crops grown on diverted acres. All farmers will be offered the opportunity to withdraw some cropland from current production. To achieve this reduction in acreage and to assure the conservation of this land for future use as needed, the Federal Government will provide financial assistance to farmers in establishing the appropriate protective cover, and will also make annual payments related to the length of time needed to establish the new use of the land. It is anticipated that this program will reduce the acreage planted to feed grains, thus restricting the expansion of livestock production.

To insure that the increased acreage in protective uses will not lead to expansion of forage-consuming livestock, it has been recommended that grazing be prohibited on the land put into the acreage reserve and, for a specified period, on land retired from crop production under the conservation reserve program.

The soil bank program will of course be operative in the Great Plains States. It should be supplemented there by a special Great Plains program, which has been developed through intensive studies and cooperative efforts of Federal, State, and local interests. In portions of 10 Western States between the Corn Belt and the Rocky Mountains, high prices during and after World War II drew into hazardous crop production, notably wheat, much land that should be in permanent grass. To speed the return to sounder land use and better balanced farm practices in this area, additional legislation is being proposed.

The rural development program was initiated in 1955 as a long-run cooperative undertaking to help farm families in a low-income range to improve their earning power. Most of these farmers do not contribute appreciably to farm marketings or benefit from price supports. Some are small-scale commercial farmers who come under price-support programs, especially for cotton and tobacco, but their incomes have been low even when farm prices have been highest. While the rural development program cannot yield substantial results quickly, it is of high importance as a means of developing agriculture's human resources, as explained further below.

Many parts of our agricultural policy are working well and require only moderate changes. These together with the new measures now put forward, as set forth in the recent message on agriculture and the budget message, constitute a many-sided attack on the ills that beset agriculture in spite of, and in part because of, its great productive strength. There is no sure and easy cure for persisting surplus conditions. We must continue to be on guard lest measures designed to help do harm instead, and we must be ready to adjust our programs as experience may dictate. The programs now recommended, if framed wisely and adopted promptly, will promote the welfare of farmers and the Nation.

II. HELPING LOCAL COMMUNITIES REDUCE UNEMPLOYMENT

Just as the recent decline of agricultural income requires the attention of the Federal Government, so too does the problem of substantial unemployment which has persisted in some urban communities despite the attainment of practically full employment in the Nation at large. Local unemployment often proves stubborn when it stems from special causes, such as a dwindling market for the products in which a community has specialized, the removal of one or more of its key firms to other places, a lag in the technology of its principal industry, or the depletion of a natural resource on which the local economy is based. As noted in last year's Economic Report, "such 'structural' or 'spot' unemployment may remain even when the Nation's economy practically reaches full employment." The expansion of general economic activity during the past year has indeed sharply reduced the number of areas suffering from chronic unemployment, but it has not eliminated the problem any more than have previous expansions in our history or in that of other industrialized nations.

The fate of distressed communities is a matter of national as well as local concern. At present, numerous private groups, as well as State and local agencies, are assisting communities troubled with serious unemployment in working out practical solutions. The Federal Government has also actively interested itself in the problem. As far as feasible, Government contracts are being placed with firms in labor surplus areas. An inducement has been given to the location of defense production facilities in such areas by allowing tax amortization benefits beyond those granted elsewhere. Also, the Office of Area Development in the Department of Commerce has been enlarged, so that it could better serve local needs. Although these programs have proved helpful, experience demonstrates that bolder measures are needed. To this end, a new area assistance program is recommended for aiding communities that have experienced persistent and substantial unemployment.

The program is designed around four major principles. First, Federal assistance should aim at helping communities to help themselves. Major responsibility in planning and financing the economic redevelopment of their communities must remain with local citizens. Second, the program should aim at lasting improvement of job opportunities by the establishment or expansion of productive industries. Projects that generate only temporary employment do not help a community solve its basic problems and may even worsen its predicament. Third, Federal assistance should be contingent on the active participation of governmental authorities who are close to the troubled community; that is, the State or local government or a community-sponsored development or credit corporation must provide part of any financial assistance required for specific projects. Fourth, Federal aid must not be extended to a community if the proposed project will create unemployment in some other area.

In line with these principles, a new unit—Area Assistance Administration—is proposed in the Department of Commerce, to be headed by an Administrator and to be aided by an Advisory Board consisting of the Secretary of Commerce as Chairman, the Secretaries of Labor, Agriculture, Treasury, and Health, Education, and Welfare, and the Administrators of the Housing and Home Finance Agency and the Small Business Administration. The Area Assistance Administration will provide technical assistance to communities or larger areas, either directly or through grants, for studying their resources and preparing practical plans for industrial development. It will also extend capital improvement loans for projects that promise to improve a community's longrun economic outlook but for which financing cannot be obtained on reasonable terms from private sources. The loans should be made in participation with the State or local government, acting either directly or through a proper community agency. The Federal loan should not exceed, say, 25 percent of the cost of the project, while the State or local share must not fall short of, say, 15 percent. This loan program should be confined to communities that have had an unemployment rate of around 8 percent or more during the greater part of the preceding 2 years. But the loans should be available for a wide range of projects; such as the construction of industrial facilities, the purchase and alteration of existing facilities, or the consolidation and development of tracts for industrial sites.

Areas suffering from chronic unemployment could also be helped to develop their economic base by changes in certain programs currently administered by the Housing and Home Finance Agency. Congress should authorize the Housing and Home Finance Administrator to give priority to applications received from areas of substantial and persistent unemployment for Federal aid in financing needed public facilities under title II of the Housing Amendments of 1955. Also, title I of the Housing Act of 1949 should be amended to make benefits under the urban renewal program available for industrial redevelopment of business sections in these areas.

Besides undertaking the functions of technical assistance and of lending for capital improvements, the Area Assistance Administration will need to concern itself with aiding communities in making effective use of the numerous Federal programs already available to local economies; such as the interarea placement service of the U.S. Employment Service and its State affiliates, the lending program of the Small Business Administration, and the program of vocational education of the Department of Health, Education, and Welfare. Only by properly coordinating its own functions with related activities of other agencies, including those of the States and localities, will the projected Area Assistance Administration be able to realize the great promise of reducing pockets of chronic unemployment without unduly heavy costs to the Federal Government or undue interference in local affairs.

To put the new program of community assistance into effect, it has been recommended that a revolving loan fund of $50 million be established for the Area Assistance Administration, and that an adequate appropriation be made to cover its technical assistance program. The latter program should not be confined to areas of chronic unemployment. On the contrary, its scope should be wide and designed to aid both urban and rural communities in developing balanced and progressive economies. Attention should also be given to skill improvement programs. All these are activities in which State universities and other local institutions can be very helpful, and they deserve encouragement.

III. LIFTING INCOMES BY RAISING PRODUCTIVITY

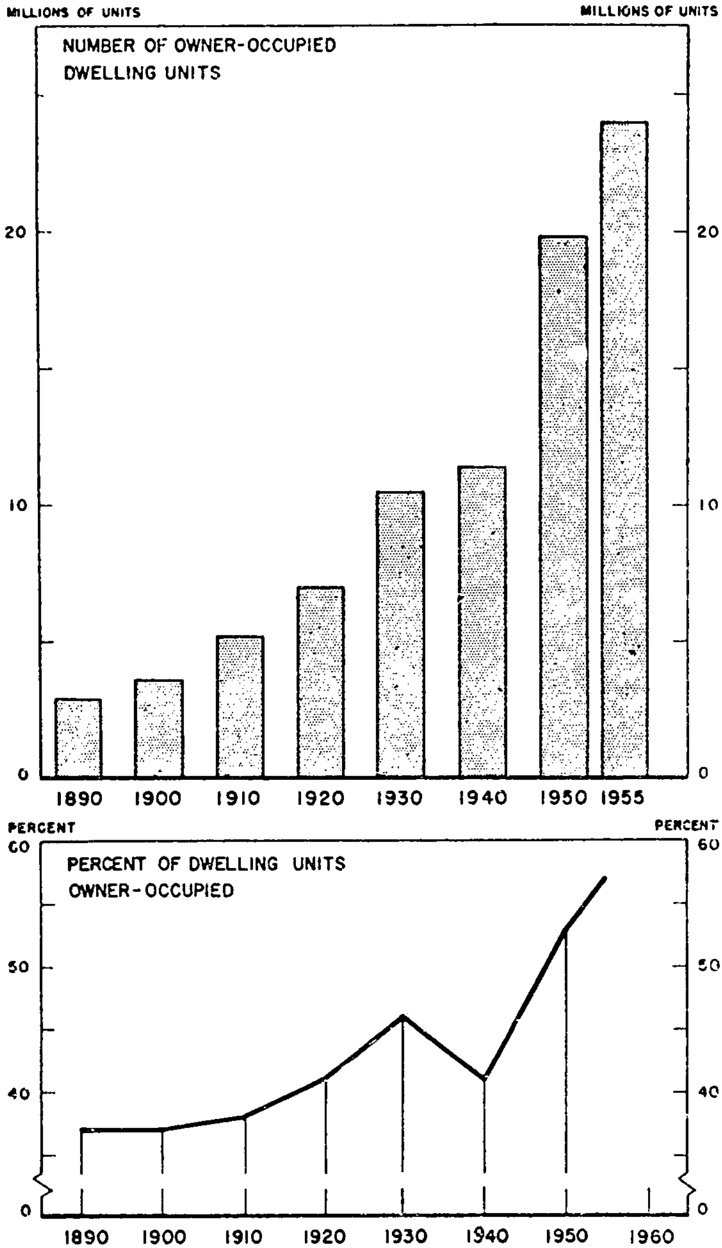
The wide diffusion of expanding incomes in the United States is the outstanding social achievement of our time. As tens of millions move steadily from one rung of the income ladder to the next and higher rung, disparities of income are lessened. The ownership of a good home and automobile by an American family is now the rule rather than the exception. Opportunities for cultural as well as material improvement have become larger. The past year has brought additional and widespread advances in general well-being. Nevertheless, too many families and individuals still have to get along on incomes that are inadequate by American standards. The situation keeps changing, and the dimensions of present-day poverty are not reliably measured. Yet there can be no better time than the present, when the Nation as a whole is enjoying unprecedented prosperity, to make a special effort to improve the economic status of the least fortunate among us.

The causes of low incomes are many. Special measures—both private and governmental—are needed to cope with some of them, such as protracted illness, and they are considered later. But the basic cause of low incomes has always been low productivity, irregular employment, or both. By pursuing policies that foster a high level of employment, extensive investment in new and more efficient tools of production, the improvement of general education, and the extension of research and development, the Government makes the largest contribution of which it is capable to the lifting of low incomes. When jobs are readily available and the productivity of labor is rising, as has been notably the case in recent years, the most powerful forces of all are already at work for lifting low incomes. The Government can, however, still do a great deal to help people who have been left behind in the onrush of progress, by undertaking special programs for raising their productivity. It is highly important that efforts in this direction be extended.

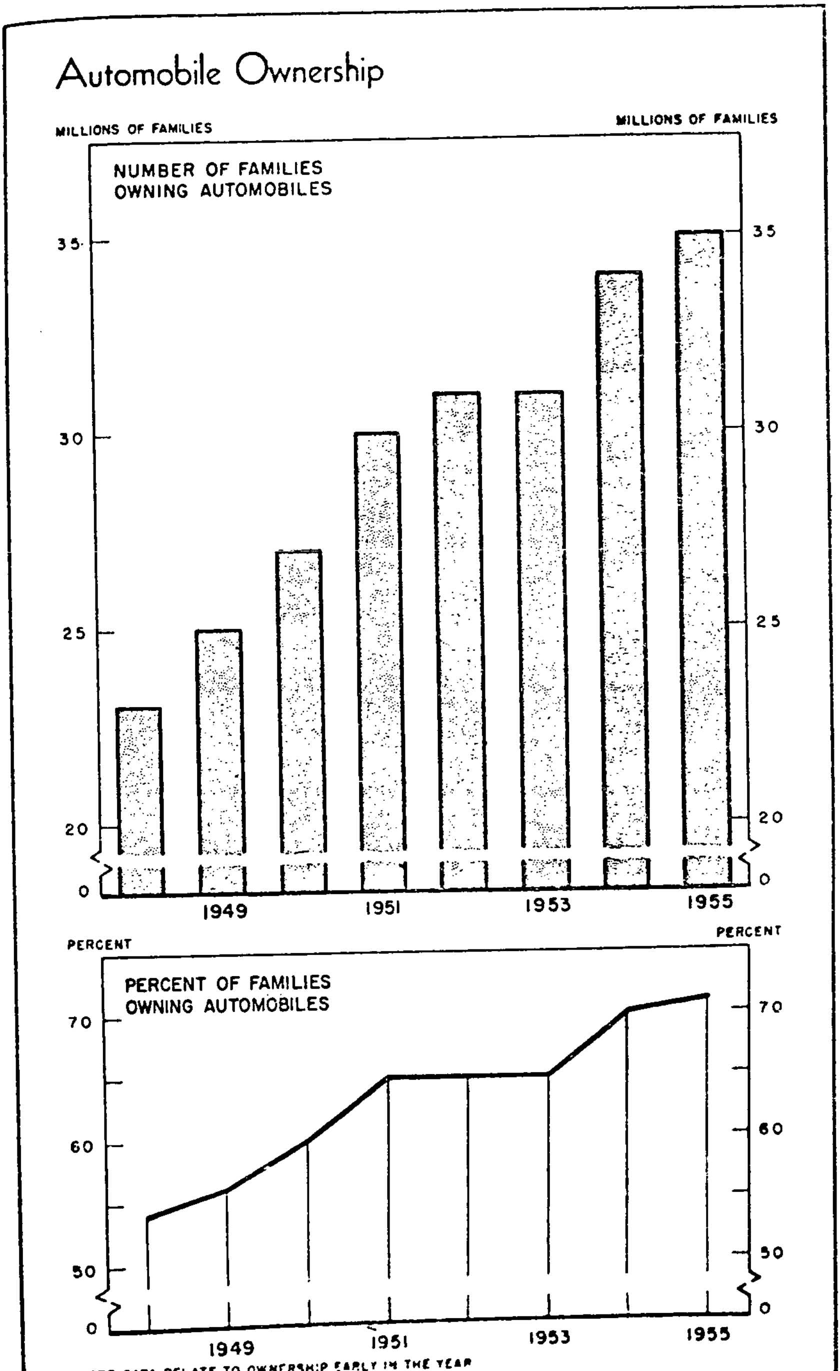
One of the largest groups of low-income families is in rural areas, mostly on farms too small for efficient operation. It includes many part-time farmers. These low-income farm families are widely distributed, but a large proportion live in the South. The Department of Agriculture explored this problem in a detailed report, "Development of Agriculture's Human Resources," presented in April 1955. Subsequently, a special message to the Congress urged the prompt launching of a long-range rural development program aimed at helping these families improve their economic status, and requested a special appropriation for the purpose.

Under the leadership of the Department of Agriculture, the rural development program was inaugurated in June 1955. The program rests on two basic principles. First, lasting improvement can be achieved only by increasing the productive capacities of individuals and by enlarging the economic base of rural communities.

Home Ownership



SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.



NOTE: DATA RELATE TO OWNERSHIP EARLY IN THE YEAR
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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Second, cooperation of Federal and State agencies, as well as of local and private groups, is essential for success. By the end of 1955, pilot operations had been started under State and local leadership in 30 counties and local trade areas in 12 States. The selected areas vary widely in type of farming, economic resources, and potentials, extent of industry, and other respects. Thus, the local programs being developed will vary over a wide range, and should yield invaluable experience as the whole program is expanded.

Numerous constructive activities are already underway. Improvements are being made in the facilities for general education and for vocational training. Improved health and nutrition are being promoted. Members of farm families are being helped to make fuller use of State employment counseling and placement services. Farm, business, and civic groups, working cooperatively with Federal and State officials, are attempting to bring more industry into low-income rural areas and to develop better rounded rural economies. The Federal Government is assisting in still other ways. The Farmers Home Administration has allocated funds for loans to small farmers in pilot areas where additional capital, unavailable through private sources, is needed to make farm improvements that promise to raise productivity. The Soil Conservation Service and the Forest Service are assisting the pilot programs in their respective fields of competence. The Agricultural Research Service is attempting to determine how small farmers may most successfully conduct their farm operations. All Federal activities connected with the rural development program are being coordinated by an interagency committee, and the Federal extension staff is assisting the State extension services in guiding the pilot operations.

The rural development program is a soundly conceived and basic approach toward solving a highly important social and economic problem. This promising program requires greater Federal support. The Congress is urged to enact legislation which will permit the Federal Government's contribution to the program to be expanded, in line with recommendations previously made.

As a result of the White House Conference on Education, the need for improving our scheme of elementary and secondary education is better understood across the Nation. But we must also seek to improve the effectiveness of adult and vocational education in both urban and rural areas. Well-directed programs of vocational training can help people, those in the middle or advanced ages of life as well as young men and women, to become more skilled workers and earn larger incomes. The major part of the extensive facilities now available for this type of education is supplied by State and local governments. The Federal Government should continue its program of grants to aid and stimulate the States in this important work.

Vocational rehabilitation provides a means by which specialized treatment and education help disabled individuals to improve their incomes. Over 600,000 veterans, who became disabled during World War II and the Korean conflict, have received special training under a program of the Veterans' Administration. Also, the Office of Vocational Rehabilitation of the Department of Health, Education, and Welfare administers a program of grants-in-aid to the States, designed to restore handicapped men and women to lives of usefulness and independence. Since 1950 about 60,000 persons have been rehabilitated annually. As a result of legislation in 1954, the States now have an opportunity to expand this vital activity. It is hoped that the States will enlarge their programs of vocational rehabilitation accordingly, so that the productivity of their disabled citizens may be increased. It is also hoped that the acceptance of these rehabilitated workers in useful employment will continue to grow through the activities of the President's Committee on Employment of the Physically Handicapped and associated efforts.

Despite all that may be done through education and other means to raise the productivity of individuals and thereby improve their economic status, some will continue to receive low incomes. Minimum wage laws do not deal with the fundamental causes of low incomes. Accordingly, this condition can be corrected only to a limited extent by such laws. However, as pointed out in the last Economic Report, minimum wage laws can assist the comparatively small number of workers who are at the fringes of competitive labor markets. Last year's report, therefore, urged the Congress to increase the minimum wage from 75 to 90 cents an hour. It also pointed out that the lowest paid workers are currently excluded from the protection of the minimum wage, that its coverage is no less important than its amount, and that an effort should, therefore, be made by the Congress and the States to bring additional workers under cover of the law. Some advances were made by the States during 1955, and it is hoped that this progress will continue. The Congress also raised the minimum, but did not act on coverage.

By setting the minimum at $1 per hour instead of 90 cents, it has become more difficult to widen the coverage without causing serious economic disturbance in certain areas and fields of activity. Yet the need for an extension of coverage remains, and the Congress is again requested to proceed as far as is practical in this direction.

IV. IMPROVING THE ECONOMIC STATUS OF OLDER PERSONS

Families headed by older individuals account for a large proportion of the families with low incomes. To a considerable extent, therefore, the task of lifting low incomes consists in raising the productivity of older persons, facilitating their access to employment, and strengthening the private and public programs that contribute to their economic security. This aspect of the low-income problem will become increasingly important as the number of older persons and their proportion in the adult population increase. For that reason an interdepartmental working group on aging is concerning itself now with policies favoring the employment of older persons, including those who have yet to reach retirement age, and with the consideration of their needs in programs for education, rehabilitation, housing, health, and recreation. A broad study of employment-hiring practices, of the productivity of older workers, of counseling methods, and other aspects of this important subject is underway in the Department of Labor.

The Federal Government has already taken significant steps to improve the economic status of older persons, both before and after retirement age. To enlarge their access to employment, the Federal-State Employment Services give special attention to older workers in job placement. In 1954 about 10 million additional workers were brought into the system of old-age and survivors insurance (OASI). At the same time the benefits were raised, and the law was modified to encourage retired persons to engage in some remunerative work. At present about 9 out of every 10 workers are covered or are eligible for coverage under this insurance system, which helps sustain the independence and dignity of people in their declining years. About two-fifths of all persons 65 years or older are now receiving OASI benefits and this proportion will increase. As a result, fewer persons will be obliged to seek public assistance. Contributing to the same end are the pensions available to elderly veterans who have non-service-connected disabilities and receive limited incomes.

Business firms have also made great strides in providing retirement benefits for their employees. Private employee pension plans now cover some 13 million persons. The number of retired workers drawing benefits under these plans has been estimated at about 800,000, about twice the number of beneficiaries 4 years ago.

Additional measures, both private and governmental, are needed to advance the status of the elderly. One is the further extension of the coverage of OASI to self-employed groups and other workers not yet included. Since the Federal Government employs many in the latter group, it should grant the basic protection of OASI to its personnel, and make suitable adjustments in present retirement programs. It would also be helpful if business firms reviewed their pension programs with a view to making the vesting privileges more liberal and to adjusting the conditions for retirement so that older persons who remain vigorous and highly productive can remain longer in useful work. As a safeguard for our rapidly increasing private pension funds, it would be desirable to require Federal registration of these plans and reports on their administration and finances. Private welfare funds should be handled in similar fashion, and the Congress is requested to enact legislation toward both purposes.

Another need of many elderly persons is greater protection against the economic hardships of illness. This need of retired workers should be borne in mind, as far as practicable, in employer-sponsored health insurance programs. Also, the extension of commercial prepaid health insurance plans to older people requires encouragement. Reinsurance through pooling of risks by private carriers, or if need be through a Federal program, would be a constructive step in this connection.

The problem of adequate housing for the elderly requires special consideration. It would be desirable to give preference to older persons and their immediate families in admission to federally assisted public housing projects. States and municipalities should consider adopting a similar policy. The National Housing Act should be amended to authorize insurance under especially favorable mortgage terms for apartment projects built by nonprofit organizations for occupancy by elderly persons. Favorable mortgage insurance terms should also be accorded other multiunit rental projects designed for at least partial occupancy by the elderly. Finally, provision should be made to permit third parties, which could be either organizations or individuals, to guarantee monthly interest and amortization payments in behalf of older persons buying a home under a federally insured mortgage.

V. COPING WITH PERSONAL HARDSHIPS

In considering the problems of agriculture, of chronic "spot" unemployment, of low-income families, and of elderly persons, we have seen that it is possible to design constructive programs to improve the economic status of people who have not participated fully in the advance of prosperity, and that it is not necessary to rely exclusively on the Federal Government in doing so. We now turn to other economic difficulties, those which sometimes bring financial ruin or a loss of security to individuals and families. Sound ways of mitigating such hardships can be found, and we should go about this task with determination.

The severity of the floods that occurred last year in the Northeast and the Far West has emphasized again the need for protection against the human and economic losses resulting from such catastrophes. Many private groups and individuals, as well as the Federal, State, and local governments, offered prompt and generous assistance to the communities and citizens struck by disaster. Nevertheless, needs of this type should be reduced in the future, and when they arise should be met more systematically. Toward these ends it is recommended, first, that the Federal Government accelerate work on practical flood control projects, and second, that it provide reinsurance for private carriers offering flood insurance. We must not stop, however, with the second measure since private carriers, lacking a firm actuarial basis, may be unable to offer the desired protection on the scale that is needed. To provide against this contingency, a joint Federal-State program for indemnifying flood victims on losses to real property, business inventories, and household effects should be authorized. The necessary costs can be met partly by premiums paid by private citizens desiring flood protection, and partly by Federal and State contributions. As experience under the proposed program accumulates, private carriers may be able to offer policies at costs which will render unnecessary the continued operation of a government-supported indemnity plan.

Reduced economic circumstances of people are frequently associated with misfortunes which carry with them financial costs that exceed the resources of even provident folk. Prominent among the causes of such personal hardship is severe and protracted sickness, sometimes requiring long hospitalization. The cost of providing for catastrophic illness through regular insurance payments would be modest, but insufficient progress has as yet been made with this type of insurance despite the remarkable spread of voluntary health insurance plans. Very recently, some business firms have begun to provide broadened health insurance for their employees, and this development deserves every encouragement. Also, private insuring organizations should be encouraged to extend voluntary health prepayment plans in two directions, first, to cover catastrophic illness, second, to cover persons not now being reached through usual group enrollment methods. Permissive legislation for private pooling of risks or Federal reinsurance may be needed for this purpose.

Our oldest form of social insurance is workmen's compensation, now universally accepted as a fair means for relieving the financial burden on individuals of industrial injuries and occupationally connected diseases. With the encouragement of the Department of Labor, 42 State legislatures acted in 1955 to strengthen their legislation on workmen's compensation. In 35 States these legislative changes brought an improvement in benefit provisions. The States are urged to extend this great advance by making further necessary improvements. At the same time, to meet more adequately the industrial hazards faced by workers under Federal jurisdiction, the Congress is urged to increase the benefits available under the Longshoremen's and Harbor Workers' Compensation Act, as recommended last year. But we must keep in mind that compensation and rehabilitation, despite their obvious importance, are poor substitutes for the prevention of occupational injuries and diseases. Much progress has been made in this field, but efforts to improve occupational safety and hygiene should be intensified; they deserve the fullest support of the Government, employers, employees, and labor unions.

Loss of income as a result of temporary disability that is not work connected, no less than unemployment caused by economic factors or by work-connected disability, causes serious drains on family resources. Many private firms have voluntarily sought to protect their employees against this hazard, and four States now require that they do so. Legislation to provide nonoccupational temporary disability insurance for workers in the District of Columbia was recommended in the state of the Union message. The Congress is requested to require District employers to provide the needed insurance either directly or through private carriers, on a basis that would divide the costs of the stipulated benefits between the employer and his employees. The States are also urged to consider the neglected problem of loss of income through nonoccupational temporary disability.

The personal and family hardships that arise from loss of employment have been considerably alleviated by the Federal-State system of unemployment insurance. Important improvements have been made in this system in the last 2 years but further progress is needed. We return to this problem later in the report.

There is also a need for attending constructively to some human difficulties that arise in the process of carrying out urban renewal programs. The scope of this activity, which promises so much for the future of our cities, is increasing. Since renewal programs involve the demolition of large areas, many urban families inescapably lose their homes in the process. Large numbers of them find satisfactory housing elsewhere; but in view of the part that the Government plays in urban renewal, it should, where necessary, assist the displaced families. To meet this need largely through private enterprise, the Congress was requested in 1954 to establish a program of Federal loan insurance which would have made home mortgage credit on exceptionally favorable terms available to individuals displaced from their homes by urban renewal or other public projects. The program enacted by the Congress fell short of the administration's proposal and has so far made little contribution to the solution of the problem. It is recommended that the Congress amend the present law, so that it will conform more closely to the recommendations previously made.

Representative CURTIS. It may be, indeed, that public relations can solve these problems when economics can't, but we might look to that.

Now, Dr. Heller, your predictions for gross national product—using that as a term for economic growth—for 1963 were underestimated, were they not?

Dr. HELLER. We had an estimate before this committee a year ago of a GNP of $578 billion, as the mid-point of the range from $573 to $583 billion. Last spring we went to the upper end of the range, and GNP is coming out at $585 billion instead of the $583 billion we estimated. Last year, I might say, our estimate was considered unduly bullish, and we were criticized for that. I think that the average estimate by private forecasters was around $570 billion.

Representative CURTIS. And this was predicated on a tax cut, was it not?

Dr. HELLER. It was predicated on an accelerating GNP in the second half of the year related to the tax cut, that is correct.

Representative CURTIS. Exactly, and we were warned through official statements of the executive department that if we didn't move with the tax cut, we might even be faced with a recession.

Dr. HELLER. However, Representative Curtis, it was said flatly in the President's Economic Report and in ours last January that we expected expansion to continue throughout 1963, that we expected no recession in 1963, and that statement was not founded on the enactment of the tax cut

Representative CURTIS. There were a number of Presidential messages to the Congress and speeches that suggested just as I have said, that there was a prospect of recession in the event the tax cut didn't go through. The only point I am making, and I think it is a very obvious one, is that Congress, in my judgment, was wise in not adhering to that advice. We had a better GNP result without the tax cut than you predicted with it. I think that if, indeed, this budget which is being proposed lives up to its label, and I am not sure that it can live up to its label of being an expenditure cutback, then a tax cut could stimulate the economy. But I am very worried about this, Dr. Heller. In November of 1963 and as late as November 21 when the Senate passed the last debt ceiling bill, the administration had given Congress the expenditure levels for fiscal 1964 of $97.9 billion. Is that not correct?

Dr. HELLER. It was $97.8 billion

Representative CURTIS. Yes. Then in the next 2 months, after the unfortunate assassination of the President, President Johnson came in, made quite a number of statements about cutting back expenditures, and they were related to fiscal 1964. Yet the state of the Union message gives us the revised figure of $98.4 billion for expenditures—$97.8 was the latest figure. In other words, while they were talking about cutting expenditures, they actually increased by $600 billion.

Now, would you care to comment on that in the context of cutting back on expenditures?

Dr. HELLER. The only comment on that is that each year I think you will find that successive estimates have often changed within this range of roughly half a billion dollars. We do know that forecasting of Government expenditures is necessarily an imprecise art and science though not, perhaps, as imprecise as forecasting the GNP. Nevertheless——

Representative CURTIS. Is it that imprecise when we are dealing with 6 months of the fiscal year that have already passed and the immediate months, with as firm a figure as we could get in November of the 97.8? How can you make a statement about cutting expenditures and end up with $600 million more less than 2 months later?

Dr. HELLER. Of course, the expenditure program for the current fiscal year is very largely determined by previous actions. You may underestimate it or overestimate it at a different time, but I think perhaps, Mr. Curtis, since the Director of the Bureau of the Budget will be appearing before this committee, and since he is unquestionably far more conversant with the details than I am, this might be a better question to direct to him.

Representative CURTIS. I fully intend to explore that. You can pass that buck to him, too, but I still think the Council of Economic Advisers should know. Indeed, you refer to these expenditure levels and they become important data. Who is responsible for them is another question. That I agree.

You refer, I notice, to an austere budget. Last year it was referred to as a tight budget. Is there a distinction between an austere budget and a tight budget?

Dr. HELLER. That is a very difficult point to distinguish. Last year, of course, all of the expenditures other than those for defense, space, and interest, represented a decrease from year to year, and that was the reference to the tight budget. This year there is an overall cut, and indeed I may assure you that it is a solidly based and sincere cut which the President of the United States fully intends to follow through on.

This year there is an overall cut in the budget, and it seemed to me, and to my colleagues, to merit the word "austere."

Representative CURTIS. We were told in the Ways and Means Committee—and also the public was told—that the budget for 1965 would be a tight one. President Johnson went to work on this tight budget and cut it considerably, so it becomes austere. Yet the austere budget and your own report reveal that we are going to spend $2.5 billion more, not less, in the calendar year 1964, which carries on just 6 months of this budget. This does not include the increase in salaries, increased interest rates we are paying, and a few other items. So——

Dr. HELLER. Mr. Curtis——

Representative CURTIS. It appears to me that we are dealing in strange semantics.

Dr. HELLER. On that point, the calendar year 1964 is made up of 6 months of the fiscal 1964 budget——

Representative CURTIS. That is correct.

Dr. HELLER. In which there is still a substantial overall rise and then the first 6 months of the fiscal 1965 budget in which there is a very substantial tapering, and what we are saying is——

Representative CURTIS. Oh, the cut is going to be in the months of 1965 after the election, is that it?

Dr. HELLER. What we are saying is that the purchases by the Federal Government—taking a year-to-year comparison, and recalling that there has been a rise during 1963—will continue to show a small rise in 1964 from the level reached at the end of 1963, and that, for the year, there will be a $2½ billion increase in purchases of goods and services, not in total Federal expenditures, over 1963. This is not at all inconsistent with a cutback in the 1965 budget.

Representative CURTIS. You are suggesting that the $2.5 billion increase is primarily relating to the latter part of fiscal 1964 and the first part of 1965 and that after December 31, 1964, we are going to see this tapering off but not before.

Dr. HELLER. The rate of increase will be tapering off throughout 1964 but, of course, the first 6 months are the result of programs already enacted by Congress, not part of the budget program.

Representative CURTIS. Maybe we can close this colloquy because my time has been up, by referring to your term "rate of increase." If we are talking about increase, then we are in agreement, and the only thing you are saying is that you aren't increasing as much, perhaps, as you did the first 2 fiscal years of the administration. Is that about right?

Dr. HELLER. With the proviso that we are looking only at the calendar year 1964 in this colloquy.

Representative CURTIS. All right. Thank you.

Representative REUSS. Senator Sparkman?

Senator SPARKMAN. Dr. Heller, I appreciate your presence. I want to ask about the rate of employment which is a perennial concern of this committee.

Unemployment is about 5½ percent now and you anticipate that is going to remain more or less level throughout this year? Is that right, or will be reduced perhaps to 5 percent?

Dr. HELLER. With the early enactment of the tax cut, our projection is that we will be moving down toward that 5 percent rate by the end of the year and on below it in the years to come, 1965 and 1966.

Senator SPARKMAN. Now, how many unemployed does that——

Dr. HELLER. That is roughly 4 million on a seasonally adjusted basis.

Senator SPARKMAN. You mean 5½ percent is roughly 4 million in numbers? The reason I ask is that, I remember some early studies made by a House committee I was on back in the days of the "Okies" and the "Arkies," the sandstorms and dust storms. We were studying at that time this question of unemployment and the migration of labor. It goes through my mind now that we felt that a number of unemployed of some 3 to 3½ million, was normally to be expected. Am I wrong about that, having in mind that people are moving and shifting from one job to the other, temporarily out of work, and so forth.

Dr. HELLER. It sounds high, particularly for that period.

Senator SPARKMAN. It certainly does with references to the worry that we now have over a 5½-percent level.

Dr. HELLER. If you are striking an average of actual unemployment over a period of years, it might indeed have been that high and indeed a lot higher during the thirties, but in terms of what the students of this subject would say was an irreducible minimum, that is certainly too high.

Senator SPARKMAN. I don't know that the figure was the irreducible minimum, but what would be the normally expected number of unemployment, transitory, and from job-to-job and place-to-place, and so forth?

Dr. HELLER. There is a fair amount of difference of opinion on this, but I think if we appeal to our experience in the postwar period, we had an average of about 4 percent unemployment from 1947 to 1957 and the number of unemployed when demand was very strong dropped as low as 3 percent—I think it fell slightly below 3 percent—but that was under conditions of some inflationary pressure.

Senator SPARKMAN. During war years?

Dr. HELLER. I am thinking of the period during the Korean conflict.

On the basis of an examination of frictional, seasonal, and structural unemployment, it seems to us that reaching an unemployment rate of 4 percent, as an interim goal, would be a considerable achievement, not having known that figure since 1957. However, with the aid of such measures as manpower development and training, youth employment measures, better education, better vocational education, and so forth, one ought to be able to keep moving the target down below 4 percent.

I agree with you, the word "irreducible" minimum is not a very fortunate choice of terms because unemployment is always capable of further reduction as we improve the productive power, the education, and the skills of people.

Senator SPARKMAN. I hope sometime in the course of these hearings that we may have a discussion of the question of automation and how it is going to work against that force. May I just ask you for a quick answer to this. How profitable is training and retraining to be as against automation?

Dr. HELLER. How profitable can it be?

Senator SPARKMAN. Yes, how successful? In other words, are we going to be able to create new jobs to offset those that are lost as a result of automation?

Dr. HELLER. This is one of the basic purposes, of course, of the stimulative effect of the tax cut. That is, on one hand, while we are increasing productivity through automation and other forms of technological advance, which displace workers, we have to increase demand for the products and services of American industry, which absorbs workers. Then you build a bridge between the two by manpower training, education, and other measures which improve both the skill structure of the labor force and its mobility. But it is true that the problems which we tend to lump under the heading of automation include very substantial problems of readjustment and reabsorption into the productive work force. We have to be vigilant and to work on this problem at all times.

Senator SPARKMAN. And it will take some time to work out that adjustment or readjustment.

Dr. HELLER. It certainly can't be done overnight. The President has proposed an expansion of our manpower training and development activities, to help smooth the adjustments that arise out of technological advance and to help retrain workers, so that they can be reabsorbed into the productive process.

Senator SPARKMAN. Now, Senator Douglas told me before I came in that some reference was made to a couple of reports made by a subcommittee of which I was the chairman back in the mid-fifties, 1955 and 1956, I believe it was. If I remember correctly, there was a report on agricultural labor and another report on low income families generally. I remember there were hearings on those reports with a great deal of interest. Have you read them by any chance?

Dr. HELLER. I have them here. We have read them in connection with our own studies.

Senator SPARKMAN. Which report came first?

Dr. HELLER. Well, since they are both dated January 5, 1956, I have some difficulty in determining.

Senator SPARKMAN. Well, perhaps so. I was thinking they came out——

Dr. HELLER. That is, if I have the right ones. Report No. 1308 is on automation, and 1311—now we have the answer—is on low income.

Senator SPARKMAN. Just a moment, is one of those on automation?

Dr. HELLER. There is one on automation and technological change and one on low income population. Perhaps I missed your references.

Senator SPARKMAN. I think there was also another one emphasizing agricultural workers. The one on automation was from Mr. Patman's subcommittee.

Mr. Chairman, the report "Low Income Population at Substandard Levels of Living," is quite brief and I read it over yesterday again. It impressed me as making at that time pretty much the same findings and to a large extent the same recommendations that are being made today. Since the chairman has already incorporated the recommendations of that report into these hearings I will not ask to include the entire report but do want to call attention to its findings as well.

Dr. HELLER. Senator, in my earlier comments before you came in, I noted that we had made very good use of these studies and I am indeed impressed with the relevance of what you said in this report at that time, and I think it is a continuing indictment, of our advancing and very prosperous society, that we have not made more progress in eliminating poverty, and this is what moved President Johnson to declare all-out war.

Senator SPARKMAN. That is exactly the thought I had, that we have this—I won't say the same pockets of poverty, but the same general pattern now that we had then—and I hope that out of the present recommendations we do get a real program that may make a change.

In this connection, the President has made rather strong recommendations. I recall President Kennedy made reference to it at different times during his lifetime, to the program for the special benefit of Appalachia. How would that be different from the program generally throughout the country?

Dr. HELLER. I am somewhat handicapped in speaking about that because the dimensions and content of that program have not yet been made final. We know that the Under Secretary of Commerce, Franklin Roosevelt, has been working hard on that program. It is to have various aspects, including primarily attempts to improve the physical resources of the region to build up its earning power.

Of course, another very important emphasis of an attack on poverty must be to build human resources and to provide the education, health, and other means that enable people to escape from poverty.

Senator SPARKMAN. Thank you very much. My time is up.

Representative REUSS. Senator Javits?

Senator JAVITS. Dr. Heller, we are always glad to see you and your colleagues on these annual occasions.

Is it fair to say that President Johnson has not changed the fundamental direction of President Kennedy and that he is still relying on a tax cut to deal with endemic unemployment?

Dr. HELLER. This is the chief reliance, yes.

Senator JAVITS. And in that respect the policy just continues, is that right?

Dr. HELLER. It continues with certain differences, perhaps in emphasis on some of the accompanying programs and the development of the poverty program which had not yet been formulated at the time of President Kennedy's tragic death.

Senator JAVITS. Thus far the administration is calling for two big things: (1) The same tax cut I have been calling for since August 1962; and (2) the so-called war on poverty to be financed in fiscal year 1965 with new obligational authority of $500 million, is that right?

Dr. HELLER. Senator, in the opening round of the war on poverty, new obligational authority of $500 million is proposed specifically for the poverty program, and not derived from other programs. In addition there is over $500 million which can be drawn from various other programs that bear on poverty; that is, education programs, health programs, and the like, which would be put into the first year's new obligational authority for the attack on poverty. So I think it is fair to say that the first year's attack would be more in the order of a billion dollars than $500 million.

Senator JAVITS. Well, aside from that, we have no new techniques for attack, have we? We just call it an attack on poverty and we allocate some money. What have we developed that is really the strategy of a war on poverty?

Dr. HELLER. Subject to the constraints that final decisions have not been made yet and are not to be announced until a special message comes to the Congress, I think it is fair to say that the central theme of the attack will be to focus responsibility more sharply with respect to getting at the causes and roots of poverty and to join Federal, State, and local resources in a concerted community attack on poverty. Surely this is not a problem that can be surmounted overnight, and no one has any illusions about this, because much of it has to be attacked through improving the education, the health, and the living conditions of our children in poverty status.

This does not yield 'an overnight payoff. It does, however, offer us a good chance at long last to get at these roots and to cut down the incidence of poverty.

Senator JAVITS. Well, Dr. Heller, let me tell you first that I am all with the idea of a war on poverty, a war which has been going on, should be going on constantly. What concerns me very deeply is the fact that in this case the war on poverty is mixed up with the war on unemployment, and I have very serious doubts as to whether you can sweep unemployment under the welfare rug, and that is why I press this point with you.

Is it not a fact that when the President speaks of a war on poverty, he is proposing to deal not only with the endemic poverty which we know so well, especially a person like myself living in the biggest city in the country, but he also proposes to deal under that same general heading with unemployment?

Dr. HELLER. The two are interrelated, Senator, but I don't think it is fair to say that the two are here being confused. That is, the creation of opportunities, strong opportunities for employment is, if you will, a prerequisite for opening exits from poverty. That does not automatically mean that the people who are in poverty status are able to use those exits because of existing conditions of ignorance and lack of skills and squalor and disease.

It is quite significant that about half of those in poverty status do have jobs. In other words, there is not by any means a complete coincidence of unemployment and poverty. In fact, it is somewhat over half of the people in poverty status that do have jobs simply do not make enough to provide a decent living for their families.

So it is very important to distinguish between the problem of unemployment and the problem of poverty, recognizing where they overlap but also recognizing cleary where they do not overlap, where they are distinct problems.

Senator JAVITS. Now, has any estimate been made as to the more than 4 million unemployed, as to how many in this group are in the poverty status on which you are going to make war?

Dr. HELLER. No. I don't believe we have that figure. Of course, it would have to be adjusted for the continual change in the composition of that 4.5 million, because, as Secretary Wirtz has pointed out on occasions, something like 14 or 15 million people become unemployed some time or another during the year, while the number at any one time stays in the 4 to 4.5 million range that you mentioned.

Senator JAVITS. Well, let's take a program like manpower retraining. Is that going to be part of the war on poverty or is that going to be part of the efforts to deal with unemployment caused by automation, technological difficulties, distressed areas, and so forth?

Dr. HELLER. Well, again they are bound to be interrelated. In other words, in order to equip people to take on new jobs—and this includes many of the people in poverty status—the manpower development and training program needs to be stepped up, and indeed one of the proposals that would be made is for some share of the Manpower Development and Training Act undertaking to be focused specifically on the poverty-stricken areas, so that it could be used as an instrument for dealing with the poverty problem.

Senator JAVITS. Now, I just have a minute, Dr. Heller. As you know, I have been very disquieted about this because I think it may take our eye off the unemployment target and fix it on the general problem of poverty which is grave and difficult and endemic, but I don't think it is the target which we are trying to shoot at in dealing with endemic unemployment. So I ask you this question:

Our gross national product went up from $555 billion in 1962 to $585 billion in 1963. Now, you say if we get a tax cut that it is going to go from $585 to $623 billion, an increase of $38 billion which is on the same order of magnitude that has been our experience in the past 2 years.

Now, have you seen any material moving of the problem of endemic unempolyment just because that GNP rose in the area of $30 billion?

Dr. HELLER. No.

Representative KILBURN. Would the gentleman yield right there for an explanation?

Dr. Heller, I bow to your superior knowledge, but there has always been a question in my mind, and because I admire you so much I would like to get your explanation on it. Supposing that everything was just the same, the employment and everything else was just the same, and we had inflation of 10 percent.

Wouldn't the gross national product go up 10 percent?

Dr. HELLER. Yes, indeed. You are putting your finger——

Representative KILBURN. So the gross national product as a thermometer has to be taken into consideration whether we have inflation or not.

Dr. HELLER. Indeed it does. I appreciate what you have just said, and in our statement we are very careful to note, first, there was the $100 billion expansion, and second, when corrected for price movement, that represented a 16-percent increase in real product in these 2¾ years.

That correction always has to be made in order to know what the real situation is.

Senator Javits, coming back to your question about this $30 billion increase without any reduction in unemployment. As you may know, we have cited this fact again and again as an indication of how tough a problem we have before us, and that we are not going to make any substantial inroads on it unless we step up the rate of increase in demand and rate of increase in GNP. I cited specifically in my statement the figures in order to show that when our GNP has risen faster, we have made a dent on unemployment.

I cited, if you will recall, that when GNP was advancing at an average annual rate of 7.3 percent in the first six quarters of our current expansion, unemployment did drop from 7 to 5½ percent. But since the spring of 1962 it has advanced approximately $50 billion in money terms, uncorrected for price changes, or in real terms at an average annual rate of only 3.9 percent and that was not fast enough to lower our unemployment rate.

With the stimulus of the tax cut and an anticipated growth of 5 percent in the year ahead instead of 3.9 percent, we think we will begin to melt some of this iceberg and it will melt under the heat of stronger job opportunities and higher ——

Senator JAVITS. My time is up. I just wanted to say to you, as you know, my point always has been that I do not believe the tax cut alone will do it. I think we have to do a number of other things basic to the economy, on exports, antitrust laws, on profit sharing, and so on, and this is the real problem.

Thank you, Mr. Chairman.

Representative REUSS. Mrs. Griffiths?

Representative GRIFFTHS. Thank you. I apologize for being late, and if someone else has already asked my questions, just say so.

I would like to ask you what would be the effect of the passage of the medicare bill in its present form on the tax cut?

Dr. HELLER. Mrs. Griffiths, I don't have a ready answer to that. I assume you mean exactly what would be the amount of collections compared with the amount of payout in the period when the tax cut was going into effect. I seem to recall that the way it was scheduled, there would actually be a larger payout in the beginning as the benefits became available than the amounts being paid in, that is, there would be an additional stimulus to the economy. I know that was the case when I last took a sounding on it, but I am afraid that I have to say that in terms of current information on this, I couldn't confirm that without going back to check on it.

Representative GRIFFITHS. Would it or would it not decrease to some extent the value of the tax cut?

Dr. HELLER. Well, if my recollection of the form and timing is correct, then actually it would slightly augment the tax cut in its early period rather than detract from it, but please permit me on this point to correct the record if I find some change has been made since I last looked at it.

Representative GRIFFITHS. I would be delighted.

(Subsequently the following was submitted:)

When the administration presented the hospitalization expense bill in 1963 it hoped for passage that year, and it planned for a January 1965 commencement date for both benefits and the taxes to finance them. However, because of the legislative delays, present plans call for postponing the effective date for a year—until January 1966. Thus there would be no fiscal impact at all during either 1964 or 1965.

Representative GRIFFITHS. May I ask also what would the effect of reduction of car prices in connection with the tax cut be on investment?

Dr. HELLER. I am sorry, I missed——

Representative GRIFFITHS. I observed that the President has asked that the prices of cars be reduced. What is the effect of the reduction of car prices on availability of investment capital when you consider also the tax cut?

Dr. HELLER. May I start out by correcting the record on this? Neither the President nor the Council of Economic Advisers has called for a reduction in car prices.

Representative GRIFFITHS. I am sorry. I just read the headline. I thought it said——

Dr. HELLER. Those headlines jumped to certain conclusions.

Representative GRIFFITHS. I see.

That is all I have.

Representative REUSS. Senator Miller?

Senator MILLER. Dr. Heller, in your statement you say the economy fully completed its first $100 billion of expansion from the recession trough of early 1961 in just 2¾ years.

Now looking at the January issue of Economic Indicators, on page 2, I find that at the beginning of this period or at the end of 1960, the GNP was $502.6 billion, and at the end of the third quarter it was $588.7 billion, and subtracting those two, I would get an $86.1 billion increase in GNP in the 2¾ years, rather than the $100 billion contained in your statement.

Dr. HELLER. Senator, that was the 16 percent advance that I was referring to in terms of correction for the change in prices. In other words, that is the application—I am sorry. Perhaps I——

Senator MILLER. Why don't you come up with $86.1 billion instead of $100 billion?

Dr. HELLER. I am told by my colleagues that you apparently took the annual figure for 1960 and the third quarter figure for 1963. We ought to be very sure that we are talking about the same periods and the same thing—the rate of GNP for the first quarter of 1961 was roughly $500 billion and the rate of GNP——

Senator MILLER. I have $502.6 billion here per your figures on page 2.

Dr. HELLER. It is $500.4 billion, Senator; $500.4 for the first quarter of 1961, current prices, and $600 in the fourth quarter of 1963 in current prices. So that is——

Senator MILLER. I am looking——

Dr. HELLER. $99.6 billion.

Senator MILLER. I am looking at this second column on page 2 of your report and it says after the year 1960, $502.6 billion. And that is in the column headed "Total Gross National Product."

Dr. HELLER. That is the annual average for the calendar year 1960 as against the rate of gross national product in the first quarter of 1961, which was $500.4.

Senator MILLER. All right. Then if we took the $500.4 and subtracted it from the $588.7, which is the last figure in that same column, representing the third quarter of 1963, I would have about $88 billion rather than $100 billion.

Dr. HELLER. Sir, the fourth quarter figure, which is in the annual report which has been submitted to you, shows on page 207 that there was a rise from the third to the fourth quarter—as given to us by the Office of Business Economics of the Department of Commerce—to $600 billion.

Senator MILLER. At the end of the fourth quarter, how much should I put down here?

Dr. HELLER. Well, in terms of the fourth quarter as a whole, it would be an even $600 billion of gross national product at an annual rate against the $500.4 in the first quarter of 1961.

Senator MILLER. Well, if I understood you, just said the increase was about $6 billion in the fourth quarter?

Dr. HELLER. No; the increase was about $11 billion. It was from $588.7 to $600.

Senator MILLER. $600 is the figure at the end of the fourth quarter.

Dr. HELLER. For the entire fourth quarter. We do not have estimates of GNP for periods shorter than calendar quarters.

Senator MILLER. I understand. Then coming back to this third quarter figure of $588.7, if I subtracted the beginning figure of $500.4 which you just gave me, I get $88 billion increase in GNP.

Dr. HELLER. In 2½ years, rather than 2¾. Two and a half.

Senator MILLER. I am talking about the 588.7 which is opposite the third quarter figure.

Dr. HELLER. Yes. But the other one is the first quarter 1961 figure, and that means that in two and a half years——

Senator MILLER. I see.

Dr. HELLER. It has advanced that much, but in 2¾ it has advanced $100 billion.

Senator MILLER. I see. All right.

Now, according to your response to Congressman Kilburn, that is not real GNP?

Dr. HELLER. That is correct, in that it is not adjusted for price changes.

Senator MILLER. You should subtract from that——

Dr. HELLER. We always present two figures, one the advance in terms of current prices and secondly, the advance as adjusted for the so-called GNP deflator which takes account of price changes.

Senator MILLER. Yes. And the $100 billion of expansion to which you refer in your statement is not adjusted for price corrections.

Dr. HELLER. No. Adjusted for prices, it would be $81 billion (in 1963 prices) and become a 16-percent increase in real terms, as I indicated earlier.

Senator MILLER. In other words, to get a meaningful figure, that is, to talk about a real GNP increase, you should not have used that figure of $100 billion. You should have used the figure of $81 billion; is that correct?

Dr. HELLER. I think one always has to present both of them because of the fact that most of the discussion of the GNP is in terms of current prices, but it has to be accompanied by the other. And may I say our comparisons with past periods have been in terms of real increase in GNP and not the uncorrected increase.

Senator MILLER. Well, I hope that is the case.

Dr. HELLER. That is.

Senator MILLER. But when you say the economy completed an expansion, it seems to me that we really ought to talk in terms of a real expansion rather than this inflated expansion.

Dr. HELLER. That is why we added the 16 percent.

Senator MILLER. Well, but I didn't see the $81 billion. I just saw the $100 billion in there.

Let me pursue this a step further. We had the $81 billion real increase in GNP in the 2¾ years.

Dr. HELLER. Yes, sir.

Senator MILLER. Now, if we are really looking for economic expansion, shouldn't we subtract from that the increase in the national debt?

Dr. HELLER. No, sir.

Senator MILLER. It seems to me, Doctor, that if I went to the bank and borrowed $3,000, then I bought a car costing $3,000, that I would do violence if I were to say I had an economic expansion of $3,000.

Dr. HELLER. We are talking here about a measure of economic output. If I may use your example and take, say, an automobile company, let us say that the Ford Motor Co. had borrowed $100 million in a given year, and in the same year produced, say, $2 billion worth of cars, that production is a $2 billion contribution to the gross national product. We would not subtract the $100 million of debt incurred.

Senator MILLER. I would agree, but that is not the phrase you used. You didn't talk about an expansion in the gross national product, Doctor, You said the economy completed an expansion, and that is what I am talking about. Is it fair to say that we have had an expansion of the economy if we had gone down $21 billion in additional national debt, that is, on the minus side, but we have offset it by $21 billion of purchases?

Dr. HELLER. Well, one measures the expansion of the economy by its total current output of goods and services. I think that is the best single measure we have, and in terms of the use of our human and material resources, we are today producing that much more than we were at the beginning of 1961, with this price correction, The fact that it was financed in part by debt and in part by equity financing and in part out of current income, and so forth, does not change the end product, which is $100 billion, or, corrected as we have indicated, $81 billion more output in goods and services at the end of 1963 than at the beginning of 1961.

Senator MILLER. Well, may I say that I recognize that and that I think it would be helpful in your discussion of this phase of our economy if you would make it clear that you are talking about an increase in purchases rather than an expansion in the economy, because some people get the idea we have had a real genuine type of expansion, which means that taking the increased debt into account, we have still gone ahead, and I would like to suggest that your committee explore this possibility because I think that perhaps it may give us a little clue as to what is troubling us on the fact that we have an economic GNP increase and yet we are still saddled with this severe unemployment.

What I am getting at is this: First, as you say, we should knock this $100 billion down to real figures of $81 billion, then take another $21 billion off that representing—please hear me out, Doctor. I am just suggesting that you explore this.

Dr. HELLER. I am listening, Senator.

Senator MILLER. All right.

Then take another $21 billion off that representing the minus side of this expansion, which is the increase in the national debt.

Then take another $12 billion off that, which represents the increase in State and local debt during this period of time, and you will get down to around $35 billion of what many people I think would consider genuine bona fide economic expansion. And if you do that, you are going to find your annual economic expansion growth has been about 2.5 to 3 percent and, Doctor, that is not going to satisfy our unemployment problem, and I think that is why it hasn't been satisfied.

In other words, I don't think we are going to be getting anywhere by talking in terms of output if at the same time we don't recognize the minus factors in our economy.

I would like to ask just one further question. On page 35 of the Economic Report of the President, the statement is made:

The farming sector of the economy has also shared in the advance.

I would like to know how you reconcile that statement with the fact that your Economic Indicators show that during this same period of time, farm parity ratio has fallen from 80 to 76?

Dr. HELLER. On your earlier comment, I would just say that there is a very deep and fundamental difference between us on how one computes the advance in the economy and the advance in production, and that to offset the debt that is incurred is to take a minus which certainly is not an offset to the real increase in wealth and production and income of the economy.

Senator MILLER. Pardon me. Did you say could not take it as an offset against increase in wealth?

Dr. HELLER. I would not take it as an offset as an increase in the annual productive capacity and performance of the economy because, of course——

Senator MILLER. This you and I would have no argument over, but when you said as an offset against wealth, I would have to differ with you. If we have an increase in wealth on the one hand, we have got to take off the increase in debt on the other if we are going to get a true net increase.

Dr. HELLER. One must strike a balance between our assets and our liabilities, and those, of course, are for the very great part held within the country and therefore what may be, let us say, my debt is the asset of the Northwestern National Bank in Minnesota or to someone who has a deposit there.

I think, therefore, that this is something which we should always try to be clear about; but the fact that we have had a 16-percent real advance in the productive performance of this economy remains undiminished by the debt that has been incurred by both private and public units in that period.

On your other question, that of the farm community sharing in the advance, I think it is fair to say that as far as the net income per farm is concerned, there has been a rather substantial advance in agricultural income. To share does not necessarily mean that it has shared enough. All we are saying is that there have been advances in net income per farm during this period that have accompanied the general advance in the economy, though they have not been as fast as——

Senator MILLER. If you had said merely that, there had been an increase in the net income per farm, I wouldn't have asked my question, although I think it would have been helpful if you had coupled with that statement the fact that the number of farms declined 367,000 during this period of time. I think that would have been helpful. But what you have said was that the farming sector of the economy has also shared in the advance, and it is to that that I direct my question when your Economic Indicators show that farm parity ratio fell from 80 to 76. I can't reconcile those two figures.

Dr. HELLER. One has to look not only at the parity but the question of farm income, and I think when you look at farm income, it is substantiated by the figures. The farm parity question is another one which I know is of significance to the farmer.

Representative REUSS. Senator Proxmire?

Senator PROXMIRE. Dr. Heller, this is another very fine masterful report. I think if any administration has ever made a tax cut appealing, certainly the Johnson administration has done it.

I am very tempted—I can't say I am convinced, because I have been against the tax cut right along and still am, but I must say to couple the tax cut with the significant holding down of spending and maybe a reduction in spending, plus an attack on poverty which I think is commendable and obviously has to start in a relatively modest way, is exactly the way to go about it.

I think that you and the administration deserve a lot of credit for that.

I am very worried about several aspects of this, though, and I would like to ask you about them. The President started off in his statement to the Congress in his Economic Report by saying that the past 2¾ years know no parallel in our history for peacetime economic expansion, $100 billion, never anything like that before. And there are all kinds of indicators which are very encouraging.

Now, of all the times in our history for us to have a tax cut to expand the economy further, it seems to me this may be one of the worst. If we should have a tax cut now, we can justify a tax cut anytime I can think of except in wartime for the past 50 years. Isn't that correct?

Dr. HELLER. Well, Senator, I think that that question and the implied assertion in it underestimates the size of our economic problem, the unemployment and underutilization problem. I think it underestimates the size of our potential which is, of course, related to it, the fact that this economy of ours really has just an enormous output potential, that even an industry like the automobile industry which is operating at record levels has unused capacity which could be engaged by fuller levels of demand. And I think it also underestimates the determination of the American people to make full use of their potential.

President Johnson has constantly stressed for many years that the full use of our potential is the highest purpose of Government.

Senator PROXMIRE. Yes; but wasn't this whole concept argued throughout the thirties and forties and most of the fifties on the ground of compensatory fiscal policy, that is, in periods of recession that there would be the fiscal policy of reducing taxes, increasing spending, trying to compensate for a stagnant economy. In periods of boom and expansion, on the other hand, that the tax would either be increased or at least maintained and you would try to balance the economy and iron out the valleys and the peaks.

Now, it seems when the President has said the last 2¾ we have had a wonderful expansion, moving ahead at record rates, now is the time to zoom a little more. What I am worried about is what happens 2 or 3 years from now if your prognostications on the multiplier and accelerator don't really work out?

Dr. HELLER. Two comments I think are in order there:

One is that this policy is still compensatory in the sense that it compensates for the underutilization by the private economy of the existing resources of manpower and machines.

Second, I am rather proud of the advance that has been made in our thinking on these problems. That is, we look not only at the ups and downs but at the level around which those ups and downs are fluctuating, and it turns out that while we have had a very substantial expansion of which we can be proud, the achievement—either in employment and production—has not reached levels that we have demonstrated very well in the past we are capable of.

Senator PROXMIRE. I think there is no question the case is strong. We should have more employment and more utilization of our resources, and so forth. But I am also wondering whether or not the tax cut is going to do the job.

Now, our present tax rate, according to the Treasury table which Senator Russell Long used in a speech on the floor, averages for all returns about 27.6 percent. That is the tax, the part of the tax which is taken in taxes.

Now, I understand that the table that he put into the Congressional Record is fascinating because it shows that the more you make, the less you pay in percentage. It shows if you have an income between $750,000 and $1 million a year, it is 28.6; $1 and $2 million is 23.8; and if it is $5 million and over, it is 23.7.

At any rate, this table among others has indicated to me that the notion that by reducing taxes as we are that we are going to release all kinds of new incentive and eliminate the enormous burden of 91 or 86 percent or whatever it is that has been slowing down investment and slowing down spending, too, that this is going to be accomplished. What is going to happen apparently is instead of an effective rate of 27.6, we will have an effective rate of maybe 23 or 24 percent.

Now, why are you so sure that this will yield a lesser deficit? I would like to call your attention to the fact that for 9 years, between 1946 and 1954, during those peacetime years we had virtually no deficit at all in aggregate. We had a deficit of maybe $2 billion during that period. Then we had a tax cut similar to the tax cut we have now, not quite as big. Following that we had a $40 billion deficit in the next 10 years.

Now, that apparently is because the multipliers don't work out quite as people expected them to, and there were a lot of other factors involved also. If your multiplier is not perhaps 3, as you expect it to be, but is somewhat less than that, aren't we likely to dig ourselves into a deeper debt hole, have deeper deficits, becuase you are reducing taxes at a time when we aren't balancing the budget and when we are enjoying a big expansion and a boom economy? And yet not able to balance the budget?

Dr. HELLER. If the results of the tax cut went against all previous experiences in this country and the experiences in country after country overseas, then, of course, you are right, we would have difficulty achieving the double objective of a balanced budget and a balanced economy.

A study of past experiences, including the early years of experience after the 1954 tax cut, also fit this pattern. The later recession years were far enough away from the tax cut itself so that the deficits experienced then can't be traced to the tax cut. The recent United Kingdom experience is another example, of course, of a tax cut very comparable to ours. If you convert their GNP to ours, it was a cut of about $11.7 billion.

Senator PROXMIRE. What was the date of the cut?

Dr. HELLER. The date of the cut was last April and they have since had a marked fall in unemployment and a marked rise in industrial production and retail sales.

Senator PROXMIRE. I think there is no question in my mind that you get an immediate response. You get people spending perhaps more than the tax cut would enable them to spend. But the record of the 1954 cut indicates that doesn't last very long, maybe 2 or 3 years. And after that we get the $40 billion deficit which followed in the 10 years after that tax cut. As you recall, there was a period when we did quite well, 2 or 3 years right after the tax cut when we had more than a balanced budget. But it seems over the years you work into a situation where your deficit gets deeper.

Apparently your argument is, if we had cut taxes by $20 billion instead of by $7 billion in 1954, that we would have a lesser deficit now than we have and that we would have far better economic activity.

Dr. HELLER. One always has to relate the tax cut or tax levels to two other factors. One is the level of demand in the private economy, and second, the level of Federal expenditures.

Of course, in the 1954 situation, Federal expenditures were still declining from the levels of Korea. That is one factor.

Second, once that adjustment was made, you had a very strong combination of both private consumer demand and an investment boom in those years that sustained expansion along with the tax cut right through until about mid-1957, when the softening occurred.

I think that had we had a $20 billion tax cut at that time, a lot of it would have run off into inflation. I think this would have been too strong.

Senator PROXMIRE. That is my next question.

Dr. HELLER. Too strong a stimulus to the economy.

Senator PROXMIRE. The President expressed concern about the price increases but it is my understanding in the next few days we are going to get an indication of a fairly substantial increase in prices. Last year we had the largest increase since 1958 in the price level. After the 1954 tax cut we had an inflation of approximately 10 percent in the ensuing 4 or 5 years.

What is there to persuade us in view of the fact that we have a booming economy in many ways that this very big tax cut is not going to result in running off quite a bit into inflation?

Dr. HELLER. You are putting your finger on a problem that has, of course, concerned us in the economic reports and one with which we have dealt at some length. We have a good deal of confidence that the basic situation in the economy is one that is not favorable to the development of inflationary pressure; indeed, one that contains many elements of defense against inflation.

May I cite not only the fact that we have very substantial excess unemployment, but that we have coming onto the job market this year more than a million new workers, rising to 1.2 to 1.4 million in succeeding years. These new workers, by the way, have about 40 percent more training and education than those who are and will be leaving the labor force.

In addition, our advance in productivity is displacing about 2 million workers a year and making them available for other jobs. And on top of this, we are currently using on the average about 87 percent of our industrial capacity, not 92 percent as the managers and owners of these plants would like to have as their optimum rate of production.

And as you look down the roster of industries, it is extremely hard to find one that would say that it is already operating at capacity and would have to break bottlenecks, so to speak, to increase its production.

So we have the capacity to absorb a very substantial increase in demand without having that increase run off into higher prices.

I cite also the fact that the tax cut itself, by cutting costs, by stimulating further investment, will provide a still better base on the cost side for containing such inflationary pressures as might develop.

I think we are in a very favorable position to avoid inflation. However, at the same time past expansions tell us that as production expands and as the economy does get closer to full utilization, there are greater temptations to raise prices and raise wages, and that is why the President made the appeal to both labor and management that he did for continuation of the responsibility and restraint that has been shown in the past 3 years.

Senator PROXMIRE. My time is up. You make a strong case for a tax cut. And yet we have a booming economy. There is beginning to be some inflationary pressure, that I would first like to see some reliance on monetary policy for economic stimulation. After all, this is the established conservative economic policy we have used throughout our history. We should try monetary policy before we resort to this extraordinary policy of deliberately deepening the deficit.

Thank you very much.

Representative REUSS. Senator Jordan?

Senator JORDAN. Dr. Heller, I should like to talk to you briefly about unemployment and the effects of unemployment. I think you have mentioned a figure of approximately 4 million unemployed presently.

Dr. HELLER. Roughly 4 million.

Senator JORDAN. And that approximately 1 million new people would be coming into the labor market every year.

Dr. HELLER. Yes, sir.

Senator JORDAN. And approximately 2 million more would come into the labor market by reason of automation, men being displaced by machines.

Dr. HELLER. These are people already in the labor market who would become available for new jobs because they are displaced by all the advances in productivity, not just, of course, the automation advances.

Senator JORDAN. In our Employment and Manpower Subcommittee of the Labor and Public Welfare Committee we had extensive hearings on manpower and unemployment. One of the impressive points developed in these hearings is that the number of man-hours of overtime is fairly comparable to the unemployed man-hours in the country today.

Now, a suggestion has been made, if the rate of pay for overtime were increased, it might discourage overtime and make more jobs available to more people.

Would you care to comment on that?

Dr. HELLER. Senator, President Johnson has proposed that industry committees be set up to study the conditions in each industry and determine the extent to which it is feasible without inflating costs to convert overtime into additional jobs.

On the basis of rather extensive conversations with executives in various industries, we recognize that there are situations in which overtime is almost an inevitable part of the productive process. But in others, it does seem that it has become so regularized that it could, without significant additional cost, be converted into additional jobs. The idea is to have tripartite industry-by-industry committees—labor, management, and public members—which would study these situations and make recommendations. The Secretary of Labor would then make a final determination on the basis of these recommendations as to which industries would qualify for this and what the terms should be.

Senator JORDAN. What we would accomplish would be to spread the income allocated to labor over more people, rather than increase labor costs; is that not true?

Dr. HELLER. That is correct. This is not a method of increasing the total number of work hours available. This is a method of spreading those that are now——

Senator JORDAN. Or the amount of the substance of the industrial community that goes to labor because——

Dr. HELLER. That is the basic purpose of it. You stated it exactly.

Senator JORDAN. All right.

Now, then, my next question has to do with shortening the workweek. It has been suggested that we could shorten the workweek from 40 to 35 hours. This would be a panacea that would accomplish great things in unemployment. Would you care to address yourself to that?

Dr. HELLER. As you know, Senator, the President in his state of the Union message made a very strong statement on that point indicating that the arbitrary reduction to a 35-hour week would involve us in increases in costs and a deprivation of a source of productive power that would seem to go against our economic interests at the present time.

Senator JORDAN. In other words, you would conclude that that would be inflationary.

Dr. HELLER. We would.

Senator JORDAN. But you think that a tax cut would not be inflationary?

Dr. HELLER. The reduction to a 35-hour week would create cost pressures that would tend to generate what we call cost push inflation. The colloquy I had with Senator Proxmire was concentrated more on the question of demand pull inflation, whether the tax cut would generate so much demand that it would exceed the capacity of our present labor force and present factories at existing prices. We do not think that that is the case.

Senator JORDAN. This involves unused industrial capacity and, of course, unused manpower, and you think these can be put to use without being inflationary?

Dr. HELLER. We do.

Senator JORDAN. Did I understand you to say that industrial plants are presently operating at 87 percent of capacity?

Dr. HELLER. Yes, 87 percent of capacity, by a measure compiled by the Federal Reserve Board—a measure that, while not perfect, we regard as the best available.

Senator JORDAN. Dr. Heller, we received testimony in the Employment and Manpower Subcommittee that there is a substantial percent of obsolescence in industrial plants, running as high as 20 to 25 percent in some instances.

Now, if we push the use of obsolete machinery and equipment beyond the point where it can operate efficiently, would that not point towards an increase in prices and an inflationary trend?

Dr. HELLER. It could tend to do so. One has to strike an average for industries to start with. I use the figure of 92 percent because that is what plant managers themselves have said, in surveys by McGraw-Hill, in particular, that they regard as their optimum or most efficient operating level. Now, if they are right that means that on the average we can expand from the 87 percent to the 92 percent rate—5 percentage points—and still increase efficiency, and reduce unit costs of production in the process. There is no question but that this average cannot be applied to every industry.

In some industries——

Senator JORDAN. Not across the board.

Dr. HELLER. Not across the board. Some industries are going to have higher costs as a result.

Senator JORDAN. Thank you.

Representative REUSS. Senator Pell?

Senator PELL. Thank you, Mr. Chairman. Serving with Senator Jordan on the Manpower Committee, I very much support that line of questioning, because there is no more important element in our economy than human beings and, in fact, that is the end objective of our discussions.

As you know, Dr. Heller, I am among those who have some reservations on the tax cut. However, I have been exposed to so much testimony on the part of such able witnesses the past couple of years here that on balance I believe it would probably be in our Nation's interest to pass it.

In connection with the tax cut at this time, when we are both running a deficit and when we are booming along, from a statistical viewpoint, I was wondering if you felt that any compensatory action which might be taken by the States to increase their taxes when Federal tax rates decline, would take some of the life out of this proposal, some of the bubble out of the champagne.

Dr. HELLER. This is an important question. Let me state my conclusion first. I really don't believe that there will be a significant offset from the State-local sector to the impact of the Federal tax cut, and I would like to say why. State and local units are spending all of the tax dollars they are getting, and then some.

Now, some of the expanding incomes resulting from the impact of the tax cut will be going into State and local coffers just automatically, at existing tax rates. The study by the Treasury for your committee I believe showed this was well over $2 billion. That will increase their capacity to meet their very heavy responsibilities.

Secondly, they are, of course, increasing their tax rates continually, but their added receipts are being immediately spent for new schools, teachers, roads, and all the rest. That spending has just as much effect in stimulating the economy as if you or I or an industrial firm put our Federal tax savings into either consumption or plant and equipment spending.

Senator PELL. To interrupt for a moment, though, following your argument to its conclusion, couldn't one say we should raise the Federal tax structure to be able to put more money into roads, training, and so forth?

Dr. HELLER. Through the stimulus to the economy that will come from the tax cut and through the direct support of State and local revenues, as well as the indirect effect, we will in due course achieve that objective—we will have a stronger base on which to build both State, local and Federal, programs. I think our prospects for that are a good deal better with the tax cut than without, because of its stimulative effect on the economy.

Senator PELL. As you know, I followed with interest the tax reforms that have been offered by the administration, particularly the dividend and interest withholding tax, and I understand we should wait some years to see if the present voluntary reporting works. But won't the cut in your opinion reduce the possibility of further tax reform? Isn't this sugarcoating the pill without the bitter contents?

Dr. HELLER. That is a very tough question and goes well beyond economics into the question of, shall we say, congressional balance of considerations in dealing with taxes.

I think that the 1962 measures and the 1964 measures to come do represent a heartening reversal of trend in terms of the reform side of the tax structure. In other words, there is a good deal more restoration of base than there is undercutting of base. Tax reform is a long and hard process. It has sometimes accompanied tax increases, sometimes accompanied tax decreases, and it has sometimes been paired with increases and decreases.

Senator PELL. With regard to the genuine effort that was made in 1954 to overhaul the tax structure, while the revised rule book was thick when it came out, it was still thinner than it had been before. What was the general effect? Did they tighten up or loosen up?

Dr. HELLER. I think it is hard to strike a balance, and the very fact that it is hard to strike a balance is an answer to your question.

It was not a very substantial tightening up over all, because at the same time that many specific loopholes were closed, certain provisions were also made for somewhat more generous tax treatment in the base of the income tax. So it is hard to strike a balance.

Senator PELL. Thank you.

One other final question and a very general one. Not being an economist and finding the Joint Economic Committee somewhat like a concentrated course in our much-vaunted free economy, I was wondering if you could give me a horseback guess how much subsidy is paid to industry in the form of agriculture, tariffs, and Government support?

Dr. HELLER. I am sorry to say I don't have even the horseback guess.

Senator PELL. I think it would be interesting for the record to have an idea.

Dr. HELLER. We will do our best.

Senator PELL. Thank you.

(Subsequently, the following information was submitted:)

The most up-to-date comprehensive study in this area is one made by the Joint Economic Committee, 86th Congress, 2d session, titled "Subsidy and Subsidylike Programs of the U.S. Government." Chapter III of that study notes, "* * * it is probably impossible to make an estimate of the total subsidy payments of the Federal Government during any single year that would receive general acceptance." However, the study does present a variety of useful figures on subsidy programs.

Representative REUSS. Gentlemen, both Houses are now in session and I might ask if we can take a little census to see how much time we think we will take, so we can make a decision whether to go over to this afternoon without limiting anyone.

Representative CURTIS. I think we could finish by 12:30.

Representative REUSS. Does anyone disagree with that markedly?

Senator MILLER. I would like to have about 10 more minutes.

Representative CURTIS. That is what I want.

Representative REUSS. Is it agreeable for you to go on for another possible half hour, as agreeable as possible under the circumstances?

Dr. HELLER. At your pleasure. We meant it when we said this is a pleasurable occasion.

Representative REUSS. Then, Mr. Curtis.

Representative CURTIS. Mr. Chairman, I have asked our minority staff to prepare a little memorandum on the Economic Report, which incidentally I had distributed to you and the press. Particularly, this analysis is more or less directed to the point that we see inflationary forces here that possibly cannot be withheld. Dr. Heller, you and I have had exchanges before on this question of so-called idle-plant capacity, and I have tried to make the point that I felt a great deal of that which we were calling idle was obsolete and at best inefficient. In our memo, we set out some of these points, and I guess the theme would probably be expressed this way.

In several analyses we have noticed that the annual average operating rate of industry is now equal to the rate in the last quarter of 1955, just before the 1955–56 capital goods boom.

Incidentally, I want to make this point: McGraw-Hill for the first time, I believe, in their survey of plant capacity asked manufactures the question, "How much of your plant do you think is obsolete or inefficient?" The answer was 22 percent. I don't think there is any question that the businessmen would be happy to use a certain amount of inefficient plant because they gain up to a point, even though they wouldn't go on with costs.

This point is further brought out by a speech Secretary Hodges delivered on January 17, 1964, before the industrial modernization conference in Oklahoma City.

On page 4 of this, Secretary Hodges says:

New data analyses our Census Bureau is making point up these facts. They show in industry after industry that productivity of the most efficient firms is two to four times that of the average. Please note that they are two to four times that of the average, not the very least efficient.

So I think that is is important, and you could develop answers to the statements that we have set out in this analysis, but would you care to comment on this point. You say that the average now is 87 percent, but don't we have to look into the composition of that average? And this inefficient, obsolete aspect of it is a very serious one.

Dr. HELLER. I certainly agree that this is an important question. Of course, modernization of our industrial capacity was the prime objective of the 1962 tax changes—the investment tax credit and depreciation liberalization—and certainly is a major objective of the corporation tax changes and the other changes in the tax law now being contemplated. We would hope to speed——

Representative CURTIS. I am not relating it to that. I am relating it to the problem we have as to whether or not these expansionary forces will be running up against this, and you won't have this effect sopping up new demand.

You were talking about the capacity to absorb inflationary forces because of the unused plant capacity. You are now telling me you encourage further automation and further improvements to efficiency. Direct it to the point, please.

Dr. HELLER. But this is really directed to that point. Take the steel industry, for example, which is moving ahead at a rapid and encouraging pace to overcome the problem of obsolescence that it was facing a couple of years ago. They are going ahead by leaps and bounds in improving in their plant and in their technology.

Representative CURTIS. Exactly. At the very time you were pointing out, too, that they were only operating at, what was it, 60 percent capacity. The point I was making at the time in the steel hearings was that this so-called idle-plant capacity is largely inefficient and obsolete. That really should not be used and is therefore not available as a cushion against inflationary forces.

Dr. HELLER. They are a very good example of what is happening. I think we have reversed the trend of industrial machinery and plant and equipment getting progressively older.

We are seeing, I believe, a turnaround in this at the present time. Beyond that, just taking the existing capacity, we have tried to look not just at the aggregates but we have also talked with people in some of the very high production industries, such as automobiles, aluminum, and computers.

The presidents of many of these corporations have given us very encouraging responses about their ability to increase production without an increase in their average cost per unit.

Representative CURTIS. This is the point, all right, and what I will do is again direct your attention to this body of study for further development.

I would like to move on to one other point. As we move forward with automation, this creates a higher incidence of frictional unemployment; does it not?

This is one of the penalties—I don't call it a penalty—one of the costs of economic growth; isn't it?

Dr. HELLER. It is one of the problems created by faster productivity advance. You displace more people each year and you have to provide more new jobs each year; that is correct.

Representative CURTIS. Now we come over to the same area in the labor force, where you are counting on the so-called idle labor force to absorb these inflationary pressures. I would suggest to you that the talk of a 35-hour week and of increasing overtime reveals that there are already bottlenecks in the labor force because the demands are for skilled labor, not for just labor. The fact remains the problem is training and retraining. Increasing the overtime probably, unless we could pick it up to productivity elsewhere, will increase the costs. Our experience shows it doesn't provide less overtime because the need is for skilled laborers, laborers with skills. In this little memorandum that I had prepared, there is reference to a paper of Dr. Charles Killingsworth in which he points out the serious manpower bottlenecks that would come, which is the effect of inflationary forces.

(The memorandum referred to is as follows:)

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
January 21, 1964.

MEMORANDUM

To: Minority members of the Joint Economic Committee.
From: Donald A. Webster, minority economist.
Subject: President's 1964 Economic Report.

After studying the President's Economic Report, I think it is open to serious criticism as a "boom and bust" program that would overstimulate the economy in 1964, followed by a sharp dropoff in stimulus in 1965.

The administration is moving some of the stimulus originally planned for 1965 into 1964. It is doing this at the same time as it claims to be reducing 1965 Federal expenditures. The purpose apparently is to insure against recession in 1964 at any cost.

By abandoning the path to balanced and sustainable growth, the Johnson program would be likely to lead to renewed inflation that would offset the stimulus of tax reduction. In 1965, the administration's program threatens to cause a sag in economic activity that undoubtedly would be met by new and heavy Federal spending which would render the 1965 budget estimates meaningless.

I believe this should be the core of our position in the hearings on the report which begin on Thursday.

Specifically, my reasons for thinking that the 1964 stimulus will be too great, followed by too large a dropoff in 1965 are as follows:

1. Federal purchases of goods and services will rise in 1964 by about $2.5 billion. According to the new budget, they should level off in 1965.

2. The tax cut will reduce individual tax payments by $8.8 billion in 1964, as well as sharply reduce corporate tax liabilities. The proposed liberalization of the 7 percent dividend credit is a further incentive for stepped-up investment spending. In 1965 the second stage of the tax cut will amount to less than $4 billion, but this will not be fully felt because the withholding rate will already have been dropped to 14 percent.

3. The President's proposal to decrease immediately the withholding rate to 14 percent shifts a good deal of economic stimulus from 1965 to 1964. (This is less true for each month beyond February that the tax cut is not in effect.) Budget figures show that lump-sum tax refunds in 1965 will drop nearly $2 billion as a result, or to $3.7 billion from the $5.1 to $5.6 billion range of 1962–64. At the same time, individual income tax collected (other than that withheld) will increase in 1965 by $1.8 billion, or to $16.7 billion, compared to a range of $14. 3 to $14.9 billion in 1962–64. The combined effect would be sharply stimulative in 1964 and restrictive in 1965.

4. The actions referred to above will take place at a time when the economy is already experiencing vigorous expansion. The increase in GNP in the fourth quarter of 1963 was larger than in any other quarter of the year. Thus far, no signs of a slowdown in the expansion have appeared.

5. Price increases are already beginning to show up, as noted by the President. Overheating the economy in 1964 will surely lead to further pressure on prices. In contrast to what the President assumes, all price pressures by no means originate in market power exercised by unions and business.

The fact of the matter is that there is little plant capacity or idle manpower which can be readily absorbed in a new wave of expansion.

As we have repeatedly tried to point out, many industries are already operating at or close to their preferred operating rate. In others, the excess capacity is very often technologically outmoded or capacity to produce products for which there is no longer demand. McGraw-Hill last year pointed out that 22 percent of all manufacturing capacity was technologically outmoded. The National Machine Tool Builders Association has said that 64 percent of all American metal cutting and forming tools are obsolete. The Machinery and Allied Products Institute has said that the average age of the Nation's production equipment is now 9.6 years, up from 8.5 in 1955.

Analysts have also noted that the annual average operating rate of industry is now equal to the rate in the first quarter of 1955, just before the 1955–56 capital goods boom. A further inflationary factor is that once operating rates move much above 90 percent, production becomes less efficient and more costly. A large new surge in demand would bring less efficient facilities—and more costly facilities—into use. It would lead to severe pressure on industries now operating close to economic capacity. The result could be price increases that could "spill over" into other sectors of the economy.

As to idle manpower, the unemployment figures clearly show where the problem lies. In December, the seasonally adjusted rate of unemployment for married men was 3.4 percent; for men 20 years and over, 4.4 percent; for women 20 years and over, 5.2 percent; and for teenagers, 14.8 percent. A new wave of vigorous expansion, as Prof. Charles Killingsworth, of Michigan State University, has pointed out, could lead to serious manpower bottlenecks throughout the economy that would tend to put upward pressures on wages. The fact that organized labor has been planning to seek new wage gains this year testifies to its recognition of the better bargaining position which it now enjoys.

6. The administration has made clear that it wants no tightening of money in 1964. It has warned against tightening interest rates as "self-defeating."

7. The administration states that the stimulus in 1964 from its fiscal program will be three times greater than that of any of the 3 previous years.

The administration—even while warning against the dangers of inflation this year—clearly is maximizing the chances of it occurring. President Johnson's policy of wage and price restraint by admonition is not likely to be effective in the face of strong economic forces that will be at work. In some respects, they may be seriously damaging, as the steel case last year showed.

Consequences of following a "boom" policy in 1964 is that there could be a "bust" in 1965. By that time, Government expenditures presumably will be leveling off. Only a small part of the tax cut will remain to be put into effect. Some of the stimulus of the tax reduction may have been offset by inflation. Industry will have put in place much new capacity. Lower tax refunds and larger tax collections (other than from withholding) in the spring of the year will exert restraint on the economy.

In short, instead of a balanced and sustainable expansion, the administration is inviting inflation and other excesses in its effort to pack most of the stimulus of its fiscal program into 1964. It is gambling that expansion will continue in 1965 in spite of a sharply reduced stimulus from fiscal policy. If that fails to happen, we can be sure the result will be the scrapping of the current estimates for the 1965 budget expenditures and a new surge of Federal spending to stave off any economic decline.

Representative CURTIS. At any rate, I wanted to direct attention to those things, because herein lies, I think, an area of disagreement between your analysis and at least my analysis. Possibly it could be resolved somewhat by further study into both of these areas to see how much of this unused plant capacity really could be absorbed and how much of this idle labor really could be picked up, considering the problem we have of skills.

And then one final thing on this: I do have what I think is a beneficial suggestion. It was called to my attention, I might say, by our able executive director, Mr. James Knowles. Instead of talking in terms of reducing the workweek and even overtime, let's consider reducing the work year. There is a movement toward cutting back—

increasing vacation time. I found that private employment agencies have grown up whose sole service is providing employees to fill in temporarily during these vacation periods. I do think that this, going along with a productivity increase, would help by providing more jobs. But I would certainly dislike to see—and I am pleased with the administration's resistance to—the 35-hour workweek.

Dr. HELLER. May I say particularly on that last point that I think we are entirely in agreement. A reduction of the workweek that comes naturally, so to speak, as a trend toward more leisure—that is, taking some of our higher standard of living in more vacations and in a lengthening of the vacation period—is entirely welcome. Agreeing that this is a desirable trend is not inconsistent with opposition to an arbitrary and artificial drop to a 35-hour week.

Representative CURTIS. The identification of it as a workweek instead of, as I have identified it, as a work year, relates more to what we recognize as the vacation. That is why I suggested that it should be the work year, which is what is occurring rather than I think the 3-day week kind of thing.

Dr. HELLER. I think that is a good shift of emphasis to take these factors into account.

Representative CURTIS. Thank you.

Representative REUSS. Dr. Heller, in the President's Economic Report, he refers to the Federal funds to be devoted to the war on poverty. He speaks of, and I quote, "over $1 billion of new funds in the first year." You started to break that down, but I wonder if you can give us a somewhat more complete breakdown. I have difficulty locating the billion dollars.

Dr. HELLER. I will do my best, Mr. Chairman. The new budget lists the following proposals for new obligational authority.

Representative REUSS. New obligational authority.

Dr. HELLER. New obligational authority directed specifically to the war on poverty. The proposed new antipoverty legislation—the community action program—would authorize expenditures of $500 million. In addition, there would be over $330 million appropriated for other new legislation closely related to the war on poverty. Third, there would be earmarked from existing programs, roughly, $360 million also to be put at the disposal of this more sharply focused war on poverty, for a total of over $1 billion of new obligational authority to be used; carrying out comprehensive local programs in areas of concentrated poverty.

Representative REUSS. I have a little difficulty understanding that third category; existing programs, as constituting new funds. What is new about that third category?

Dr HELLER. Well, what is new about it is the way in which it would be applied to this problem, by being channeled into local communities as part of comprehensive and coordinated community action programs. No one denies what has been suggested; namely, that we have hundreds of millions, indeed, billions of dollars of expenditures that in one way or another bear on the problem of poverty, whether it be in education programs or health and welfare, and so on. And this is a case of trying to make more effective use of funds from existing programs, so that——

Representative REUSS. If I may interrupt at this point, if you are going to count existing programs, actually the third lump should be much larger. I think I could undertake to prove that there are billions in the budget, the impact of whose expenditure is to alleviate poverty.

Dr. Heller. I completely agree. All I am saying is——

Representative Reuss. How do you segregate out this $360 million?

Dr. Heller. This is simply an allocation that would be made for the attack on poverty through the coordinated community action programs. Thus it would be mobilized in a new way. And may I say again, of course, that I am here dealing with a subject on which the Budget Director will be able to give you much more precise answers.

Representative Reuss. I find that third category a little metaphysical. I wonder what it was proposed to do with that $360 million before the attack on poverty. I am sure it wasn't intended to waste it, and I would have thought that that is precisely what it would be used for in any event.

Dr. Heller. There will be a significant redirection of it. I find myself under somewhat of a handicap by the fact that program details have not yet been made completely final. As I say, the Budget Director will be able to take this out of the metaphysical and bring it down to the empirical, so that you will have a firmer answer than I am able to give you at this time.

Representative Reuss. Fine. I will withhold further questions until Mr. Gordon is with us.

However, one last question to which you may know the answer: This $1 billion of new funds, is this all to be spent in fiscal 1965?

Dr. Heller. The fiscal 1965 expenditures would be in the order of magnitude of just under $600 million.

Dr. Heller. The fiscal 1965 expenditures would be in the order of magnitude of just under $600 million.

Representative Reuss. Only about half would be spent——

Dr. Heller. Only about half of the funds appropriated would be spent in the first year. This recognizes the reality that it takes time to start up a new program and to make sure that funds are spent effectively and efficiently. Obviously this amount is not sufficient to root out the problem of poverty. No one has any illusions on that.

Representative Reuss. Senator Miller?

Senator Miller. Dr. Heller, we are agreed now that this $100 billion figure should be reduced by $19 billion to get the real GNP of $81 billion. Are you saying, then, that we have had $19 billion of inflation in the last 2¾ years?

Dr. Heller. There has been an advance in the GNP deflator, to be precise, of about 1½ percent per year. That is, the average increase in prices of all components of the gross national product has been about 1.4, 1.5, or 1.6 percent per year. This figure, by the way, probably does not take full account of such advances as are made in the quality of the products that are being produced. Studies by several economists suggest that improvements in quality really offset a good part of that.

Nevertheless, accepting the adjustment, for price changes, brings the figure down from a 20-percent increase in money terms to a 16-percent increase in real terms.

Senator MILLER. So that we have had $19 billion of inflation during the last 2¾ years.

Dr. HELLER. I tried to indicate that because of the advances in quality, I would not want to label this as inflation. There has been that amount of price change in the products involved; yes.

Senator MILLER. Well, isn't that pretty much what we mean when we talk about the inflation, that this retail price index has gone up? Isn't that what happens when we have these escalator clauses over in Detroit when the retail price index goes up, that the employees automatically get a wage increase, and the idea behind that is so that they will have more dollars, although they will be worth less, just to enable them to keep even?

Dr. HELLER. That their cost of living has gone up about 1.2 percent a year on the average in recent years.

Senator MILLER. So this represents $19 billion of what I suppose we could logically refer to as inflation in the 2¾ years, isn't that right?

During that period of time we have added to the national debt, had deficit spending of around the same figure, haven't we, $19, $20, $21 billion?

Dr. HELLER. I'm sorry. Over the——

Senator MILLER. During the same period of time we have had an addition to the national debt from deficit spending of about the same figure.

Dr. HELLER. Yes. At the same time, however, the national debt as a ratio to our total product steadily went down.

Senator MILLER. I understand, but what I am getting at is this. Say $19 billion of inflation, $19 billion of deficit spending. Now, President Johnson has presented the Congress with a budget deficit of about $5 billion. On that basis, on the basis of the last 2¾ years, do you gentlemen have any estimate of how much inflation we may expect during the next fiscal year with that $5 billion deficit budget?

Dr. HELLER. The assumptions that go into our projections of GNP are essentially a continuation of the movement of the GNP deflator that we have had in the past 3 years.

Senator MILLER. So that we might expect $5, $6, or $7 billion additional inflation during that period of time. Is that correct?

Dr. HELLER. In other words, we would have to subtract from the increase in money GNP $5 billion or so.

Senator MILLER. Yes.

Dr. HELLER. For the rise in the GNP deflator, in order to get the relevant 5-percent real increase which we gave you in our statement.

Senator MILLER. Yes.

Dr. HELLER. That is correct.

Senator MILLER. Now, if we did not have the tax cut go into effect this year, the President could have presented a balanced budget, or if anything, even a surplus budget; could he not?

Dr. HELLER. We do not believe so, Senator. We believe that without the tax cut, we would have run a very substantial risk of flattening out—possibly a recession or downturn—in the latter part of this year. We have had a long sustained expansion. That doesn't necessarily mean we have to have a recession, in the absence of additional stimulus. But looking at past history, looking at the forces of expansion that currently exist in the private economy, the very great likelihood is that, without the stimulative effect of the tax cut, we would have an economic downturn that would create a much bigger deficit.

We recall, of course, the 1959 fiscal year deficit which was projected as a $500 million surplus and turned into a $12 billion deficit primarily because of the onset of recession. Recession is the most costly thing that we could have in terms of adding to the national debt, and one of the basic——

Senator MILLER. We have no disagreement over that at all. My view is that, if our economy continued to expand as it has in the last 2 or 3 years without a tax cut, we could expect a balanced budget for this year. Now, if you say we can't or at least it is unlikely, then you must be saying that without a tax cut we cannot expect the economy to go ahead at the same rate as it has been going.

Dr. HELLER. I am saying that, without the tax cut, we could not expect the economy to move ahead at the same rate that it has been going, indeed, even without allowing for the disappointment effect. We would face the likelihood of a tapering off and possibly even a downturn. The President noted in his message that we would have to put the gross national product for 1964 at $10 to $15 billion lower without the tax cut. This, of course, would have an enormous impact on revenues.

Senator MILLER. It is possible, though, that the economy might continue on at the same rate without a tax cut; is it not?

Dr. HELLER. Well, if you put it within the whole range of possibilities, one has to say anything is possible. But we have——

Senator MILLER. Of course, in a year——

Dr. HELLER. But in advising the President, we have to deal with what is most probable in terms——

Senator MILLER. Well, is it any less probable today that the economy will continue on at the same rate without a tax cut than it was a year ago?

Dr. HELLER. I should think so; yes.

Senator MILLER. When we were being told the same thing——

Dr. HELLER. I should think so; yes. We have had, of course, the buoying effect of the expectation of the tax cut during 1963. I don't think that is a factor that can be dismissed. If you were to remove this anticipation effect, the disappointment could have a very sharp reaction. Business confidence is a very important factor in the continuation of our expansion.

Senator MILLER. Doctor, we had that buoying effect over a year ago when the tax cut was talked about and still our economy has gone right ahead as has been pointed out here today. I don't know that the buoying effect has been particularly responsible for this. Possibly the investment tax credit which was enacted by Congress last year had something to do with that. I have heard a lot of talk about this expectation but I am not sure that it has been any greater than it was a year ago. I haven't observed a lot of people investing money in anticipation of the tax cut or a lot of people spending money in anticipation of the tax cut.

Dr. HELLER. I think the main impact of it probably is in terms of business expectations. We have consulted very carefully with our business advisory committees and individuals, and they are pitching a good many of their plans to this anticipation. Once the tax cut has become a reality, they are very likely to readjust their plans upward.

Senator MILLER. Thank you very much for your responses.

I would like to ask consent to have a table entitled "Monthly Personal Income in the United States," which includes agricultural income, appearing in the business news reports from the U.S. Department of Commerce, the year 1963, released January 20, inserted in the record.

Representative REUSS. Without objection, so ordered.

(The table referred to follows:)

Monthly personal income in the United States

[Seasonally adjusted annual rates in billions of dollars]

	December 1963	November 1963	October 1963	December 1962	November 1962	October 1962	Full year 1963	Full year 1962
Total personal income	475.2	472.6	471.2	452.1	449.9	447.7	463.0	442.1
Wage and salary disbursements, total	320.3	319.2	318.7	302.9	301.5	300.1	312.3	297.1
Commodity-producing industries	126.9	126.2	126.3	119.6	119.9	119.4	123.8	118.5
Manufacturing only	100.9	100.2	100.2	94.9	95.0	94.6	98.3	94.2
Distributive industries	81.0	81.0	80.9	78.4	77.5	77.4	79.8	76.6
Service industries	50.8	50.6	50.4	47.7	47.3	47.1	49.5	46.4
Government	61.6	61.3	61.0	57.3	56.9	56.3	59.3	55.6
Other labor income	12.8	12.8	12.8	12.4	12.3	12.3	12.6	12.1
Proprietors' income:								
Business and professional	38.3	38.2	38.2	37.0	37.0	36.8	37.7	36.5
Farm	12.5	12.6	12.7	13.5	13.4	13.3	12.8	13.3
Rental income of persons	12.2	12.2	12.2	12.0	12.0	12.0	12.1	12.0
Dividends	19.8	18.5	18.2	17.7	16.9	16.8	17.8	16.6
Personal interest income	33.8	33.5	33.2	31.3	31.1	30.9	32.5	30.0
Transfer payments [1]	37.5	37.6	37.3	35.7	36.0	35.8	36.9	34.8
Less: Personal contributions for social insurance	12.1	12.0	12.0	10.3	10.3	10.4	11.8	10.2
Total nonagricultural income [2]	458.5	455.7	454.1	434.1	432.0	430.1	445.7	424.5
Total agricultural income	16.8	16.9	17.0	18.0	17.8	17.6	17.3	17.6

[1] Consist mainly of social insurance benefits and veterans' payments.

[2] Equals personal income exclusive of net income of unincorporated farm enterprises, farm wages, agricultural net interest, and net dividends paid by agricultural corporations.

Representative REUSS. Senator Jordan.

Senator JORDAN. One question—pursuing the line of questioning of my colleague, Senator Miller. A year ago when we were told that we might expect a depression unless we had a tax cut, we stumbled along throughout the year without a tax cut, and perhaps it was expectation that bolstered up the economy, but we ended up with a gross national product higher than you expected. We were told also a year ago that if we made any substantial reductions in Government spending it would be disastrous, it would be deflationary. Comes now the same proposition and we are told that if we don't get a tax cut now, we are on the verge of a depression. But the story has changed with respect to Federal spending. We are given now what is called an austere budget.

Now, have we removed the emphasis we put on big Government spending? A year ago we were told we couldn't cut this budget and it has been cut substantially by this Congress, probably not enough, but it was cut substantially. Now comes an austere budget and we are talking about an austere budget. What is the difference in the change of emphasis there?

Dr. HELLER. Well, operating in terms of the assumptions you have given, there is partly a difference in timing. I do want to repeat, Senator, that we did not predict a recession in 1963 with or without a tax cut. We were unequivocal about that in our report as was the President in the report submitted to the Congress. When he referred to recession it was at an unspecified future date.

A year ago, action on the tax cut was just beginning. We had hopes. I don't know whether I should call them expectations. We had hopes we might have a tax cut by midyear or relatively soon thereafter. Nevertheless, that was 6 or 8 months in the future, and the role of increasing Federal expenditure, therefore, was relatively greater in comparison to the tax cut than it would be this year because presumably we are on the threshold of a tax cut right now.

That is point No. 1. The timing is different.

Second, the change in the timing of the effectiveness of the tax cut makes a very great difference. By dropping the withholding rate from 18 to 14 percent immediately, we get a great part of the continuing stimulus of the tax cut right away rather than waiting for a large part of the second installment in 1965. Consequently, the tapering off and indeed reduction in expenditures for fiscal year 1965 is very greatly outweighed by the effective tax cut in 1964 and enables us to have a greater fiscal stimulus than we have ever had before and makes a cutback in the budget quite consistent with expansionary stimulus from Government's fiscal operations as a whole.

Senator JORDAN. That leads to a question that is frequently asked me and I think I know the answer, but why do we gear our tax cut at $8.8 billion, we will say, for individuals, and $1.4 billion for corporations? If that is good, people say why isn't twice that much twice as good? Why don't we reduce the withholding rate to 10 percent rather than 14 percent?

Dr. HELLER. Senator, this bears directly on the exchange I had before, with Senator Proxmire in particular. One has to gear changes in fiscal policy to the productive capacity of the economy, to the manpower, and productive machinery, and plant and equipment that are available; one must judge how much of the stimulus can be reflected in increased production and income, and jobs and profits, and how much of it would just simply run off into inflation. We think this program is of such size and timing as to utilize the unused capacity and not run off into inflation.

Of course, many of our critics say that productivity is advancing so fast we are not even going to be able to use——

Senator JORDAN. Any less would not be enough and any more would be too much.

Dr. HELLER. Economic science isn't that perfect.

Senator JORDAN. I wonder what the tolerance for error is.

Dr. HELLER. I have great faith in the American productive system. This is an enormously ingenious and productive society, and if there is more demand, our free enterprise system will find ways to meet it.

Senator JORDAN. I think the last year's results have borne out your statement. Thank you.

Representative REUSS. Thank you very much, Dr. Heller, for your superb presentation, as usual, and for that of your colleagues. We will be seeing you again.

This committee will adjourn now and resume hearings in this room at 10 o'clock Monday morning when we will hear Budget Director Kermit Gordon.

(Whereupon, at 12:35 p.m., a recess was taken until 10 a.m., Monday, January 27, 1964.)

JANUARY 1964 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, JANUARY 27, 1964

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

The joint committee met, pursuant to recess, at 10 a.m., in room 1114, New Senate Office Building, Hon. Paul H. Douglas, chairman, presiding.

Present: Senators Douglas (presiding), Proxmire, and Jordan; and Representatives Patman, Reuss, and Curtis.

Also present: James W. Knowles, executive director; Hamilton D. Gewehr, administrative clerk; and Donald A. Webster, minority economist.

Chairman DOUGLAS. The committee will come to order.

We are very happy to have the Director of the Bureau of the Budget, Mr. Kermit Gordon, with us this morning.

Please proceed in your own way.

STATEMENT OF KERMIT GORDON, DIRECTOR, BUREAU OF THE BUDGET; ACCOMPANIED BY ELMER B. STAATS, DEPUTY DIRECTOR; CHARLES L. SCHULTZE, ASSISTANT DIRECTOR; AND SAMUEL M. COHN, DEPUTY TO THE ASSISTANT DIRECTOR FOR BUDGET REVIEW

Mr. GORDON. Thank you, Mr. Chairman. I would like first to introduce the people accompanying me.

On my right is Mr. Elmer Staats, Deputy Director of the Bureau of the Budget.

Chairman DOUGLAS. An old friend.

Mr. GORDON. On my left is Mr. Charles Schultze, Assistant Director——

Chairman DOUGLAS. Another old friend. We are glad you brought him.

Mr. GORDON. And on his left, Samuel Cohn, Deputy to the Assistant Director for Budget Review.

I am mindful that you asked witnesses to hold their statement to a half hour. I am afraid the statement I have prepared for the committee is somewhat longer than that. I would like, if you are agreeable, to submit the entire statement for the record and to read just parts of the statement.

Chairman DOUGLAS. Thank you.

Mr. GORDON. Mr. Chairman and members of the committee, it is a pleasure for me to appear before you today to discuss President

Johnson's first budget. There are four topics I should like to comment on: The fiscal strategy of the 1965 budget, the program strategy it reflects, measures taken to achieve greater economy and efficiency, and, finally, improvements in budget presentation.

FISCAL STRATEGY OF THE 1965 BUDGET

The fiscal strategy of the 1965 budget is based on three propositions:

(1) The American economy, despite 3 years of strong expansion, is still operating significantly below its comfortable potential—both with respect to its labor and capital resources.

(2) These circumstances call for a budget which will spur the expansion of the economy and help to narrow the gap between actual and potential output and employment.

(3) In its combined tax and expenditure policies, therefore, this is a strongly expansionary budget, which relies principally upon stimulus to the private sector of the economy as a means of achieving full prosperity.

BUDGET TOTALS

Table 1 gives a summary of the budget totals according to the three principal budget concepts—administrative, consolidated cash, and national income basis.

(Table 1, referred to, follows:)

TABLE 1.—*Budget totals*

[Fiscal years; in billions]

	1963 actual	1964 estimate	1965 estimate
Administrative budget:			
Receipts	$86.4	$88.4	$93.0
Expenditures	92.6	98.4	97.9
Deficit	−6.3	−10.0	−4.9
Consolidated cash budget:			
Receipts	109.7	114.4	119.7
Expenditures	113.8	122.7	122.7
Deficit	−4.0	−8.3	−2.9
National income basis:			
Receipts	109.3	113.6	118.8
Expenditures	112.6	119.1	121.5
Deficit	−3.3	−5.5	−2.8

Mr. GORDON. The 1965 administrative budget totals show receipts of $93 billion, expenditures of $97.9 billion, and a deficit less than half that of the current year. Expenditures in 1965 are almost $1 billion lower than those estimated last January for 1964, and are $500 million below our latest estimates for 1964.

On the more comprehensive consolidated cash basis, 1965 payments to the public are estimated at $122.7 billion. Other outlays, on balance, will rise by enough to offset the $500 million decrease in administrative budget expenditures. Cash receipts will rise from $114.4 to $119.7 billion; the cash deficit will fall from $8.3 billion in 1964 to $2.9 billion in 1965.

Federal expenditures in the national income accounts will rise by $2.4 billion—to $121.5 billion. In the national income accounts, receipts and expenditures are measured as they enter the income and output flows of the economy. Loans and other transactions which do not directly affect income or output are therefore excluded. Since the net volume of Federal lending in 1965 is much lower than in 1964, the national income account expenditures rise by a larger amount than either administrative budget or cash expenditures.

Within the total of Federal national income account expenditures, the two major categories are "purchases of goods and services" and "transfer payments." In fiscal year 1965, direct Federal purchases of goods and services—that part of the Nation's total output of goods and services used by the Federal Government—are estimated at $69.1 billion, an increase of $1.3 billion over 1964. These purchases will represent less than 11 percent of the gross national product, just under the 11- to 12-percent range of recent years.

In addition, the Federal Government in 1965 will spend $52.4 billion in the form of transfers of purchasing power to other sectors of the economy. This is an increase of $1.1 billion from 1964. These outlays—primarily for such transfer payments as social security and other retirement benefits, veterans' compensation and pensions, unemployment insurance, and grants to States—do not represent a direct Federal demand for the Nation's output of goods and services. They do, however, increase the purchasing power of other sectors of the economy and enable these other sectors to increase their purchase of the Nation's output.

PROGRAM STRATEGY OF THE 1965 BUDGET

Although administrative budget outlays will fall by one-half billion dollars, this is not a standstill budget. It provides, and provides generously, for an expansion of public services in the areas of education training, health, labor, and welfare.

It further provides funds to initiate a major attack on poverty, and for a new developmental program in Appalachia. A growing and progressing nation has an expanding need for public services of many kinds. A budget program which failed to take this into account would not be responsive to the needs of the American people. Yet this fact does not dictate that total budget expenditures must rise each year. There are two major sources of budgetary savings which, if pursued vigorously, can provide funds for the needed expansion of highly desirable programs:

First, existing programs must be subjected to a continuing and searching review in order to avoid unnecessary increases, to prune obsolete functions and installations, and, wherever consistent with national objectives, to substitute effective private or State and local action for Federal action.

Second, the programs which the Federal Government undertakes must be carried out with maximum efficiency. Productivity gains must continue to be made in Government service. Improvements in efficiency stem both from the introduction of major innovations in management and logistics, and from the accumulation of many small improvements forced upon program managers through a firm system of personnel and expenditure control. As a means of inducing management improvement, the ends-means squeeze in Government can be as effective as the cost-price squeeze in business.

In the normal course of events, the savings realized from these two sources—even when vigorously pursued—would provide only a partial, though an important, offset to the necessary increases in expenditures arising out of growing workloads and urgent new programs. In 1965, however, another major source of budgetary savings will be possible. The budgets for the fiscal years 1962–64 provided funds for a very rapid buildup in our military strength. Having reached these higher capabilities, we can now maintain, and, indeed, raise still further these strength levels with lower annual defense expenditures.

Thus, the savings from vigorous and across-the-board program reviews, from major improvements in efficiency, and from the reduction in military outlays, have made it possible both to provide a major increase in certain programs relating to the development of the Nation's human resources, and at the same time to reduce overall budget expenditures. We do not propose—apart from improvements in efficiency—"to do more for less." Rather, we propose to do more of some things, less of other things, and to spend less on balance.

In the following sections I would like to spell out the elements of this budget strategy—both its increases and its decreases.

THE 1964 AND 1965 BUDGETS COMPARED

The central features of the 1965 budget, as it compares to its predecessor, are shown in table 2. As this table makes clear, the expenditure pattern of the 1965 budget is built upon the foundations provided in the preceding budgets of President Kennedy.

(Table 2, referred to, follows:)

TABLE 2.—*The 1964 and 1965 budgets compared*

[In billions]

	Change from prior year (administrative budget)			
	New obligational authority		Expenditures	
	1964 budget document	1965 budget document	1964 budget document	1965 budget document
National defense	+$2.2	−$0.2	+$2.4	−$1.3
Space	+2.0	+.1	+1.8	+.6
Interest	+.3	+.4	+.3	+.4
Subtotal	+4.6	+.3	+4.6	−.3
Health, labor, welfare, and education (including attack on poverty)	+2.1	+2.6	+.9	+.9
All other	−2.0	−1.7	−.9	−1.1
Total	+4.7	+1.2	+4.5	−.5

Mr. GORDON. Defense: The decrease of $1.3 billion in national defense outlays in fiscal year 1965 is now possible because of the great gains in military strength achieved in the last 3 years. A year ago, the budget called for an increase of $2.4 billion in expenditures for national defense. This was a continuation of increases begun 3 years ago designed to raise us to new heights of military power.

The cumulative total of defense expenditures during fiscal years 1962 through 1964 was $17 billion more than would have resulted if the 1961 level had been maintained. The gains in military strength from this increase have been such that further improvements can now be made at reduced annual outlays. For example, in 1965 we will continue to increase the number of Minuteman missiles, Polaris submarines, nuclear attack submarines, and Air Force tactical forces squadrons.

The Department of Defense cost reduction program has made a further major contribution to the drop in defense expenditures. Savings actually achieved in 1963 from this program were well over $1 billion; the rate of saving will increase steadily until it amounts to $4 billion per year in 1967.

Space: The space program proposed for 1965 also stands on the foundation of the major increases in expenditures which have occurred over the past few years. The estimated rise of $0.6 billion in 1965 is only one-third as large as the increase proposed in the 1964 budget, and is the smallest increase in the space program since 1961. The amount proposed for 1965 does not represent any lessening of our determination to put a man on the moon in this decade. Rather, it represents the achievement of a level of effort toward which we have been building for several years.

Interest: Uncontrollable interest charges are up in 1965 by approximately the same amount as estimated in last year's budget.

These three sectors of the budget—defense, space, and interest—were estimated to require an expenditure increase of $4.6 billion in the 1964 budget document. In 1965, outlays for these programs are estimated to decline by $0.3 billion. This sharp reversal makes it possible in 1965—within the limits of a hold-the-line budget—to place greater emphasis on programs which respond to urgent human needs.

OTHER MAJOR EXPENDITURE DECREASES

In addition to defense, a major source of expected savings in 1965 is an intensification of our successful policy of substituting private for public credit wherever feasible. During fiscal year 1963, over $1.1 billion of mortgages and other financial assets were sold from the portfolios of Federal agencies to private lenders. These sales are expected to increase to $1.6 billion in 1964 and to $2.3 billion in 1965, reducing net expenditures by these amounts. The increase estimated for 1965 partly reflects proposed legislation to authorize sales of certificates of participation in pools of loans owned by the Federal National Mortgage Association and the Veterans' Administration. Sales of these certificates, estimated at $300 million in 1965, will help to broaden private participation in housing loans by attracting private investors from areas outside the mortgage market.

Decreased production of cotton, feed grains, and tobacco, as compared with the exceptionally high 1963 (crop year) levels, are expected to reduce Commodity Credit Corporation expenditures by about $500 million. Savings of about $230 million will also result from proposed legislation relating to our programs for cotton and dairy products, which will shortly be spelled out in a special message to the Congress.

MAJOR EXPENDITURE INCREASES

Aside from a rise in expenditures by NASA of about $600 million and in interest payments of about $400 million, expenditure increases in 1965 are concentrated primarily in those areas which contribute to the development of human resources, and which closely relate to the President's decision to initiate an all-out attack on poverty. These areas—such as education, manpower training, health, and youth employment—will complement our effort to spur economic growth through tax reduction. The latter will provide a sharp increase in job opportunities. The former will help to equip the unemployed and the young people of America with the education, skills, and physical vigor to fill those jobs productively.

The attack on poverty: The budget provides $500 million in special funds for launching a major attack on poverty in the Nation, for which the President will shortly propose legislation to the Congress. To strike effectively at chronic poverty, we must break the vicious cycle in which the ignorance, disease, and squalor of this generation's poor are passed on to the next.

There are already a number of existing programs directed toward this end, but the key to this attack will be a joint Federal, State, and local effort to concentrate their various resources at the community level for a planned assault on the root causes of poverty, particularly as they affect the younger generation.

Funds will be sought to enable local communities with major pockets of poverty to develop intensive and concerted action programs. Funds to supplement existing Federal activities, and to develop new approaches in the areas of education, training, health, and other community services, will be requested to provide these action programs with the weapons they need to be effective. Other legislative proposals—for example, the Youth Employment Act, the National Service Corps, the community work and training bill, the new omnibus housing bill, and particularly a new proposal for special educational project grants—will also provide new authorities and funds which can be woven into the local community action programs. Taking into account the $500 million in special funds, the funds from the other related new legislation—mentioned above—and funds under ongoing Federal programs, we estimate that over $1 billion of new obligational authority can be made available in fiscal 1965 for these coordinated community action programs.

Education: Education expenditures will increase by about $350 million over 1964. The budget provides for funding a number of new education measures, principally those recommended last year which are still under consideration in the Congress. While the program covers the broad range of education from elementary schools to adult education, it is selective in the choice of specific areas requiring Federal help. Among the most important elements of the education programs are:

Strengthening our elementary and secondary school system through grants for increased teachers' salaries and for classroom construction.

Expanding the fellowship program under the National Defense Education Act to help meet the need for highly trained college teachers, scientists, and others.

Providing work-study and student loan insurance programs to help assure that no qualified student is denied an education because of financial need.

Training: Efforts to increase training and employment opportunities for unemployed workers and youth account for substantial increases in budget expenditures estimated for 1965. For example:

The budget provides for increased expenditures of nearly $200 million to finance programs authorized by the broadened and expanded Manpower Development and Training Act. Under these programs, more than 275,000 unemployed workers will be trained in 1965, including many youths found unqualified for military service. Of the total, an estimated 60,000 workers and youths will receive basic literacy training in order to enable them to move on to regular vocational training.

Under the proposed Youth Employment Act, for which 1965 expenditures are estimated at nearly $100 million, work and training would be provided for 60,000 youths next year through conservation work camps and work projects in local communities.

Complementing these manpower programs is an expanded program for vocational rehabilitation. Funds are proposed to restore 133,000 individuals to economic independence in 1965, an increase of 21 percent over 1963.

Health: In the field of health, the most important step to be taken remains the provision of health insurance for the aged through the social security system. Health proposals in the 1965 budget would raise expenditures by $100 million and would include expanded reseah, coconstruction of facilities, and training:

Health research expenditures will increase to support two new Institutes of Health started in 1963, and to provide for the training of additional research personnel, particularly in mental health.

Expenditures will rise as the program enacted last year to ncrease the capacity of medical and dental schools gets underway.

Under a proposed revision and expansion of the Hill-Burton Act, Federal aid for construction of medical facilities would provide help for the modernization of older general hospitals (most of which are in urban areas) and for the construction of facilities for the chronically ill and aged.

Legislation is being proposed to improve and expand nurses' training in order to meet the increased needs for nursing services.

Expenditures will also increase as we move forward in our programs for the mentally ill and retarded under authority enacted last fall.

In sum, the plans and programs of the Federal Government as reflected in the 1965 budget are designed to assure that the priorities given to Government programs square with the problems we face as a Nation.

EFFICIENCY AND ECONOMY

The budget estimates for fiscal year 1965 are based on continued strong emphasis on cost reduction, improved efficiency, and tight control of Federal employment.

I am sure the members of the joint committee are fully aware of the President's personal interest in these matters. I would like to sketch briefly some of the actions that have been taken and some that are planned in order to keep the Government economy program moving ahead.

Automatic data processing equipment: Some of the most impressive savings we identified a few months ago in our report on Government-wide cost reduction efforts resulted from the installation of automatic data processing equipment. Our interest in this area is twofold: to get the maximum improvement in efficiency and economy, and to be sure that these major investments in equipment are handled in the Government's best interests. At the present time, annual executive branch expenditures for procuring and operating ADP equipment run to about $800 million.

We concluded some time ago that in most situations the taxpayer is better off if ADP equipment is purchased outright rather than leased. We adopted this as a general policy and issued purchase guidelines to the agencies. In both the 1964 and the 1965 budgets, we have provided for financing ADP equipment purchases. In fiscal 1964, for example, $254 million is being expended for these purchases, which is about $190 million more than it would cost in the short run simply to lease the equipment. While leasing would have reduced 1964 expenditures, we felt that good business judgment required higher immediate outlays to cover purchases. This action will result in annual savings estimated at $76 million. We expect that the 1965 figures, which are now being compiled, will tell a similar story.

In addition, we believe that savings can be achieved by promoting more sharing of this costly equipment among the agencies. To test this idea, we set up an experimental sharing operation in Philadelphia in cooperation with the regional Federal Executive Board. It worked well enough to persuade us that joint-use arrangements should be extended to other cities where there are concentrations of Federal agencies, and we are in the process of seeing to it that this gets done. Secretary McNamara has initiated similar joint-use arrangements within the Department of Defense, which is our largest single user of ADP equipment, and we expect that his action alone will produce savings of about $7 million a year.

We are, of course, taking steps to avoid proliferation of ADP equipment in Government agencies where the benefits would not justify the cost of purchase. One solution is to set up a computer service center for agencies in the Washington area, on an experimental basis, to retail computer time and service to agencies having an occasional need for computer facilities. The Bureau of Standards has agreed to provide this service, and they are now in business.

Finally, in response to growing interest in the Congress in the problems connected with the growing use of ADP equipment, the Bureau of the Budget has underway a comprehensive study of all aspects of the Government's management of ADP equipment. We expect to complete the study, with the help of consultants drawn from outside the Government, by June 30.

GOVERNMENT EMPLOYMENT

The President has laid great stress on the importance of holding down Federal employment. Even though workloads under both existing and new legislation are continuing to rise, he has made plain his strong belief that we ought to be able to handle this work through increased efficiency and productivity instead of expanding our work force.

While the 1965 budget permits selective increases in employment in some agencies and programs, these are more than offset by cuts elsewhere. The budget figures show a reduction of 1,200 people in total

Federal civilian employment between June 30, 1964, and June 30, 1965.

In fact, employment levels will be below the figures shown in the budget. This is because the President on December 24 directed agency heads to make further reductions wherever possible below the year-end employment targets approved in the budget, and to report to him quarterly on their progress in making better use of their manpower. We have not yet completed our analysis of the agencies' initial responses, but it is already clear that we will end both fiscal years considerably under the budget totals.

This stress on the control of manpower will not diminish merely because the budget has been completed and forwarded to the Congress. For more than a year, under procedures established by President Kennedy, all agencies have been seeking to tighten their use of manpower through better practice.

The Bureau of the Budget has taken the lead in developing techniques for measuring improvements in productivity in Federal operations. In addition, the Bureau, working with the Civil Service Commission and the agencies concerned, has initiated a program of surveys of agency practices in manpower management and control. In the past few months, for example, we have conducted pilot surveys in the Department of Labor and in the Federal Aviation Agency. This year we plan to conduct at least six such surveys.

IMPROVED MANAGEMENT

But the drive to control Federal civilian employment is only part of a basic concern with the total costs of doing the Government's business. Good management also includes good purchasing, good budgeting, good planning, and good cost analysis.

During the past 3 years we have made real progress throughout the executive branch in improving management and reducing costs. A week after succeeding to the Presidency, President Johnson stepped up the pressure by instructing the heads of agencies to give priority attention to management problems and to report to him on prospects for increasing efficiency and reducing costs. These reports are now being reviewed.

The most impressive example of a successful cost-reduction program is, of course, that of the Department of Defense. The first full year of operation under this program was completed last June 30, and the original savings goal of $750 million for fiscal year 1963 was exceeded by actual savings of nearly twice that amount—$1.4 billion. Secretary McNamara's present goal is to achieve recurring annual savings of $4 billion by 1967. The 1965 budget for the Defense Department would have required appropriations of an additional $2.4 billion had it not been for the savings to be realized in that year under Secretary McNamara's program. To take just one example, it was possibile to reduce the Air Force 1965 budget by nearly $500 million through more precise calculation of requirements for aircraft and missile spare parts, reductions in stock levels, and better use of inventories through a worldwide reporting system.

But other departments and agencies have also turned up evidence of a genuine concern for economy and efficiency.

In 1963 the State Department closed 13 consular posts, reducing costs by $500,000 a year.

The Department of Agriculture is closing field offices and consolidating activities, saving almost 700 employees in 1963 and an additional 580 employees in 1964.

The Federal Aviation Agency is reducing air traffic control centers from 29 to 21 with annual savings of $7 million. FAA and the Defense Department have combined their long-haul technical communications with annual savings of $5 million.

Last year the State Department, in its Bureau of Economic Affairs, eliminated requirements for 1,000 separate economic and commercial reports per month—which means 1 million fewer documents a year coming into Washington from missions abroad.

In the Atomic Energy Commission, improvements in production processes and techniques are expected to save over $38 million in 1964.

These illustrations are representative of a much larger catalog of examples which clearly reflect a strong and continuing climate of cost consciousness throughout the executive branch.

Fiscal procedures themselves sometimes require reexamination as a means of saving money. A case in point came to our attention through the Comptroller General. This relates to the practice of advancing cash to State and local governments or to educational institutions under various grant programs. In a number of cases, payments have been made to grant recipients before the latter actually needed the cash. Recipients have invested the excess cash in various short-term obligations and have earned interest thereon. The Comptroller General has made the very sensible point that the advance payment practice tends to accelerate the Federal Government's borrowings and to increase our interest costs.

To deal with this problem, the Bureau of the Budget has been working with the General Accounting Office and the Treasury Department in the development of a new procedure which would retain cash in the Treasury until it is actually needed for disbursement by the recipient. We expect to test this new procedure this spring, and put it into effect in fiscal year 1965. We anticipate that this procedure will save the Government about $8 million a year in interest costs.

The President's economy drive reached to the very top of the Federal Establishment on December 20, when the Bureau of the Budget acted to restrict the number of luxury automobiles used by officials of the executive branch. While this will not yield much in the way of dollar savings, it will have a salutary effect in making it plain that economy in Government operations is not limited to the rank and file employees but extends up to the top executives as well. The effect of our new instructions will be to reduce ultimately by about 75 percent the number of luxury vehicles now operated by civilian and military agencies all over the world.

Chairman DOUGLAS. I want to congratulate you and the President. If you remember your Homer, you will remember how the Trojans spoke of the long black ships of the Argives which descended on the shores of Asia Minor and from them came the predatory Greeks. We on the Hill have had a somewhat similar feeling when we have seen these long black Cadillacs coming up and descending from them the hordes of Greeks, not bearing gifts but instructions. So we congratulate you on this effort.

Representative CURTIS. Mr. Chairman, I might say that I am a little worried that this cut is the Trojan horse itself. We had better look to see what is really going on in these expenditures, instead of having our attention diverted to things like this, although I am glad to see the Cadillacs cut.

Chairman DOUGLAS. Well, I am speaking of the new method of locomotion, the automobile rather than the former method of locomotion: the horse.

Mr. GORDON. I chose to emphasize that paragraph, Mr. Curtis, because I know that the chairman in the past has made a number of speeches on this subject.

Representative CURTIS. I notice, Mr. Director, that there are a lot of headlines in the newspapers directed to these items, as there should be, but at the same time, actual expenditures increase $600 million. I will get to that later.

Chairman DOUGLAS. Can't you give the administration something for effort?

Representative Curtis. Effort, I think, to throw powder in the eyes of the public and the Congress, yes.

Chairman DOUGLAS. This is 1964, not 1984.

Representative CURTIS. Thank you.

BUDGET PRESENTATION

Mr. GORDON. This committee has long had an interest in the way budgetary information is presented, particularly for those interested in economic and fiscal analyses of the Government's activities. This interest was most recently shown in the hearings and report of the Subcommittee on Economic Statistics last year on "The Federal Budget as an Economic Document." Let me, therefore, describe briefly some of the changes we have made in the budget presentation this year, a number of which are responsive to the recommendations in that report.

First, the 1965 budget contains three new special analyses. This brings to 12 the number of such analyses, which give information on various Government-wide activities, involving a number of different agencies and programs.

The analysis of employment—"Special Analysis C" on page 347—summarizes actual and estimated executive branch civilian employment, describes significant employment changes in some agencies, and compares Federal civilian employment to State and local government employment and to the population as a whole.

The analysis of health programs—"Special Analysis G" on page 397—provides information on all health-related programs of the Federal Government, including medical services, community and environmental health activities, and medical research. The usefulness of such information was pointed out in the subcommittee's report on the budget. (We are currently making plans for the inclusion in the next budget of a new analysis of all the educational activities of the Government.)

The analysis of international transactions of the Federal Government—"Special Analysis L" on page 446—is the outgrowth of a special procedure established in the executive branch in 1962 for reviewing systematically all Federal international transactions in order to minimize the adverse effects of such transactions on the balance of payments. The analysis summarizes the estimates of Federal receipts and expenditures from 1963 to 1965 developed under this procedure, by agencies, geographical areas, and types of transactions. These estimates indicate a decline of about $800 million in net Federal payments abroad between 1963 and 1965 (excluding special receipts of a nonrecurring nature).

Second, other material has been added along lines suggested in the subcommittee's report on the budget in an effort to provide more comprehensive information on the Government's finances. For example:

"Special Analysis B," which previoulsy covered transactions of public enterprises and trust funds, has a new section this year (p. 344) presenting on a gross basis the total expenditures from all Government-administered funds except deposit funds. The gross expenditures and applicable receipts of public enterprise funds, which are included in the administrative budget total on a net basis, continue to be shown separately in this analysis.

Another innovation in the 1965 budget is the presentation for the first time of data on expenditures and revenues of seven self-supporting Government activities; for example, the Federal Deposit Insurance Corporation, the Federal intermediate credit banks, and the banks for cooperatives. These data have not previously been shown in budget documents, although partial figures for three of the activities have been included in the trust fund and consolidated cash totals. In the 1965 budget, a memorandum section at the end of part 5 shows these new "annexed" budgets; detailed budget statements for them appear in the appendix. Like the budgets for the legislative branch and the judiciary, the annexed budgets have not been reviewed by the President.

Third, changes have been made in some of the existing special analyses to increase their usefulness. For example:

"Special Analysis E," which provides information on the Government's credit programs, contains a new table (p. 379) setting forth separately the estimated sales to non-Federal buyers of loans and mortgages from the Government's portfolio.

"Special Analysis H," which brings together information on expenditures by all Government agencies for research and development, has been expanded somewhat and shows separately for the first time the totals for research, for development, and for the portion of research funds used for basic research.

As you know, the budget has many and varied uses and users, and it is doubtful whether we will ever be able to satisfy all needs and requests for information. Nevertheless, as shown by the examples I have outlined, we are steadily trying to increase the usefulness of the budget document and we hope to make further improvements. We welcome the continued interest and cooperation of the Joint Economic Committee in this effort.

(Subsequently, the following letter and exhibit was received:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., January 29, 1964.

Mr. JAMES W. KNOWLES,
Executive Director, Joint Economic Committee,
House of Representatives, Washington, D.C.

DEAR JIM: I am enclosing for the information of the Joint Economic Committee and its staff copies of a statement, "Principal Federal Statistical Programs in the 1965 Budget," prepared by the Office of Statistical Standards to describe the subject matter content of the new statistical projects summarized in "Special Analysis J" of the budget document.

We shall be glad to provide any additional information on statistical programs which the committee may desire.

Sincerely yours,

RAYMOND T. BOWMAN,
Assistant Director for Statistical Standards.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., January 27, 1964.

This statement describes the subject matter content of the new projects summarized in "Principal Federal Statistical Programs," Special Analysis J of the 1965 Budget of the United States.

The 1965 budget recommends the expenditure of $120.8 million to produce the principal statistics used by business, Government, and the public at large. Of the total amount recommended, $94.3 million is for the current programs of Federal statistics and $26.5 million for periodic programs.

A summary description of the new projects included in the principal current statistical programs and the activities proposed under the periodic programs in 1965 follows.

RAYMOND T. BOWMAN,
Assistant Director for Statistical Standards.

PRINCIPAL FEDERAL STATISTICAL PROGRAMS IN THE 1965 BUDGET

The principal statistical programs of the Federal Government in the 1965 budget are those programs which provide general-purpose statistical information for the use of the Government and the public. The new projects included in the statistical programs recommended for 1965 are presented in two categories: current programs which represent the continuing year-to-year statistical activity of the various agencies, and periodic programs which typically are the large-scale census-type surveys taken once or twice a decade.

The continuing objectives of the Federal statistical system are to provide accurate, comprehensive, and timely data needed for the operations of the Government, to furnish the public with information about the functioning of the economy and the welfare of the people, and to insure efficient utilization of Government resources and minimum burden on respondents. The attainment of these objectives requires continuous evaluation of the needs for statistical information. To aid in evaluating the Government's overall statistical activity and to indicate the relationship of general-purpose data-collection programs to agency objectives, the significant components of current Federal statistical activity are brought together and classified by broad subject areas in this analysis. These areas and the amounts involved are summarized in table 1. (See p. 100.)

The new projects included in the 1965 budget reflect the most urgent of the specific needs for data which have been identified by Federal agencies and emphasized in appraisals of the adequacy of existing economic and social statistics by the Joint Economic Committee of the Congress, the Subcommittee on Census and Government Statistics of the House Committee on Post Office and Civil Service, the President's Committee To Appraise Employment and Unemployment Statistics and other groups representing business, labor, and research organizations. Each project has been evaluated in terms of overall statistical program needs and alternative requirements for available resources.

The current statistical programs included in this statement represent a substantial part of the data collection and processing activities of the Federal Government. Since it is not always possible to separate production or use of data from other aspects of agency administrative responsibility, some statistical activity is not included. The current statistics activity presented in this analysis includes the entire programs of the following agencies: (1) The Economic Research Service and the Statistical Reporting Service in Agriculture, (2) the Bureau of the Census and the Office of Business Economics in Commerce, (3) the Bureau of Labor Statistics in Labor, and (4) the National Center for Health Statistics in the Department of Health, Education, and Welfare. In addition, the general-purpose statistical activities carried out as a part of the overall program of selected agencies are included. The agencies whose general-purpose statistical programs are so included are the Corps of Engineers (Defense); Social Security Administration, Welfare Administration, and Office of Education (HEW); Bureau of Mines (Interior); Bureau of Employment Security and the Office of Manpower, Automation, and Training (Labor); Internal Revenue Service (Treasury); Civil Aeronautics Board, Federal Trade Commission, Federal Home Loan Bank Board, Housing and Home Finance Agency, Interstate Commerce Commission, National Science Foundation, and the Securities and Exchange Commission.

The periodic statistical programs for which funds are recommended in 1965 for the Bureau of the Census include the 1963 economic censuses, the 1964 Census of Agriculture, the initial phases of the national housing inventory and preparatory work on the 1970 censuses. In addition, provision is made for the Bureau's program to develop and modernize automatic data handling equipment.

The agencies and amounts involved in both the current and periodic statistical programs included in this analysis are shown in table 2. (See p. 101.)

CURRENT PROGRAMS

LABOR STATISTICS

This area includes statistics on employment, hours, and earnings, by industry; number and characteristics of persons in the labor force, whether employed or unemployed, labor turnover, wage rates, industrial relations, industrial hazards, foreign labor conditions, and productivity. Programs of the Bureau of Labor Statistics in these areas and statistical programs of the Bureau of Employment Security and the Bureau of Mines are included, as well as the estimates of farm labor requirements and supply prepared by the Department of Agriculture and research on scientific manpower resources carried on by the National Science Foundation. Statistical and general research activities of the Office of Manpower, Automation, and Training, of the Department of Labor, are included in this area for the first time in 1965. In addition to analytical and appraisal functions in support of policy-planning, this staff has responsibilities for coordinating manpower research and for administering a program of contract research on manpower and automation problems. Figures for prior years have been adjusted to include these OMAT activities.

Manpower and employment data

Accelerated study of various aspects of manpower and employment statistics was initiated last year in response to the recommendations of the President's Committee To Appraise Employment and Unemployment Statistics. In 1965, the experimental work undertaken to sharpen labor force concepts will be expanded; a study will be made of factors affecting labor force participation; methods of strengthening State and area manpower estimates will be investigated and statistics on hours and earnings by industry and area expanded.

The panel of households, set up late in fiscal 1964 to carry on experimentation and research in concepts and methods used in measuring labor force activity will be in operation during 1965. This panel constitutes a representative sample of the population, independent of that which produces the current monthly series of labor force estimates. Proposals for changes in and additions to the present labor force questionnaire will be tried out on the new panel ($650,000 BLS).

The coming fiscal year will also see the beginning of a long-range effort to test and improve the reliability of State and local estimates of employment and unemployment, now based only in part on current data. Data drawn from administrative records of unemployment insurance programs will be supplemented by an increasing amount of information drawn from special surveys of households and investigation of employer records ($350,000 BES).

Monthly estimates of employment and hours based on reports of employers to State employment security agencies and the Bureau of Labor Statistics will be strengthened by enlarging samples of reporting employers for some industries, especially in the service trades. Increased emphasis will be placed on obtaining estimates of weekly hours. The employer reports on employment and hours, now available for States and more than 100 major metropolitan areas, will be extended to additional urban centers and labor turnover estimates for nonmanufacturing industries will be prepared for 55 standard metropolitan statistical areas ($225,000 BLS; $215,000 BES).

Among other projects provided for in the 1965 budget of the Department of Labor are:

(*a*) A study of reasons for persons entering or leaving the labor force ($175,000 BLS), and

(*b*) Extension of programs, still in developmental stage, of estimates of employment by occupation in major industries ($80,000 BLS; $30,000 BES).

Planning for the initiation of national job vacancy statistics will be continued by BLS. BES and the State employment security agencies will expand their work of developing area estimates of job vacancies ($165,000 BES).

The National Science Foundation will undertake additional manpower studies and improvement of coverage of the National Register of Scientific and Technical Personnel. Emphasis in the manpower studies will be directed to problems of estimating demand for scientists of various types. In addition to providing for normal growth, the National Register will also include more extensive coverage of engineers and social scientists ($330,000 NSF).

Wage statistics

Funds are provided for strengthening the sample of the national professional, administrative, and technical salary survey. This survey is the basic source of information used in making recommendations for change in Federal salary levels ($75,000 BLS).

DEMOGRAPHIC AND SOCIAL STATISTICS

Demographic statistics measure the population growth of the Nation and its political subdivisions and provide basic information on characteristics of individuals and families; included is the body of data generally referred to as "vital statistics"; i.e., births, deaths, marriages, and divorces. Social statistics are concerned primarily with data on the well-being of people, their health, education, and welfare.

Principal statistical programs included here are those relating to the above activities in the Bureau of the Census, the National Center for Health Statistics, the Office of Education, the National Science Foundation, the Social Security Administration, and the Welfare Administration.

Much of the information in this category, particularly with respect to population statistics, comes from periodic census programs covered later in this report.

Population statistics

In recognition of the growing problems related to planning for cities and areas, a program to provide an annual series of population estimates for local areas was inaugurated in 1964 by the Bureau of the Census. This program will be expanded in 1965 to cover an increased number of cities and metropolitan areas. Efforts will also be directed to improvement in the methodology and scope of population estimates through the use of data now becoming available with the introduction of computers in the Internal Revenue Service ($350,000).

Health and vital statistics

The increase recommended in the 1965 budget for the National Center of Health Statistics provides for carrying out current research on the feasibility of automatic coding of basic data involving approximately 8 million State and local records of births, deaths, marriages, and divorces. The recommendation also provides for continued development of a hospital discharge survey, one of the major objectives of the Health Records Survey. This survey will collect statistics about patients discharged from a nationwide sample of hospitals covering such types of data as diagnoses, operations, and other hospital services, hospital charges, and a number of socioeconomic characteristics of discharged patients ($235,000).

Education statistics

The 1965 program recommended for the Office of Education includes a substantial provision for strengthening of the planning staff, for methodological research and for further preparatory work on a system to develop a flow of basic data from records in individual schools and school systems for incorporation in national statistical totals. In carrying out its improvement program, the Office will follow recommendations of the Committee on Education Statistics appointed by the Commissioner of Education ($525,000).

Statistics on social sciences

Recommendations for the 1965 program of the National Science Foundation provide for increased emphasis on analysis of the social and economic impact of research and development activity. Statistical projections of such activity in selected economic sectors, data dealing with the impact of scientific advances and improved technology on the national economy and the effects of the dissemination of scientific information on the economy are among the subjects to be investigated ($280,000).

PRICES AND PRICE INDEXES

This program area includes the collection and processing of data for four major price index series. The Bureau of Labor Statistics prepares the Consumer Price Index and the Wholesale Price Index. The Statistical Reporting Service, Department of Agriculture, compiles the indexes of prices paid and of prices received by farmers. The Bureau of the Census is also preparing experimental indexes of the prices of new houses.

The revision of the Consumer Price Index, a 5-year program in the Bureau of Labor Statistics, will be completed in 1964. Publication of the index on the revised basis will be started early in the year. The revised index embodies major improvements which are considered essential to its continued reliability. These involve an increase in the number of items priced, extension of pricing to cover entire metropolitan areas including suburbs, and the use of independent samples in pricing in order to provide a means of estimating the accuracy of the index. The 1965 budget provides for the increased cost of maintaining these improvements ($200,000).

The budget recommendations also include funds to enable the Bureau to prepare separate indexes for the six metropolitan areas with a population of 1 million or more which are not now included in the revised national index. It is planned to add these six major metropolitan areas to the revised national index in January 1966 ($100,000).

Work on the construction of price indexes organized on the basis of the standard industrial classification, to supplement the existing Wholesale Price Index, based on commodity groupings, will be accelerated in 1965. Industry-sector price indexes will permit comparisons with other major economic data now presented on an industry basis, such as production, employment, hours, and productivity ($85,000).

PRODUCTION AND DISTRIBUTION STATISTICS

The principal programs included in this area are those involving the collection and analysis of data on agricultural production, marketing, and distribution in the Statistical Reporting Service and Economic Research Service of the Department of Agriculture, the statistical activities relating to industrial production, domestic and foreign trade and transportation of the Bureau of the Census in the Department of Commerce, and the statistical work of the Bureau of Mines in the Department of the Interior dealing with minerals and their products. Also included are transportation statistics activities of the Corps of Engineers in the Department of Defense, the Interstate Commerce Commission, and the Civil Aeronautics Board.

The budget for 1965 reflects no program change for the Economic Research Service. Only minor changes are contemplated for three agencies concerned with transportation statistics, small increases being budgeted to carry workload and some additional economic analysis and research.

Agriculture statistics

Over half of the total increase budgeted for program expansion or improvement of production and distribution statistics is for the long-range plan of the Statistical Reporting Service in the Department of Agriculture for improving crop and livestock estimates through the use of enumerative surveys and objective measurements of yields on a probability sample basis. This is the fifth stage of a program initiated in cotton-growing States in 1961. An amount of $685,000 is included in the 1965 budget to provide for putting pilot surveys in additional States on a full operating basis.

An additional amount of $62,500 is requested for the Statistical Reporting Service to provide for continuing the expanded level of the cattle-on-feed reports. An equivalent amount was appropriated to carry out this program for the last half of the current fiscal year.

The 1965 budget contemplates a reduction of $94,000 in the consumer survey program of the Statistical Reporting Service.

Business statistics

Two further steps in the development and improvement of the business statistics program of the Bureau of the Census are provided for in this budget. One is the initiation of a new retail inventories series. Need for this kind of data was pointed up by the Federal Reserve Board Consultant Committee on Inventory Statistics in 1955, the Census Bureau has done extensive work on developing and testing techniques for collecting the data. The survey for which $108,000 is requested in 1965, initially will produce physical and dollar volume indexes of retail inventories of all large consumer durable goods as a group. It is expected that at later stages the survey would be extended to provide measures of inventories of specific classes of merchandise such as furniture, lumber and building materials, and various types of appliances.

Weekly, monthly, and annual sales estimates are made for a variety of kinds-of-business and geographic areas, including the major retail centers of the Nation. The changing pattern of retail trade—new types of stores, movement of retailing into suburban areas, and growth of regional and neighborhood shopping centers—requires systematic and continuous updating of the sample of stores which report retail trade data. The present retail area sample design must be enlarged and revised to reflect the basic changes which have occurred in the retail universe; $100,000 is provided in the census budget for this purpose.

Foreign trade

This budget includes provision for the next step in a long-range export statistics program initiated by the Bureau of the Census in fiscal 1963. Work has been going forward on a complete revision of the commodity coding structure for reporting export shipments so that this information will be comparable with information about domestic production and with international trade reports of other countries, most of which use the Standard International Trade Classification (SITC) prepared by the United Nations; $109,000 is requested in this budget to install the new code system which is scheduled to go into effect at the beginning of calendar year 1965. The additional funds will provide for printing and distributing the new code structure, preparing revised computer programs, identifying and correcting errors arising from the transition, and preparing tabulations which will provide a bridge between the old and new system. Subsequent stages in the long-range program will be directed toward working with exporters to eliminate errors at the source record for export statistics, the shipper's export declaration.

CONSTRUCTION AND HOUSING STATISTICS

Basic construction and housing statistics are obtained through current programs in the Housing and Home Finance Agency, the Bureau of the Census, and the Federal Home Loan Bank Board. In addition, funds are requested in the 1965 budget to enable the Bureau of the Census to prepare to take in November of 1965 a national housing inventory. This latter proposal is described later under the periodic census programs.

An increase of $1.1 million is recommended for the urban studies and housing research activities of the Housing and Home Finance Agency. About half of the increase is for expansion of the present program of collection and analysis of statistical data on housing markets and costs. This portion provides for statistics on new rental units and their occupants to supplement the existing series on the characteristics of new owner-occupied housing, the market for existing housing, and the interaction between segments of the new and existing housing markets. The remainder is for studies of urban growth, development, renewal, and organization; and of the problems encountered in providing expanded or improved public facilities and services.

As part of its program to improve construction-put-in-place statistics, the Bureau of the Census plans to design and initiate in 1965 a sample survey to measure private nonresidential value in place in the 13 Western States not now adequately covered. The recently established monthly progress reporting system for private nonresidential buildings is presently limited to the 37 Eastern States, since the reporting sample is drawn only from the individual project reports supplied by the F. W. Dodge Corp., which limits its operation of this type to this geographic area. To cover the entire United States, it is necessary to draw a sample of new private nonresidential building projects in the West and obtain reports on their construction progress. This sample will be drawn from lists of large projects provided by construction news sources and from building permits, supplemented by an area sample, particularly in the areas where building permits are not required. ($150,000.)

NATIONAL INCOME AND BUSINESS FINANCIAL ACCOUNTS

This general category of statistics includes the estimates for the national economic accounts—i.e., national income, gross national product, and interindustry purchases and sales—financial data for industry, and the measurement and analysis of business trends. The accounts provide summary analyses of economic changes for consumers, business, governmental units and international transactions.

About $8.8 million is recommended for fiscal 1965, or $0.6 million above the amount available in 1964. The base amount in both periods includes $120,000 transferred to the Office of Business Economics from other areas of the Department of Commerce for regional economic studies.

The additions to the base amount are recommended primarily to meet increased demands for information on the U.S. balance of payments and for detailed analysis of income and product relationships.

National economic accounts

In recognition of the importance of the balance-of-payments problem of the United States, an additional $155,000 is requested to increase the resources of the Balance of Payments Division of the Office of Business Economics. Additional resources will be used to: (*a*) improve estimates of U.S. investment abroad and foreign investment in this country; and (*b*) to strengthen the analytic work and data collection on major types of international transactions.

An increase of $70,000 is recommended for strengthening estimates of national income by industrial origin and estimates of consumer expenditures in the gross product accounts. This work will involve a detailed study of employment and payroll data for the trade and services industries derived from records of unemployment insurance compensation, old-age and survivors insurance, and census data. The detailed study is needed to reconcile sizable discrepancies in payrolls among these sources of employment data.

An increase of $60,000 is included to incorporate a large volume of new data available from the last decennial Census of Population and other sources. New information on income size distributions for entrepreneurial and wage earner families and on composition of total income by type of income such as wages, dividends, etc., will also be provided.

The Office of Business Economics will undertake to advance its statistical and mathematical techniques for analysis and measurement of relationships among the various components of economic activity. These new techniques, with the aid of the electronic computer and recent developments in statistical methodology, will help in quantifying the interrelationships of the various factors which influence short-run and long-term changes in the economy. In addition to its use with these new techniques, OBE will further extend the application of automatic data processing in the calculation of the economic accounts. Eighty thousand dollars is provided for this work.

Business financial accounts

The increase of $110,000 for the Statistics Division of the Internal Revenue Service provides for technical statistical assistance to other offices of IRS on the taxpayer compliance measurement program and recognizes the added workload resulting from changes in the tax laws and from regulations from increased tax returns filings. The program that produces the widely used Statistics of Income and related tabulations will continue at about the same level as in fiscal year 1964.

An additional $46,000 is provided to permit the Securities and Exchange Commission to carry out several recommendations of the Special Study of Markets Group for improvements in statistics needed to analyze securities markets conditions. New or improved series would be produced on securities retired, underwriters' compensation, and holdings and tradings by institutional investors, and on the securities and over-the-counter market.

PERIODIC PROGRAMS

The periodic statistical programs for 1965 include provision for the major censuses scheduled by law at 5- or 10-year intervals. Funds are also included for work on the initial phases of the national housing inventory to be conducted the following year and for modernization of automatic data processing equipment in the Census Bureau.

Economic censuses, 1963

These censuses cover business, manufactures and mineral industries, and transportation. They provide information for the year 1963 on number of establishments, sales, product shipments, inventories, number of employees, man-hours worked, payroll costs, operating costs, and quantity of materials used and capital expenditures in manufacturing and mineral industries. This information is presented by kind of business, by geographic location (e.g., State, county, city, standard metropolitan statistical areas, central business district, etc.) and by various other classifications such as sales size, employment size, legal form of organization, degree of product specialization, and type of operation. Preparatory work for them was started in 1962. Total cost is estimated at $21.1 million of which $7 million is provided for 1965.

For the census of business approximately 70 different report forms, tailored to the 412 different kinds of businesses, were mailed to nearly 2½ million establishments engaged in the retail, wholesale, and service trades. Sample surveys will be designed to obtain supplementary information on capital expenditure, retail credit, value added, and other items not requiring reports from all establishments in the various trades. The main part of the work of tabulation of reports and preparation of data for publication will be done in fiscal year 1965.

The census of manufactures covers some 300,000 manufacturing plants in 430 separate manufacturing industries; the census of mineral industries involves obtaining reports from 35,000 establishments in 55 individual mineral industries. The work scheduled for these censuses in 1965 is similar to that in the business census, i.e., primarily tabulation and preparatory work on final reports.

The census of transportation consists of four major segments: (*a*) a commodity transportation survey will provide data on the transportation and geographic distribution of products by manufacturers, showing the means of transport, origin, destination, type of commodity, and weight of shipments; (*b*) a national travel survey will collect data on selected factors of passenger transportation of major significance in local or urban transportation, as well as information on the volume and nature of trips beyond the local areas; (*c*) a survey to obtain data on the inventory and use of private and for-hire trucks; and (*d*) a bus and truck carrier survey will obtain data for those carriers not subject to the economic regulations of the Interstate Commerce Commission. The census of transportation, as required by the census law, is designed to provide information which is not compiled and published by regulatory agencies and will thus provide for the first time data not otherwise available.

In 1965 final reports will be issued for the national travel survey, truck inventory and use survey, and the bus and truck carrier survey; and preliminary reports will be issued for the commodity transportation survey.

Census of agriculture, 1964

The 1964 Census of Agriculture will provide for each State and county: (1) a count of farms by size, income, tenure, and type; (2) an inventory of agricultural land and the ways in which it was used; (3) the amount of each farm product produced and sold; (4) an inventory of the kinds and numbers of livestock and poultry on farms; (5) a count of farms with specified equipment including important farm machines such as tractors, motortrucks, and cornpickers; (6) a count of people on farms, by sex, age, and employment and income; and (7) a record of the important cash expenditures made by farmers.

This is the third year for which funds are budgeted for work in connection with the census of agriculture. The program for 1965 provides for the field collection of the data for the 50 States, Puerto Rico, Virgin Islands and Guam and for a part of the tabulation and publication of these data. The field enumeration will occur in the fall of 1964 after the completion of a major part of the 1964 harvest. The enumeration will be performed by approximately 24,000 temporary enumerators and 1,800 temporary crew leaders. Approximately half of the tabulation and publication will be completed in 1965. The remainder of the work will be completed in 1966 and 1967. The 1965 provision for this census amounts to $16.5 million.

Preparation for 19th Decennial Census

Funds for 1964 in the amount of $740,000 were made available to do research and field testing of procedures intended to permit effective use of a list of household addresses in the conduct of the 1970 Census of Population. This project will be continued in 1965 and will test the feasibility of a plan to use a list of households, initially available from the 1960 census, updated for new construction and corrected by the Post Office Department, as a principal means of distributing questionnaires to be used in the 1970 census. Alternative methods of preparing the mailing list are also being explored. If feasible, the use of mailing lists and related procedures will reduce the cost and improve the quality and timing of field work for the 19th Decennial Census. In addition, preparatory work will be undertaken with respect to specific problems encountered in the past in taking this census; $1.1 million is recommended in 1965 for the preparatory work on the 1970 census.

National housing inventory

The national housing inventory to be taken in fiscal 1966 will require preparatory work in 1965. This inventory will provide data on the number, size, quality, and characteristics of the Nation's housing, and of the housing in 25 standard metropolitan statistical areas; $1.7 million is recommended to carry out the necessary work in 1965.

Modernization of automatic data processing equipment

Modest provision is made in the 1965 recommendations to enable the Bureau of the Census to work on the automating of document handling and other problems associated with data input and retrieval while using high-speed data processing equipment ($200,000).

TABLE 1.—*Obligations for principal current statistical programs, by broad subject areas*

[In millions of dollars]

Program	1963 actual	1964 estimate	1965 estimate
Labor statistics (Departments of Agriculture, Interior, and Labor; National Science Foundation)	[1] 18.1	21.1	23.8
Demographic and social statistics (Departments of Agriculture, Commerce, and HEW; National Science Foundation)	14.3	16.5	18.3
Prices and price indexes (Departments of Agriculture, Commerce, and Labor)	4.6	5.1	5.7
Production and distribution statistics (Departments of Agriculture, Commerce, Defense, and Interior; Civil Aeronautics Board; Interstate Commerce Commission)	29.5	31.6	33.7
Construction and housing statistics (Department of Commerce; Federal Home Loan Bank Board, Housing and Home Finance Agency)	2.3	2.7	4.0
National income and business financial accounts (Departments of Agriculture, Commerce, and Treasury; Securities and Exchange Commission, Federal Trade Commission)	7.5	8.2	8.8
Total, principal current programs	76.3	85.2	94.3

[1] Revised.

TABLE 2.—*Obligations for principal statistical programs, by agency*

[In millions of dollars]

Agency	1963 actual	1964 estimate	1965 estimate
CURRENT PROGRAMS			
Department of Agriculture:			
Economic Research Service	8.8	9.2	9.5
Statistical Reporting Service	9.3	10.6	11.4
Department of Commerce:			
Bureau of the Census	12.8	13.7	15.3
Office of Business Economics	2.0	2.1	2.6
Department of Defense, Corps of Engineers: Commercial statistics	.9	1.0	1.0
Department of Health, Education, and Welfare:			
Office of Education: Educational statistics	1.3	1.5	2.0
National Center for Health Statistics	5.1	5.9	6.2
Social Security Administration: Statistical and research activities	4.1	4.5	4.6
Welfare Administration, Statistical and research activities	1.0	1.6	1.7
Department of the Interior, Bureau of Mines: Mineral statistics	2.2	2.4	2.4
Department of Labor:			
Bureau of Employment Security: Statistical activities	1.7	1.7	2.5
Bureau of Labor Statistics	14.6	16.4	18.5
Office of Manpower, Automation, and Training: Statistical activities	[1] 2.5	3.8	3.8
Treasury Department, Internal Revenue Service: Statistical reporting	4.3	4.5	4.6
Civil Aeronautics Board: Statistical and research activities	.4	.5	.5
Federal Home Loan Bank Board: Statistical activities	.4	.4	.4
Federal Trade Commission: Financial statistics	.3	.3	.3
Housing and Home Finance Agency: Urban studies and housing research	.4	.4	1.5
Interstate Commerce Commission: Transport economics and statistics	1.3	1.4	1.5
National Science Foundation: Statistics and research	2.6	2.9	3.5
Securities and Exchange Commission: Operational and business statistics	.3	.4	.5
Total, current programs	76.3	85.2	94.3
PERIODIC PROGRAMS			
Department of Commerce, Bureau of the Census:			
18th Decennial Census	2.8	----------	----------
1962 Census of Governments	.8	.8	----------
1963 economic censuses	2.9	8.7	7.0
1964 Census of Agriculture	.5	1.6	16.5
Preparation for 19th Decennial Census	----------	.7	1.1
Modernization of data-processing equipment	4.0	4.5	.2
National Housing Inventory	----------	----------	1.7
Department of Labor, Bureau of Labor Statistics: Revision of CPI	1.4	1.4	----------
Total, periodic programs	12.3	17.7	26.5
Total, principal statistical programs	88.6	102.9	120.8

[1] Revised.

Chairman DOUGLAS. Thank you very much, Mr. Gordon. Congressman Patman?

Representative PATMAN. Thank you, Mr. Chairman.

First, Mr. Gordon, I want to congratulate the administration—I know you had a big part in it—for keeping the budget down below $100 billion. I am agreeably surprised—in fact, I am amazed that you were able to do it. It is certainly a good effort on your part.

Now, I am disturbed about the national debt continuing to climb. Personally, I believe we should reduce the national debt as quickly as possible. I know that it is not a good time to talk about it, because we just do not have the money to do it. And since we cannot do it, it is possible we should begin to look around to see if we should change our fundamental policy about the debt. Under our policy in this Government—of course, I have had no quarrel with it in the past; it has worked fine—our money is based upon debt; no debt, no money. That has worked pretty well. But we have reached a point now where possibly we should give consideration to changing that policy.

I know President Lincoln made a step in that direction—not a very long one, but a substantial one—back in the early part of the War Between the States. Now, since it will soon be Lincoln's Birthday, it would be a good time for people talking about Lincoln to expand upon the good he accomplished by the issuance and distribution of about $356 million in money which has remained in circulation all that time. I asked the Treasurer of the United States recently to give me an estimate of how much we would have saved on that money if we had paid 5 percent semiannually. The answer was, "Between $49 and $50 billion."

Now, I know that 5 percent was a little bit high, but in comparison to the interest rates that President Lincoln was being required to pay, if he were successful in getting a loan, it was not so high after all.

So I think we should retire this national debt as soon as we can or give consideration to another method. Of course, banks, commerical banks in particular, like more debt paper all the time. That has been their campaign all the time, more debt paper. We can't blame them for that. We want the bankers to be prosperous, because they are an important part of our economy. We cannot get along without them. But at the same time, this business of no debt, no money, I think we ought to take another look at it and see if there is not another way, without a reasonable chance of inflation or deteriorating our dollar, to see if it is not possible to do that.

I believe, Mr. Gordon, you would agree with me that a large national debt is really a deterrent to progress. This debt represents money and in addition we have debts of individuals and corporations, and we are reluctant to put out too much money when these are all added together because it will cause inflation.

Do you not think it would be better, if we could ever get to that point, that we reduce the national debt as fast as possible so that individuals and corporations could increase their debts and not have inflation? Do you not think that would be a good goal to work to?

Mr. GORDON. I certainly think it would be a very desirable goal, Mr. Patman, to seek to reduce the size of the national debt. I would hope and expect, as the economy moves up to a level of full prosperity, that this will yield sufficient revenues to the Federal Government to permit some retirement of the debt. So that I would certainly agree with that premise of your position.

It is quite true that in the past there have been times—at the time of the Civil War and I believe also in 1933, which was a year in which there was a greenback issue——

Representative PATMAN. We didn't actually issue them, Mr. Gordon, although they were authorized under the Thomas amendment; yes, sir.

Mr. GORDON. I would think, Mr. Patman, that any drastic departure from established practice in a field in which feelings are so strong and fears so deep—as with respect to the circulating medium—would not be wise.

Representative PATMAN. Well, you are talking about, I think, Mr. Gordon, just issuing greenbacks. I am not talking about that at all. I am talking about studying some way except for people to go into debt and pay interest in order to have enough money to do business on. I would just like to see that studied.

Mr. GORDON. I do not think, actually, Mr. Patman, that the very slow rate of increase in the Federal debt since the war has inhibited necessary expansions in private debt.

As a matter of fact, one of the charts which I think is in front of you displays the relative increase in the Federal debt since the end of 1947, as compared with the increase in various forms of non-Federal debt.

Representative PATMAN. I know; that is interesting.

Mr. GORDON. As you see, there has been an enormous expansion, which one would expect, as the economy expands; the growth of debt is simply a kind of mirror image of the growth in output, the growth in investment, which characterizes a growing economy.

I would think it would be hard to argue that this very slow increase in Federal debt since the end of 1947 has hampered or impeded the necessary growth in private debt.

Representative PATMAN. We have had a 4¼-percent ceiling on long-term bonds since back in Woodrow Wilson's administration. Efforts have been made in the past, the last 10 years, to take that ceiling off. Quite a few of us in the House have been opposed to it and we succeeded one time in stopping the effort in the House when it looked like it was real serious and thought it would be successful. I just wondered if the administration has in mind the removal of that 4¼-percent ceiling. I ask you that because the marketable bonds now are selling at almost 4.22, I believe.

Mr. GORDON. That is correct.

Representative PATMAN. That is pretty close to the ceiling, 4¼. Since we have lived under that 4¼ ceiling so long, I just wonder if any effort will be made by the administration to get that ceiling removed.

Mr. GORDON. I am not familiar with any decision to ask for the lifting of that 4¼ percent ceiling. I will say in perfect candor that I personally would like to see it lifted. Not because, if I may stress the point, I am in favor of higher interest rates. I am not. The President and others, particularly from the point of view of the budget, are acutely aware of what the effect of higher long-term interest rates would be on our budget expenditures. The effect of higher interest rates on the cost of carrying the Federal debt, the effect of higher interest rates on the increased lending through Government programs which are in effect complementary to private lending programs, and the effect of higher interest rates on our ability to sell the mortgages and other financial assets that we have budgeted, could be very harmful in the 1965 budget. So that both for budgetary reasons and because it would be inappropriate in present circumstances in which there is still a substantial degree of slack in the economy, I would not think that a higher level of interest rates would be appropriate.

But, nevertheless, it does seem to me that there are times when monetary controls must be used flexibly and it would seem to me that the present ceiling, the 4¼ percent ceiling, does impose something of a limitation on the ability to use monetary policy flexibly and intelligently.

Representative PATMAN. I do not agree with you on that question and I think you would have a terrific fight—I know you would in the House—if an effort were made to increase that 4¼ percent rate.

I notice in your statement, you said these three sectors of the budget, defense, space, and interest, there is a decline in expenditures in 1965.

Mr. GORDON. That is right.

Representative PATMAN. If you had just picked out interest itself and left defense and space, there would be an increase of $400 million in this fiscal year. I wondered why you put these three together.

Mr. GORDON. Only because, Mr. Patman, in last year's discussion of the budget, considerable attention was focused on the behavior of this category of defense, space, and interest as opposed to all other functions of expenditure in the budget taken together. I didn't want to change the category.

But I agree fully with your point that interest payments have increased very substantially in the current fiscal year over our estimates of last January, and will increase further in fiscal 1965.

Representative PATMAN. The interest cost now is about—I believe it is second in the budget. The defense item is first and the interest is next.

Mr. GORDON. That is correct.

Representative PATMAN. That is quite a sizable amount. Of course, when you get all these bonds refinanced at 2 and 2½ percent, the interest burden will very quickly go up to about $12 or $13 billion.

Mr. GORDON. And, of course, the increase in the discount rate and the corresponding rise in short-term Treasury securities have also contributed to the substantial increase in interest costs.

Representative PATMAN. Thank you very much.

Chairman DOUGLAS. Mr. Curtis?

Representative CURTIS. Mr. Director, the last time I had the opportunity of interrogating you was in early November when the Ways and Means Committee was considering the administration's request to increase the debt ceiling. At that time, one of our basic assumptions or estimates was the expenditure level for fiscal 1964, about 5 months of which had already passed. The Secretary of the Treasury and yourself gave us the expenditure figure of $97.8 billion, which was $1 billion less than the January 1964 estimates; am I not correct?

Mr. GORDON. That is correct.

Representative CURTIS. The Senate passed this bill.

Mr. GORDON. That was, I think, in late October, Mr. Curtis.

Mr. CURTIS. We debated it on the floor of the House in early November. The Senate passed the bill on November 21, based on these same assumptions. Within less than 2 months, this estimate was increased by $600 million to the figure that you now have of $98.4 billion. Can you tell me what happened in those 2 months, particularly in light of the statements made by President Johnson and others of cutting back expenditures? It should have been less, not more. Can you explain how this $600 million increase came about?

Mr. GORDON. I would be happy to, Mr. Curtis.

The first thing, I think, that needs to be pointed out, with which you are certainly as familiar as I am, is that expenditure estimating is a very imperfect art. We are dealing here with changes in estimates of expenditures under obligational authority made available in the current year and previous years, and a wide range of assumptions have to be made on which to base any estimate of the year's expenditures.

Representative CURTIS. May I interrupt for just a minute?

Mr. GORDON. Yes, sir.

Representative CURTIS. Of course, those estimates are required by the Budget and Accounting Act. Your January 1963 estimates of the expenditure levels for fiscal 1965, of course, are even more "iffy." I agree that there are those problems. But by November, or late October if you want to put it there, you have actually experienced 4 months of real expenditures. You are dealing right in the very year, so you would agree that the estimates in late October are a great deal more firm than your estimates in January, right?

Mr. GORDON. They ought to be; yes, indeed, Mr. Curtis. We are dealing here, as you know, with a budget close to $100 billion and we are talking about a difference of $600 million. So this is a difference of considerably less than 1 percent.

Representative CURTIS. We are also discussing, if I may say so, an administration that is talking as if it is cutting but we end up with more, not less. So there is that context, too.

Mr. GORDON. In 1964, Mr. Curtis, not 1965.

Representative CURTIS. Yes; we are talking about 1964.

Mr. GORDON. As you know, one of the things that made the expenditure estimate extremely difficult last October, more difficult than almost any prior year, was that to that time the Congress had not acted on as many as half of the appropriation bills.

Representative CURTIS. May we stop and examine that just a minute? That is when I asked you in late October, what the effect would be of these continuing resolutions, because the understanding was that they were to make the executive spend more at the fiscal 1963 level, which was $92.3 billion. I then asked both you and the Secretary of the Treasury to give me a better estimate of the impact of these continuing resolutions. You were going to supply that data for the record because you hadn't made the studies. As near as I know, the studies haven't been made to date. That is the next question I was going to ask you.

Mr. GORDON. May I answer this first question?

Representative CURTIS. Yes; I want to go back to where I interrupted you, where you referred to the fact that the appropriations bills had not been passed. I was pointing out to you that that would have required a lesser expenditure level, not greater; would it not?

Mr. GORDON. Not quite, Mr. Curtis, because since the appropriation bills had not been passed, we did not know at that time in the case of most agencies how much new obligational authority would be available for the fiscal year 1964. So that the fact that the Congress had not acted by that time on the appropriations bills made it very difficult.

Representative CURTIS. But could you answer the question? Although you could not estimate it, weren't your expenditures bound to be less, not more? Your attention was being directed to an expenditure level of $92.3 billion by the fact that they had not passed. Particularly, one of the bills that had not passed was foreign aid, and we cut it considerably.

Mr. GORDON. I would like to answer your first question. There have been three questions, I think. And I have not yet had a chance to answer the first one.

Representative CURTIS. But you put in assumptions, and I am trying to follow your assumptions. You are not answering——

Mr. GORDON. If I may, Mr. Curtis, answer your first question.

Representative CURTIS. All right.

Mr. GORDON. As you know, the continuing resolution does not control expenditures.

Representative CURTIS. I thought it did. This was the question.

Mr. GORDON. The continuing resolution does not control expenditures, the continuing resolution does not control employment, the continuing resolution does not control obligations. It controls obligations out of the 1964 new obligational authority. And the difference between obligations out of 1964 new obligational authority and the rate of expenditures is a very, very great difference, indeed, as you know.

Expenditures are made out of new obligational authority, out of prior year obligational authority——

Representative CURTIS. I know full well, but let me get to the point, Mr. Director, because I asked this question. This is a matter of record and anybody can read it. I said the Congress' understanding was that the expenditure levels under continuing resolutions were kept to the previous expenditure year. Your answer, as I recall it, was that this understanding was not exactly correct, because there were some variations, but not this kind of variation. You did not answer that question that way.

Now, that is all right. I am willing to move forward——

Mr. GORDON. May I answer the first question, Mr. Curtis? I have not yet had a chance to answer it.

Representative CURTIS. I know you haven't, and let me review why. You discussed various assumptions, saying they were uncertain. I said yes; they are uncertain assumptions. But will you not agree with me that under this situation, the net should have been less, not more?

Now go back to the original question.

Mr. GORDON. I would be glad to, Mr. Curtis.

The question related to the change in the estimate of expenditures in fiscal 1964 of $600 million between October and the present.

Mr. CURTIS. I prefer November as the date.

Mr. GORDON. The first point, I think, to be made is to point out as I did that we were laboring under unusual difficulties because of the lateness of appropriations, and secondly, the fact that we did well compared with previous years in the amount of the change which occurred between October and January.

Now, remember last year, of course——

Representative CURTIS. How do you mean, "well"?

Mr. GORDON. I intended to explain that.

You will remember last year, we issued no midyear review. The midyear review is usually issued by the Bureau of the Budget within 30 days or so after the last appropriation bill is passed, with reestimates of current year expenditures and revenues. We could not do that last year, of course, because the last appropriation bill was not passed until just before Christmas. However, there have been a number of midyear reviews which have come out in the fall, at approximately the same time at which we made our estimate of 1964 expenditures. I have compared these estimates made in the fall with the estimates made the following January to see the changes which took place in this 2- or 3-month period. I find that the change this year from the fall estimate to the January estimate is less than the average change in prior years.

For example, in the 1959 budget document, the estimate for fiscal year 1958 was $800 million above the midyear review. In the 1960 budget document, the estimate for 1959 was $1.6 billion above the midyear review. We are talking here about approximately the same span of months that relates to our 1964 estimate.

This year, as you know, it is $600 million higher. Last year it was also $600 million higher. For fiscal year 1960, it was down by $500 million. So that if you take the average change in these estimates, none of which go to much over 1 percent of total expenditures, you will find that the change in the estimate this year is less than the change in estimates which occurred in previous years in both administrations.

Representative CURTIS. Would you agree with me that there were no statements made by the administration at the time of those other estimates that it was cutting back on expenditures immediately? You will agree that there were these statements this year. You read one of them with regard to Cadillacs and employment. It certainly was, as near as I can see, designed to make people think that there were going to be cuts in expenditures. Yet in this context, might I say, neither the President in his state of the Union message nor you in your budget message frankly point out that these estimates went up $600 million. Your latest figure given the Congress, upon which we based our estimates of what was needed in the way of increased debt ceiling—and these were supposed to be as careful as we could make them—was on the assumption of a $98.8 billion expenditure level. We had thought, frankly, that it could go down more. I think that there was indication in the testimony given by both yourself and the Secretary of the Treasury that the $98.8 billion might be less and, of course, what we were all directing attention to was to get expenditures down.

Mr. GORDON. You are well aware, Mr. Curtis, that these expenditure estimates historically have jumped around in the course of a fiscal year. Last year, you remember, we ended up fiscal 1963 with expenditures of about $1.7 billion less than we had estimated in January. This was an unusually large decline.

Representative CURTIS. I have said, as you may recall, this was under the discipline of the wisdom of Congress, putting your feet to the fire so we had these debt ceilings. We had the administration in three times to go over expenditure estimates. This is the first time I have seen expenditure estimates go down, as they did go down in the estimates given us in the early part of calendar year 1963, in February. Then we got another estimate around April or May, and these were going down. I was gratified, because——

Mr GORDON. Mr. Curtis, this was the first time those expenditures went down since the preceding year, when they also went down between January and——

Representative CURTIS. Yes; and we are very pleased about that, because in all those instances, we had this dialog going on in respect to the debt ceiling. I feel that it has been a good discipline. It gives Congress an opportunity to express its judgment on expenditure levels. It is the only opportunity we really have, because as you pointed out, the appropriations bills, the new obligational authority, represent an indirect way that does not actually affect the expenditure level of a particular fiscal year.

My time has run out but I will be back and we can continue.

Chairman DOUGLAS. Senator Proxmire?

Senator PROXMIRE. Mr. Gordon, I think your budget is a very excellent document. Unfortunately, the press and others have overlooked some of the most important and significant changes that you have made in this budget—I made a brief talk on the Senate floor and that is the first of a number I am going to make.

Mr. GORDON. We appreciate that.

Senator PROXMIRE. I would like to put in the record in some detail the very excellent contribution to governmental planning and to efficiency which this budget contributes.

Mr. GORDON. Thank you.

Senator PROXMIRE. In the first place, it is much more comprehensive than any budget we have ever had. It includes more governmental activities. We have in this budget for the first time expenditures on a gross as well as a net basis. Also, we have an analysis of civilian employment, which is very, very helpful to us.

I am glad at last that we have set forth frankly and clearly the sale-of-asset situation, which of course, confuses people, because most people do not think of this in terms of reducing spending.

Also, the anslysis of health is very good. I am delighted to see that and I think the Members of Congress, if they have a chance to read it and study it——

Mr. GORDON. We were very pleased with that, Senator. We are hoping next year, too, to do a parallel new special analysis on education, a cross-cutting analysis on education. We were unable to do it this year simply because of staff limitations.

Senator PROXMIRE. That is so helpful, because we look at these things from a statistical standpoint and money standpoint, as we have to and should, but we rarely take this best opportunity of all to assess the program and you give us a chance to do that here.

There is one other point I would like to make. That is your balance-of-payments section. There have been a good number of speeches on the floor of the Senate with respect to the balance-of-payments program. You set forth very clearly in your analysis L the effect of all Government programs on the balance of payments. It is a very helpful document.

Mr. GORDON. Thank you very much.

Senator PROXMIRE. There is one other statement I would like to make. I notice you say something that I think should be stressed over and over again. That is when you say under the paragraph marked "Second":

> As a means of inducing management improvement, the ends-means squeeze in Government can be as effective as the cost-price squeeze in business.

This budget, I think, is a much tighter budget than we have had in the past. There is no question in my mind that this is going to help, just because it is tight and it is tough and priorities have to be selected and made. It is going to result in more efficient operation

I would like to ask you to comment on this. You say:

> On the expenditure side, the 1965 administrative budget projects a small decline from the preceding year, while cash payments to the public are unchanged and Federal expenditures in the national income accounts rise modestly

Here is where the impact on the economy is really portrayed.

Mr. GORDON. I think it is the best measure of the impact.

Senator PROXMIRE. So that if we have an increase in expenditures from the standpoint of national income accounts and a sharp cut in taxes, it would seem that the inflationary impact might be greater this year than in any year in a long time.

Why isn't that true?

Mr. GORDON. Well, I would not call it inflationary impact, Senator, largely because I think we still find ourselves in a situation in which there is widespread slack in the economy, and as you well know, an unemployment rate of 5½ percent, corresponding to 4 million unemployed people.

It is a highly stimulative budget. But I do not believe, given the excessive volume of unemployment and given the presence of unused capital resources, I do not think that this degree of stimulus, combined, as you point out, with a small increase in expenditures in the national income accounts, would have an inflationary impact. We do not believe this threatens inflationary pressures on the economy.

Senator PROXMIRE. You already have a series of increases. You have about a 3-percent increase in steel prices; we have had a big increase in lead and zinc prices, glass prices. Some of these wholesale areas that have been stable for years are now beginning to move ahead.

Mr. GORDON. I think you can always point to this, Senator. I think it is a good thing. I think it would be a paralysis of the economic system if no prices increased. The important thing to watch is the overall index. Some prices are going up while others are going down at any point in time.

Senator PROXMIRE. They are all going the same way.

Mr. GORDON. I don't think they are, Senator.

Senator PROXMIRE. I have a list here of price increases and it is my understanding that the index itself is going to show a price increase—both retail and wholesale——

Mr. GORDON. I haven't brought it up to date, but I had a few months ago a list of wholesale price reductions. It was impressive. As I remember, they were concentrated in the field of chemicals, petroleum products, and rubber products. It seems to me the important thing is to focus on the overall index. We want the kind of flexibility in which prices do change, both up and down.

Senator PROXMIRE. The overall index, I understand, is not out yet, but I would be very interested to see what it reveals.

Mr. GORDON. We have had, as you know, a remarkable period of wholesale price stability.

Senator PROXMIRE. That is correct, and that is something we want to do our best to maintain, overall.

Mr. GORDON. I agree.

Senator PROXMIRE. Now, you have a paragraph here that I think may imply something I do not think you intend. You say:

> The economic stimulus provided by the adoption of these tax proposals should result in an accelerated rate of economic expansion. The calendar 1964 GNP is expected to be some $35 to $40 billion above 1963, compared to a $30 billion rise in the prior year. This acceleration of economic expansion will generate growth in Federal revenues, such that fiscal 1965 tax collections will exceed those of fiscal 1964 by $4.6 billion.

Now, you do not mean to imply that the reduction in the deficit is a result of the tax cut?

Would you not agree with me that the reduction in taxes, the tax cut of $7 or $8 billion this year, will result in an increase in the deficit of maybe $2 or $3 billion?

Mr. GORDON. Even after taking into account the feedback of the stimulus arising from the tax cut, there is a net loss in revenues for 1965 of about $3 billion attributable to the tax cut. The reduction in the deficit, I think, is closely tied to the stability and even slight decline——

Senator PROXMIRE. What I am trying to say is the tax cut this year is going to deepen the deficit. If we did not have the tax cut, if we maintained taxes for 1965 as they are in 1964—rather, if we maintain taxes from March 1 throughout 1964 to what they were in 1963, we would have a surplus, not a deficit.

Mr. GORDON. This would depend very much, Senator, on how you projected the behavior of the economy in the absence of the stimulus that a tax cut would provide. As you know, this expansion is about to outstrip in duration all of the postwar expansions we have had. To believe that without the stimulus provided by this budget, the economy would rise as fast as it would rise with the tax cut, would in my opinion be a very implausible presumption.

Senator PROXMIRE. No. I am not assuming that at all. I am assuming that we have a continued performance in 1964 that we had in 1963, that we had about a 4.5 increase in GNP without a tax cut, a 5-percent increase with a tax cut. That seems to be fairly logical in view of the size of the tax cut and the size of the GNP. If you have that, it seems to me clear if you can project about a $5 billion deficit with a tax cut, you can have a surplus without a tax cut.

Mr. GORDON. If the economy moves up that fast, and this seems to me a very shaky and questionable presumption. I think most of us would agree that a part of the very good performance—at least a part of the expansion of the economy last year—was both a response to the earlier corporate tax cut, in 1962, and an anticipation on the part of business firms of the tax reduction which they had been led to expect.

Now, it seems to me that the psychological effect of the failure to enact the tax cut could hardly be consistent with the kind of continued rapid expansion that you assume.

Senator PROXMIRE. Let me get at just some arithmetic. You said that the tax cut would result in a counterincrease in revenue; that is, ignoring the fact that you eliminate this revenue of $7 or $8 billion. But the tax cut would stimulate the GNP to such an extent that we would have an increase of $3 billion, not net increase, but an increase of $3 billion——

Mr. GORDON. The budget estimates, I think, show an increase of about $3 billion in 1965 over 1964 in revenues from individual and corporate income taxes.

Senator PROXMIRE. All right; fine. Now, you have a reduction, however, of—is it $8 billion in 1964?

Mr. GORDON. Well, that is not the liabilities figure. There would be a reduction under the present proposal in withholdings of about $8 billion in the present calendar year.

Senator PROXMIRE. Why would it not be proper to take the $8 billion and subtract the $3 billion and come up with a net loss of $5 billion, so that if you did not have the tax cut, you would balance the budget?

Mr. GORDON. Because the reduction in withholdings, Senator, in calendar year 1964 would not be a measure of the effect of the tax reduction on tax revenues in fiscal year 1965.

As I said, we are assuming a net decline of about $3 billion in revenues attributable to the tax cut, taking into account the economic stimulus of the tax cut.

Senator PROXMIRE. Oh, a net decline in tax revenues of $3 billion?

Mr. GORDON. That is correct.

Senator PROXMIRE. That is the figure I want.

So that instead of having a deficit of $4.9 billion, you would have a deficit of $1.9 billion?

Mr. GORDON. If you subtract that $3 billion from the deficit, that is correct, sir.

Senator PROXMIRE. On the basis of your assumptions.

Mr. GORDON. That is correct.

Senator PROXMIRE. I see my time is up, Mr. Chairman.

Chairman DOUGLAS. Senator Jordan?

Senator JORDAN. When the tax cut was first proposed, it was on the order of $11 billion. With estimates of higher levels of income for 1964, are you still holding to that $11 billion of tax cut, or will it be somewhat higher than that?

Mr. GORDON. I am afraid, Mr. Jordan, I cannot answer that question from memory. The revenue estimating is in the province of the Treasury Department, and Secretary Dillon will be here tomorrow and may be able to answer it for you. If I remember correctly, and my memory may be fallible here, the estimate of the total size of the tax cut when it was first proposed by President Kennedy a year ago was somewhat below $11 billion, and was based on calendar year 1963 incomes as then estimated.

The present $11 billion figure is calculated on the basis of the current tax proposals and actual 1963 incomes, which are somewhat higher than the earlier estimate.

Senator JORDAN. With the buoyancy in this year's income, it would be higher yet, would it not?

Mr. GORDON. Applied to a higher level of income, any given reduction in taxes would produce a higher measure of gross reduction, correct.

Senator JORDAN. I was interested in your assurance that we have stablized prices. When Mr. Heller was here last week, I recall a colloquy between Mr. Heller and Senator Miller regarding the $100 billion increase in gross national product in the last 2 or 3 years. I think they agreed finally that about $81 billion of that was a real increase; the rest of it was inflation.

Mr. GORDON. I am not sure that I would agree with the word "inflation" to describe that, Senator. I agree with the numbers. The increase in gross national product from the first quarter of 1961 to the fourth quarter of 1963 in current prices was about $100 billion, and with unchanged prices, over $80 billion.

Senator JORDAN. What would you call that $19 billion, then?

Mr. GORDON. It represents an increase in what is technically called the GNP deflator, which has been going up, as has the Consumer Price Index, although at a very low rate.

The real problem here, I think, Senator, when you are dealing with changes this small, has to do with whether the implicit price index in gross national product accurately measures changes in quality. There are arguments about this among statisticians. I know that recently, when a very able committee was established to study the Consumer Price Index, there was a feeling that despite strong and effective efforts to take account of quality improvements in the Consumer Price Index, the index has not wholly succeeded in doing so.

We are talking here of small changes on the order of 1 or a little over 1 percent a year. It is difficult in cases of increases that small to place absolute reliance on an index which is affected by quality improvement.

Take the purchase of services by the Government as part of gross national product. We know there are defects in the way Government services are measured. We know, for example, that in some identifiable parts of Government operations, there are improvements in productivity, so that the same amount of work yields more output But this is not taken into account in the way we measure the gross national product deflator.

All that I think I am really saying, Senator, is that when one is dealing with changes of the order of 1 percent, it is awfully hard to be very confident that he is dealing with real rather than illusory changes.

Senator JORDAN. I appreciate that. I am just wondering about the great reluctance of all witnesses, or their desire to stay away from the word "inflation." In a sense, they will talk about an increase in the deflator, but they will stay away from the use of the word "inflation." I don't know, myself, the difference between an increase in deflators and inflation itself.

Mr. GORDON. If you look over the past 6 years, you will find that the index of wholesale prices has been about as flat as a pool table, with some small jiggles. You will find the Consumer Price Index, which measures a somewhat different set of prices, has gone up something a little over 1 or 1.2 percent. You will find that the GNP deflator, which is the broadest kind of index, including government, investment, and such things, has gone up a little over 1 percent a year.

Now, remembering that wholesale prices—the base prices—have been quite stable, this kind of pattern, I think, can be regarded as reflecting a general climate of price stability. That may answer your point.

You can always point to prices of particular goods or particular parts of price indexes which are going up. But I think if you look at the whole picture, you can conclude that it is a fair statement to say at least over this 6-year period, we have had relative stability.

Senator JORDAN. In your opinion, Mr. Director, when will the budget be balanced?

Mr. GORDON. This is a question that was asked of me and of Secretary Dillon last year before the Ways and Means Committee, and, I think, the Senate Finance Committee. I liked Secretary Dillon's answer which was, then, "Fiscal 1968 and possibly 1967." I would say on the basis of events since then that the likelihood of a balanced budget at full prosperity in 1967 is considerably brighter than it was at the time the earlier answer was made. I would put somewhat more emphasis on the 1967 possibility.

Senator JORDAN. You would shorten it to that extent, from 1968 to 1967?

Mr. GORDON. At least to increase the likelihood of a balance by 1967.

Senator JORDAN. Now, getting back to the area of Senator Proxmire's question, you talk about "The economic stimulus provided by the adoption of these tax proposals should result in an accelerated rate of economic expansion. The calendar 1964 GNP is expected to be some $35 to $40 billion above 1963, compared to a $30 billion rise in the prior year." And you expect to accelerate that more with this tax cut. You still do not believe that that would be likely to be inflationary?

Mr. GORDON. Senator, I believe that when we have 4 million workers unemployed, when most measures of capacity utilization show that we still have a margin of unused capacity, when measures worked out by the Council of Economic Advisers show a $30 billion gap today between what we are actually producing and what we are comfortably able to produce, I believe that the degree of stimulus which is contained in this budget should narrow this gap, should create more jobs, and reduce unemployment. But I do not think that it is of the order which will carry us beyond full employment to inflation.

Senator JORDAN. Now, with respect to manpower, unemployed manpower of five and a half percent, broken down structurally, we find that the percentage of very young and very old is much higher, of course, than those in the middle-aged brackets and those of the unemployed unskilled youths are the highest of all.

Now, we have testimony before the Employment and Manpower Subcommittee showing that many of these unemployed youths who constitute part of the five and a half percent unemployed need basic literacy training before they can absorb even vocational education. It is going to be a long time before these young people are made employable under any kind of remedial action you can take in the way of doing away with poverty. Would you agree to that?

Mr. GORDON. I certainly would agree, Senator, that in present circumstances, we will have to achieve a better adaptation of the skills of the labor force to the demands of industry in order to get unemployment down significantly below the 4-percent figure which we have been talking about as an interim target. But I think the reasons you have given really explain why we have regarded 4 percent as an interim target. This, in comparison with the rates of unemployment in the European countries is still quite high and would still be regarded as extremely high in some of these countries.

Now, I agree with your basic premise and that is why I support so strongly the various efforts which are being made, and I think with increasing success, to provide the kind of training to youth and to unemployed workers necessary to adapt their skills and talents to modern job opportunities.

The manpower development and training program this year is going to train over 100,000 people. Next year, this goes up to over 275,000 people, if I remember correctly. This administration has recognized that improvements in vocational training are necessary in order to get a better fit between the skills of the unemployed and emerging job opportunities, and I think its program to provide such training is now moving very well and accelerating at a rapid pace.

Senator JORDAN. I agree with you, Mr. Director, we need it very greatly.

My time is up. I yield.

Chairman DOUGLAS. Congressman Reuss.

Representative REUSS. Mr. Gordon, when the United States Steel Co., or any other private concern budgets, let us say, for a new road from the plant gate to the office or for a new laboratory, that goes into the capital investment column and does not show up in the anticipated receipts and expenditures column. Is that about right?

Mr. GORDON. That is correct, Mr. Reuss.

Representative REUSS. Yet in your budget here, as I understand it, you have almost $17 billion worth of investments which you nevertheless book under the current receipts and expenditure headings.

Mr. GORDON. I would have to check the exact figure, Mr. Reuss.

Representative REUSS. Well, the figures I derive seem to be $8.9 billion for civilian investment outlays and $7.9 billion for other developmental purposes.

Mr. GORDON. There certainly are substantial additions to assets in the Federal budget, and you are quite right, we treat them as expenditures in the ordinary budget, chargeable to ordinary revenues.

Representative REUSS. If United States Steel in its annual budgeting practices did that with its laboratories and roads and so on, with its capital investments, it would show a horrible deficit; would it not?

Mr. GORDON. I am not sure about the particular case you chose, but it would certainly be true for many corporations. The American Telephone & Telegraph Co., of course, invests enormous sums each year. I am sure if they treated these investments as a charge against current year operating revenues, their profits would be greatly reduced or they would show substantial losses.

Representative REUSS. Would you and your associates prepare and submit, so that it can be inserted into the record a budget of the United States of America as it would appear if you followed the same conservative investment accounting practices of any private concern?

Mr. GORDON. Well, we have done——

Representative REUSS. The surplus you have should make us very happy.

Mr. GORDON. We have done some work in looking at the capital component of the Federal budget. It is not as easy to produce these figures and defend them as it might seem on the surface. One thing we would have to do to present such a statement would be to make judgments on depreciation for all physical property owned by the Federal Government, because depreciation, in ordinary corporate accounting, is a charge against current income. I am really not sure we are prepared to make such an estimate and stand behind it. The depreciation problem would be a particularly difficult one.

Representative REUSS. Well, could you not follow as closely as possible practices prevailing in corporate accounting? If United States Steel depreciates its highway from the plant gate to the office at the rate of 2 percent, let us say, I should think that that would be a fair analogy for your depreciation of——

Mr. GORDON. Where would we find our parallels, Mr. Reuss, for Polaris submarines, Minuteman missiles, B–58 bombers?

Representative REUSS. If you cannot find a comparison or a parallel, put this in a column called All Other.

Seriously, I suspect that we get an unduly gloomy view of our economic position annually because you book as a current expense that which any private corporation would book as a capital investment.

Mr. GORDON. We do, as you say, book it as a current expense although we show it separately in the special analysis D of the budget.

Representative REUSS. I suspect you will find, when you make this projection, that we are running a surplus this year, making a profit under any of your views. This might help with public education, because if we imposed on our private corporations the same Elizabethan accounting procedures we impose on you, stockholders would be in an uproar at their annual meetings, feeling that their corporate managers were going broke when, in fact, they were making sound capital investments which in years to come will enhance the net worth of that corporation.

Mr. GORDON. May we leave it, Mr. Reuss, that we will make a conscientious effort to provide figures as close as we can to the figures that I understand you to want? I am concerned about our depreciation problem. I am not sure how to handle it, but we will make a response and try to come as close as we can.

(Mr. Gordon subsequently indicated that the information referred to is being prepared and will be sent to Representative Reuss for his file as soon as it is completed.)

Representative REUSS. That is what I want. I realize that makes it difficult.

In your statement, you refer to $8 billion of additional income in the pockets of consumers in calendar 1964 as a result of the tax cut. Is that based on an assumption that the tax withholding will be reduced as of February 1, 1964?

Mr. GORDON. The $8 billion assumes March 1. We figure approximately $800 million of additional income per month, Mr. Reuss.

Now, hopefully, the reduction in withholding will become effective before then, but this we regard as a conservative estimate.

Representative REUSS. In response to a question from my colleague, Senator Proxmire, on the budget impact of having or not having a tax cut, you testified, I believe, that with a tax cut, our fiscal 1965 budget deficit would be $4.9 billion; without a tax cut, $1.9 billion.

Mr. GORDON. Well, this has to be qualified, Mr. Reuss, by saying that this makes assumptions with respect to the behavior of the economy after the psychological shock of the assumed failure of the tax cut, which I do not think are very realistic. I was simply providing the numbers to go along with Senator Proxmire's assumptions.

Representative REUSS. So that the budgetary saving, the diminution of the deficit, might in fact be less than that $3 billion?

Mr. GORDON. It might. It is perfectly conceivable, Mr. Reuss, that there would be no diminution, but an increase in the deficit, if you take a gloomy view of the response of the economy to such a shocking reversal of expectations.

Representative REUSS. Be that as it may, the fact is undeniable that with a tax cut, we have a deficit of 4.9; without a tax cut, we have a deficit that may be very little better, but at best is still close to $2 billion? So you have a deficit either way?

Mr. GORDON. Well, this is the conclusion you are drawing, Mr. Reuss. I would say that there are circumstances under which the deficit could be larger than $4.9 billion in the absence of a tax cut.

Representative REUSS. Yes. Well, the 4.9 is with a tax cut?

Mr. GORDON. That is correct. What I am suggesting is that if the shock to expectations produced by the failure of the tax cut were to precipitate a decline in economic activity, the effect of this decline might actually cause the deficit to rise. This is not, of course, a prediction, but we are spelling out the range of possibilities here.

Representative REUSS. I did not mean to tarry on this point, because it is enough for the question I am going to ask that with a tax cut or without a tax cut, we have a deficit either way on this budget?

Mr. GORDON. I believe that is correct.

Senator PROXMIRE. Would the Senator yield for just one question?

Representative REUSS. Thank you for the on-the-spot promotion, Congressman.

Senator PROXMIRE. Not necessarily. You were saying to Congressman Reuss that we would not necessarily have a $1.9 billion deficit with a tax cut, because it might be—you mean if we didn't have the tax cut, the deficit would not be 1.9? It might be more than that, might be 2, 3, or so on?

Mr. GORDON. That is correct.

Senator PROXMIRE. At the same time you would also, I know, as a good economist knowing the perils of the forecast, admit that if we do not have a tax cut, it is perfectly possible, as Fortune magazine has indicated, we could have a balanced budget. I should say "implied," not "indicated." Would you agree that that kind of a prognostication is possible?

Mr. GORDON. It is possible.

I share your uneasiness, Senator, about the reliability of short-term forecasting and of course, I am most unwilling to commit myself to a forecast on hypothetical assumptions. But certainly, if you want to assume that the economy will continue to expand at the rate we are assuming here—the rate of $35 or $40 billion a year—(which in the absence of a tax cut seems to be most unlikely) it is then perfectly possible that the result would be a balanced budget or even a small surplus.

Representative REUSS. Now, may I ask my question, which is this: In the light of the probability that there will be a deficit in the event of a tax cut, and also in the event of no tax cut, is the choice really one between having a deficit and not having a deficit, or is it between having a deficit with, at the end of the year, something like 5 percent unemployed and only 10 percent of the productive capacity of this country unused, and having an unemployment rate of something over 6 percent of the work force and something around 15 percent of the productive capacity of the country unused?

Mr. GORDON. I think that is a much more realistic choice, Mr. Reuss. As I said, depending on the nature of the psychological reaction, it would seem to me that we could very well, in the absence of a tax cut, end up with a somewhat higher deficit. I cite this simply as a kind of limit to the range of possibilities. rather than as a prediction.

Representative REUSS. In the discussion of the attack on poverty, you estimate that over $1 billion of new obligational authority can be made available in fiscal 1965 for that program? I asked Mr. Heller about that the other day.

Mr. GORDON. Yes. He told me.

Representative REUSS. He said, "Wait for Mr. Gordon." Can you give me the figures on it?

Mr. GORDON. I cannot give you them in precise detail, Mr. Reuss. As you know, the President will send to Congress both legislation for the attack on poverty and a special message supporting it. I can give you a rough idea, which I hope will satisfy you.

First we start off with the $500 million special allowance for the attack on poverty. Then, two additional kinds of outlays are planned. One is the use of funds in proposed new programs through the machinery of the community action programs, and the other is the use of funds from ongoing programs, not new programs, in the community action program.

Now, these come to something a little over $300 million, for each of these categories.

In the first category, the new programs category, let me cite just two examples. The Youth Employment Act is one. Part of the funds that would be made available under the Youth Employment Act for community work projects can be used in these community action programs.

A second would be the special projects proposals in the education legislation. Some part of these special project funds could be used in connection with the special educational projects involved in the community action programs.

Now, the total of all these——

Representative REUSS. How much do these new programs——

Mr. GORDON. The total of what could be used in the community action programs is a little over $300 million.

Representative REUSS. What about the ongoing programs?

Mr. GORDON. A good example of use of ongoing programs would be the manpower development and training program, where training projects could be established as a part of these community action programs, with financing from funds available for the Manpower Training Act. Funds provided through such programs as this could also amount to a little over $300 million. So we get a total of between $1.1 and $1.2 billion of new obligational authority; very roughly, $500 million for the special allowance on poverty; $300 million-plus for the new programs; $300 million-plus for activities out of funds available for ongoing activities.

Representative REUSS. Would you break down that $500 million special funds figure? What does that consist of?

Mr. GORDON. This is very difficult to break down, Mr. Reuss, the reason being that these funds would be made available in conjunction with State and local funds to finance community action programs for attacks on local pockets of poverty in accordance with comprehensive plans drawn up at the local level and approved by the Federal Government. These would include activities in the field of education, health, training, and job opportunities, but it is obviously impossible to allocate these funds among these various programs because they are so dependent upon the analysis of the nature of the local problem by the community and the nature of the proposals which the community makes to the Federal Government.

Representative REUSS. Do we now have authorizing legislation for any of that $500 million?

Mr. GORDON. No; we do not. The proposed legislation which the President is sending to the Congress would constitute the authorizing legislation.

Representative REUSS. Thank you.

Chairman DOUGLAS. Mr. Gordon, your estimates of revenue are, of course, based on the assumptions of the gross national product as distributed between personal income and corporate profits and the like. I probably should have addressed this question to Mr. Heller, but I was not able to be in the room during most of that time, so I will address this question to you as I presume you sat in with the Council of Economic Advisers in making their estimates of gross national product for the coming year.

Now, I take it that you are assuming an increase from $585 billion in 1963 to $623 billion in 1964, an increase of $38 billion, or about 6.5 percent. Is that true?

Mr. GORDON. Those are the correct numbers, Mr. Chairman. The $623 billion is stated as the midpoint of a $10 billion range; that is correct.

Chairman DOUGLAS. As between the ends of the years, between $600 billion at the end of 1963 and about $635 or $640 billion at the end of 1964?

Mr. GORDON. These are the calendar years?

Chairman DOUGLAS. Yes.

Mr. GORDON. Let me consult with Mr. Schultze.

Chairman DOUGLAS. Mr. Knowles has just called my attention to the fact that your figures on gross national product for the calendar year determine your estimates of governmental income for the fiscal year. Isn't that true, because of the lag in payment? In April you pay on the past year.

Mr. GORDON. Mr. Schultze has been following these numbers. I would like to ask him to answer your question.

Mr. SCHULTZE. Basically, the numbers you have given for the end of year calendar quarters are in the correct range.

Chairman DOUGLAS. I beg your pardon?

Mr. SCHULTZE. The numbers you have given, Senator, for the end of year increase in GNP that is implicit in our estimates is in pretty much the right ball park.

Chairman DOUGLAS. That is an increase of around $38 billion, or 6.5 percent.

Now, how much of this is increase in the price level? One percent?

Mr. SCHULTZE. In terms of the GNP deflator, it is slightly over 1 percent. Whether it is 1.1 or 1.2, I am not sure.

Chairman DOUGLAS. That is an increase of roughly 5½ percent?

Mr. SCHULTZE. A little over 5.

Chairman DOUGLAS. How much of this do you attribute to the secular growth in the economy and how much to the stimulus which you believe will be created by the tax cut?

Mr. SCHULTZE. Well, I will put it this way: If you assume that without the tax cut, the economy would continue to grow at roughly the same rate it has been growing over the last 5 or 6 years——

Chairman DOUGLAS. Which is?

Mr. SCHULTZE. Which is somewhere in the neighborhood of 3 or 3.5 percent a year; on that assumption, there is an additional $10 to $15 billion of GNP from the stimulus of the tax cut. Given that assumption, the stimulus would be larger by the end of the year than for the average for the year as a whole, because it takes time to percolate, if you will, into the economy. That is point No. 1.

However, I hesitate a little to give this neat an answer, because as the Director indicated earlier, if for some reason the tax cut should not be enacted, then rather than having this 5- or 6-year trend line to operate on, it might very well be possible to be operating from a lower trend line because of the disappointing impact of the failure of the tax bill. But if you discount that danger, it is somewhere in the neighborhood of $10 to $15 billion additional stimulus from the cut.

Chairman DOUGLAS. How much reemployment do you think this will effect? Do you have a figure of the ratio between additional units of GNP and additional units of employment?

Mr. SCHULTZE. Well, first, Senator, the Council's estimates indicate that, given enactment of the tax cut early this year, the economy should be passing the 5 percent unemployment level in the right direction by the end of the year.

Chairman DOUGLAS. You mean a reduction of only one-half of 1 percent?

Mr. SCHULTZE. No; by that I mean that, for example, by December—although we do not do this by months—we should be passing below 5 percent and on the way toward 4. Now, precisely whether that would be 4.8 or 4.7 or 4.9, I would hesitate to say. Frankly, I do not remember the precise quarterly numbers we worked out, but this is the basic shape of the improvement in employment.

I think the key to this, Senator, is not so much that this is directed toward getting us to a 5-percent unemployment level, but rather that it is directed toward moving the economy toward a 4-percent unemployment level. Given the timelags involved, we feel that sometime by the end of the year, the economy will have passed that 5-percent line.

Chairman DOUGLAS. When the full effects of this tax cut take take effect, how much reemployment do you expect?

Mr. SCHULTZE. Let me express it in terms of the unemployment rate. We have calculated on what I will call "cold calculation." By that, I mean we did not have any particular objective in the back of our mind. The tax cut, as best we can figure, or I should say the Council has figured, should do the job of getting the economy to the 4-percent level in terms of unemployment.

Chairman DOUGLAS. You would expect a decrease of 1.5 percent?

Mr. SCHULTZE. Correct; from what is the current level.

Chairman DOUGLAS. Yes; in absolute figures.

Mr. SCHULTZE. Correct.

Chairman DOUGLAS. That would be roughly a million people; would it not?

Mr. SCHULTZE. I am sorry, sir——

Chairman DOUGLAS. That would be reemployment of approximately 900,000 or 1 million.

Mr. SCHULTZE. Not precisely. One of the other impacts that will presumably result from the economy moving up at a faster rate is that a number of people who have dropped out of the labor force will come back in. Again, I do not remember the numbers, but there is fairly clear evidence that the slack in the economy in the last 5 years and lack of job opportunities is not only reflected in the unemployment statistics, but has also in the labor force. So when I say this tax cut is geared toward 4 percent, it will add more employment than can be gotten simply by calculating 1½ percent times the labor force.

Chairman DOUGLAS. That will also be a reduction of a short time, too.

Mr. SCHULTZE. That is correct, sir. I am sorry to say I do not have the absolute number at hand.

Chairman DOUGLAS. I understand. I do not think anyone can estimate the absolute number. These are all approximations.

Well, if that goal can be achieved, I think it is worth the tax cut—if it can be.

Mr. SCHULTZE. We certainly think so.

Chairman DOUGLAS. Now, Mr. Gordon, I, like Congressman Reuss, was very much interested in your pages on the attack on poverty and the program of the administration.

I am delighted that the administration is taking up this program. I think perhaps Mr. Galbraith's book had an unintended effect in speaking of the affluent society.

Mr. GORDON. I think many readers overlooked Mr. Galbraith's discussion of poverty in the midst of affluence.

Chairman DOUGLAS. I think in some ways it acted as an opiate on the American people. The studies which this committee has made and the comparison of employment levels with wage studies indicated to my mind that at least a fifth of the people were below subsistence level and a fourth below the subsistence-plus level.

We all remember the thirties, when President Roosevelt, in his second inaugural address, mentioned a third of the Nation ill clothed, ill housed, and ill fed. He was attacked at the time for exaggerating the situation. The statistical studies seemed to indicate that it was 37 percent, three-eighths rather than one-third, at the time.

Recently, of course, there was the remarkable book by Michael Harrington, "The Other America: Poverty in the United States," which I think is one of the most notable books we have had on this whole subject, and, as I understand, served as a stimulus for this program. I hope you do not flag in this struggle.

Mr. GORDON. I must say, Mr. Chairman, that one of the things that makes me a bit uneasy about this problem is the conclusion that I think some people have leaped to much too hastily, that this should produce quick and miraculous results. It seems to me this arises from an erroneous analysis of the real roots of the poverty problem. This is a long-term program. It is not something that is going to produce spectacular results in a short time. It has to focus on what someone has called the culture of poverty. It has to deal with root causes, the kinds of cultural and educational and family and health considerations which pass on from one generation to the next the fetters of poverty. This is obviously not the sort of thing that can be overcome in a year or 2 years. This is a beginning. It is a long-term program and a program which I think is starting off at the right level and starting off with an experimental cast to it, because a great deal of experimentation is going to have to be done in local communities to find the right route to this attack.

I agree with what you have said completely, and I would think that an examination of the Harrington book and of the Council's very excellent chapter on poverty in the Economic Report, clearly indicates that this is a long-term campaign, a campaign on which we must start immediately, but from which we cannot expect spectacular results overnight.

Chairman DOUGLAS. Well, there is a Chinese saying which I have repeated until it is shopworn and threadbare. A journey of a thousand miles begins with one step. It is very important that the length of the journey does not prevent us from taking the first step and then the successive steps.

Congressman Curtis?

Representative CURTIS. Yes. Like all Americans, I am interested in moving in on poverty. I hope before we get too far in using adjectives, though, we establish some criteria and benchmarks. I think we have too many descriptive phrases here.

Or course, I think one thing we want to do is get the ratio of income and wealth spread throughout our society. I saw some interesting figures just the other evening which took as a criterion the upper 5 percent in a society and related it to the lowest 50 percent. On that basis, the United States has about a 5-to-1 ratio; Russia a 10-to-1 ratio; other nations I saw were 15 and 20.

I don't know whether that is a good criterion or whether the benchmarks are good. But this is the kind of study I think we should get into. Otherwise, the demagogs will take this completely away and make it meaningless. We will probably end up doing a poorer job than we have been in past years, because, of course, we have been making progress in cutting down on poverty.

Mr. Director, I should have been more gracious when I started. Senator Proxmire's inquiry reminded me of this point. Indeed, I share with him the pleasure at the advancement in the budget techniques and the presentations. But I think it primarily relates to the budget as an economic document, and I certainly do applaud that movement forward.

My remarks and my inquiry are going to continue along these lines—the budget as a document to assist Congress in dealing with appropriations bills, and indeed, with fiscal policy.

As you may recall, when our Subcommittee on Economic Statistics went into the budget as an economic document, I directed attention to the need to make the budget a more effective tool for the Congress. This is particularly true, I think, in bringing new obligational authority, which, after all, is our appropriation process, closer to the expenditure levels of the fiscal year. We on the Ways and Means Committee have to deal with this because of our concern for revenues and debt management.

One of the things I had hoped we would do, I do not find here, maybe it is too difficult. In the new obligational authority request, you show about what percentage you anticipate will be spent in 1965 to some degree through your area of balances. But I thought it might even be possible to project it out into new obligational authority projected for expenditure in 1966 and 1967.

What we do is stop with 1965. Rather, we have 1965, and then that which will be spent at a later period.

This comes to this very key item of carryover balances that you do have in the budget. I think the carryover balance for 1963 was $87.2 billion. It is in the budget message. I don't have the chart immediately in front of me. You have it in both the budget—here it is. It is on page 49; is it not? Well, it does not show that figure.

Mr. GORDON. On page 51 of the budget, Mr. Curtis, I think—it is broken down into two categories, obligated and unobligated.

If you add those together, you get $87.6 billion.

Representative CURTIS. $87.6 billion. According to this estimate on page 49, table 8, you are going to have a carryover of $90.4 billion; is that correct?

Is that comparable?

Mr. GORDON. At the end of 1964 and moving into 1965, it comes to 90.4; that is correct.

Representative CURTIS. Yes; $90.4 billion.

It is interesting to me why those figures should go up, particularly as the expenditure levels went up so drastically, from $92.3 billion to $98.4 billion, comparing fiscal 1963 with fiscal 1964. So it leads to this question: Have you put in a supplemental appropriation bill for fiscal 1964?

Mr. GORDON. That is correct.

Representative CURTIS. That is around 4 billion what?

Mr. GORDON. No; the bill which was sent up the same day as the budget message proposed total new obligational authority of $2.2 billion.

Representative CURTIS. Where did I get the $4 billion?

Mr. GORDON. I think you got that because there are other items listed in the 1964 column of the budget as proposed for separate submission, but which cannot yet be submitted because the authorizing legislation has not passed.

Representative CURTIS. It actually would be true in theory for fiscal 1964?

Mr. GORDON. That is correct. It is $4.2 billion, of which $2.2 billion has already been submitted and the rest is very largely dependent on the enactment of new authorizing legislation.

Representative CURTIS. If this were granted, what would total NOA be for fiscal 1964? I thought we had it down to about $102.3 billion.

Mr. GORDON. Exactly. That is all included. Let me stress that point because there is so much misunderstanding about it.

Every penny and every job in the supplemental which went to Congress January 21 is included in the 1964 column of this budget.

Representative CURTIS. Very good. My figure was wrong when I said $102 billion. It is——

Mr. GORDON. $102.6 billion, in which that $4.2 billion of NOA is included.

Representative CURTIS. Very good. Now, getting to these details again of where this $600 million increase is from the $97.8 billion expenditure figure given us in November which became $98.4 billion. I use November because that is the figure Congress used when we passed the new debt ceiling on November 21. That increase of

$600 million is somewhere, and you may supply it, if you will, for the record.

I would like to know just where the increases are. The estimate you gave us was $97.8 billion, and, as I say, in less than 2 months on a reestimate, it went up to $98.4 billion. Why?

Mr. GORDON. We can make a detailed comparison between the 1964 estimates for expenditure included in this budget and those included in the budget for a year ago.

Now, I made it very clear when I testified before the Ways and Means Committee that—in part because Congress had not yet appropriated the funds for 1964—we could not, in those estimates, give a detailed analysis——

Representative CURTIS. That is why I ask this question each time. That assumption should have made your estimate not more but less, I would say.

Mr. GORDON. There is one fact I can cite which I think will help to clear this up, Mr. Curtis.

First, let me say that, on the basis of the historical record, any estimate of current year expenditures which we make now is subject to some error. We hope to keep the error as small as possible. We made one last year. I have, however, more confidence in the accuracy of the present estimate because we now have 6 months of the fiscal year behind us. In the first 6 months of fiscal 1964, expenditures were at an annual rate of $97.7 billion. Now we know several things about that figure.

We know, first, that historically, in something like 6 of the last 8 years, defense expenditures have tended to be higher in the second half of the fiscal year than the first. In the case of defense, we know that there is a special reason for it this year. We had a military pay increase effective October 1. We got only one-quarter of that in the first 6 months of the year; we will get two-quarters in the second 6 months. That in itself accounts for an increase in expenditures of $300 million.

We also know that we have a civilian pay increase which became effective January 1, and that we will have an increase——

Representative CURTIS. January 1 of——

Mr. GORDON. 1964. We also know that most of the expenditures have not yet been made under the impacted areas education legislation. That will come in the second half of the year. So that all these factors—although there are some offsets—indicate that the expenditures in the second half of this fiscal year will be somewhat greater than the first half.

Starting out with an annual rate of $97.7 billion actual in the first 6 months, this increases my confidence in the $98.4 billion figure.

Representative CURTIS. This increase in pay raise could have been anticipated in the November estimate, and I think these other things could, too.

Now, let me go on to what I am really leading to for fiscal 1965 expenditure levels.

Do you expect this same trend to occur? Will the first 6 months of fiscal 1965 be a little larger than the second?

Mr. GORDON. This year, it is the other way around.

First, I have not looked at it from that point of view for the entire budget. But certainly, I have looked at the pattern of defense expenditures, and here there is a quite regular pattern of somewhat higher expenditures in the second half of the fiscal year than the first. Of course, this represents half the budget.

Representative CURTIS. I will pose the question I am coming to, but my time is up so we will come back for your answer.

In the Economic Report, beginning at the bottom of page 51 and the top of page 52, it says all of the President's budget will call for a decline in administrative budget expenditures from fiscal 1964 to fiscal 1965. However, Federal purchases of goods and services are projected to increase by $2.5 billion from calendar 1963 to calendar 1964.

Now, if the second half of fiscal year 1965 will be a little greater than the first half, this increase will be a little more. I also call attention to the fact that if this figure of increased purchases of goods and services is accurate, the cost for the Federal payroll will increase for that fiscal year, because it will be a full year of increased salaries and interest rates will be going up. When I come back, I want to find out how this can be in the light of these projections of only $100 million, or, rather, $500 million decrease in expenditure levels from the $98.4 billion in fiscal year 1964 to $97.9 billion. We will have to come back to it, as I say, because my time has expired.

Chairman DOUGLAS. Senator Proxmire?

Senator PROXMIRE. The chairman, Senator Douglas, asked about the stimulative effect of various elements in the budget on the economy, inflation and so forth. I would like to ask if it is not true that on the basis of your own statement that about 20 percent of the increase will come not from a tax cut, but an expenditure increase—this seems to have been overlooked by the fact that everybody talks in the press that we are going to have a reduction in the administrative budget, but the real economic impact they have overlooked.

The real economic impact is going to be in the national income accounts area, where you are going to get—the total stimulative effect of the budget is going to include the expenditure side.

Mr. GORDON. That is correct. Of course, the expenditure increase in the national income accounts is very small compared to past years.

But on the central point you make, you know as well as anyone that we have been trying for some 2 or 3 years to get people to pay more attention to the Federal sector of the national income accounts and the consolidated cash budget. As you notice, we give them equal emphasis in the first table on the budget. But traditions are deeply rooted here, and it is very difficult to get the degree of attention for these other concepts that they deserve.

Senator PROXMIRE. On page 47 of the budget, you have a list of Federal employment. You compare some of the departments' 1964 estimate and 1965 estimate. I notice that while the Department of Defense declines by some 18,000 jobs, the net overall jobs remain about stationary. There is not much change.

Mr. GORDON. In those major departments——

Senator PROXMIRE. So all the others increase.

Mr. GORDON. The Department of Agriculture goes down——

Senator PROXMIRE. I should say the others have a net increase. The Department of Agriculture has a small decrease.

Mr. GORDON. The table that gives you the figures on all agencies is on page 53 of the budget. This lists many more of the agencies than the table which you have just called my attention to. But your main point is quite correct.

The principal decline in employment that offsets the pattern of increases and decreases elsewhere is in the Department of Defense. This is the first time that Defense civilian employment will get below a million people since the very early 1950's.

Senator PROXMIRE. Health, Education, and Welfare has increased about 5.5 percent, there, I think.

Mr. GORDON. Yes; and this is, I think, a clear reflection of the expansion in health programs and of the new education programs. This is a reflection of the same kind of emphasis which is embodied in the basic strategy of the budget.

Senator PROXMIRE. GSA has an increase, it looks like, of about 5 or 6 percent. Why is that?

Mr. STAATS. This is the employment involved in opening up new buildings, and providing for their cleaning and maintenance. It is merely shifting offices from leased space, where the employment will show up in the private sector, into Government-owned buildings where employment shows in the Government sector.

Senator PROXMIRE. Because it is more economical if they do not operate on a contract basis?

Mr. STAATS. That is correct.

Senator PROXMIRE. Unfortunately, I had not seen that column before. That is a very helpful column, I think, indicating the comparisons.

HEW is the biggest percentage increase.

Mr. GORDON. It is certainly one of the larger increases. It may be the largest.

As I pointed out in my statement, these figures, in a sense, are already slightly obsolete, because the agencies in their answers to the President's directive of December 24 have already indicated that they will be able to reduce their employment below what is shown for both these years——

Senator PROXMIRE. The Post Office decrease will be indicated here, because I remember Postmaster General Gronouski said——

Mr. GORDON. That is correct. We are currently analyzing these responses and there will be an announcement as soon as we have determined——

Senator PROXMIRE. We don't include the analyses on the basis of the President's responses——

Mr. GORDON. No; that was sent out on December 24 and the replies came in on January 10. So we were not able to include those replies in the budget figures.

Mr. STAATS. I think you will find the Post Office shows the largest single increase in absolute numbers. But, as you know, we have had an increase in mail volume from fiscal 1963 to fiscal 1965 of about 6.5 percent, with less than a 2-percent increase in personnel.

Senator PROXMIRE. The Postmaster General indicated he was going to reduce that.

Mr. STAATS. We are still working on that. We hope to achieve some further reduction yet.

Senator PROXMIRE. It is an enormous department, so the percentage decrease is still smaller than HEW.

Mr. GORDON. The reason we insist on analyzing these voluntary reductions before they are adopted is to make sure that they are not being achieved through the institution of uneconomic practices. As you know, contracting out is a way of reducing employment. Sometimes contracting out is more economical than direct hire, sometimes it is less economical. These plans have to be looked at very closely to be sure that these decreases reflect genuine and economical changes in management.

Senator PROXMIRE. I notice that you have an increase in the estimates on the interest cost.

Mr. GORDON. That is correct.

Senator PROXMIRE. And a fairly substantial increase, as I recall. What does this assume will happen to the interest rate?

Mr. GORDON. It assumes stable interest rates, Senator. But even with a pattern of stability in interest rates, there will necessarily be some rise in total interest payments.

A small part of this is reflected, of course, in the deficit and the consequent increase in national debt.

Senator PROXMIRE. It seems to me that is really optimistic in view of the attitude of the Federal Reserve Board and what happened in 1963. The rates on 3-month bills went up 20.9 percent; 6-month bills 20.2 percent; this year it is 24.6 percent.

Longer term issues went up 23 percent. The rates, of course, in my judgment, were pretty high in 1963. Now we are moving into a a period of even greater expansion and the pressure on the money market will be even higher. It seems to me on any kind of reasonable assumptions, if we accept the estimates you have given us, it would suggest that we can expect to have higher interest rates in 1964 than we had in 1963.

Mr. GORDON. I do not think that that necessarily follows, Senator.

Senator PROXMIRE. I hope not.

Mr. GORDON. At least I hope you are wrong.

Senator PROXMIRE. So do I.

Mr. GORDON. As you know, the principal source of the increase in interest rates on Government debt this year was directly related to the balance-of-payments problem. There was the increase in the rediscount rate last summer and the consequent jump in yields on short-term securities.

Now, this, combined with the proposed interest equalization tax, seems to have worked very effectively in reducing the balance-of-payments deficit.

I would hope that with the present level of interest rates and the enactment of the interest equalization tax, we would be able to keep the balance-of-payments deficit down to manageable and shrinking proportions with stable interest rates through this year.

Senator PROXMIRE. Of course, all the talk has been that the economic expansion will be kept in check with regard to prices by using monetary policy. I certainly do not subscribe to that, but that has certainly been the general assumption in the financial community.

Mr. GORDON. Senator, I think there are times when it is fully appropriate to use monetary policy to combat inflation. I think these times are those occasions in which aggregate demand threatens to outrun aggregate supply.

Senator PROXMIRE. I agree. I think this has been the philosophy that you and Mr. Heller and others when you were members of the Council of Economic Advisers have expressed. But I think you wil recognize that the Federal Reserve Board is of a somewhat different viewpoint, in emphasis if not in anything else. They are the ones in the driver's seat, and therefore it would be their view that a more realistic assumption would be that interest rates would rise and therefore you would have a greater expenditure on the national debt.

Mr. GORDON. I would be loath to accept that assumption, Senator. I hope you are wrong.

Senator PROXMIRE. Now, your estimates on the impact of the tax cut, it seems to me, in indicating that you are going to get the balanced budget by 1967 or 1968 overlooks certainly our experience of the 1954 tax cut. Just 10 years ago, we had a similar tax cut. Whatever stimulation we had we had in the year or two following it. By the year 1957, a few years following it, we started to go downhill. It would seem on the basis of the past experience, the tax cuts we have had in the past years, the stimulation seems to be in the following 2 or 3 years, and runs out of steam after that.

Mr. GORDON. I am not able to chart out the fiscal policy of the Federal Government over a long period ahead. But you are quite right, the 1954 tax cut did stimulate the expansion of the economy, a very solid expansion, for 3 years after that.

I understand that some of the people who were in the administration in 1957 thought that at that time, the Federal Government should have pursued a more active fiscal policy than in fact it did.

I think that the future policies adopted by the administration and the Congress should be adequate to cope with the problems that may arise 3 years hence.

Senator PROXMIRE. So maybe in 1957, you should have gotten another tax cut, and maybe in 1967, we will have another tax cut and try to balance the budget further by cutting taxes.

Mr. GORDON. Seriously, Senator, the administration, as you know, from the very beginning has emphasized two aspects of the tax cut, not only its effect on aggregate demand but also its effect on risk-taking incentives.

I think you have stated this. The emphasis in this direction will continue. This is a permanent change in the climate in which individuals and business behave. So I think it is a mistake to think of the effects of the tax cut only in terms of immediate impact on the total level of aggregate demand. We have emphasized from the very beginning the other side of the equation, and that is a very important side.

Senator PROXMIRE. My time is up, Mr. Chairman, but I would like to say I had a lot more faith in this incentive argument until I saw the charts put in by the members of the Finance Committee derived from Secretary Dillon's statement, which indicated that those in the top brackets, whose risk-taking incentives are very important, pay such low income taxes now that they pay less on the average than those with smaller incomes. I notice that those with incomes of a half million dollars or more pay, as I recall, something like 23 percent of their incomes in taxes. The loopholes are so attractive and apparent and obvious and known to them that any stimulation here from the incentive standpoint is not likely to be very significant.

Mr. GORDON. I might point out that the total tax program of the administration as it affects corporations embraces, as you know, the 1962 revision of depreciation guidelines, which I think is a permanent and beneficial change; the investment tax credit, which I think is a permanent and beneficial change; and the reduction in the corporate tax rate, which I think is also very beneficial.

These measures improve the climate for corporate investment and risk taking.

Chairman DOUGLAS. Senator Jordan?

Senator JORDAN. Mr. Gordon, I am looking at page 352, special analysis "D." I approve of the special analysis you have done here. When you get into corporation accounting terminology, I find myself more at home. I am wondering why business accounting practices could not be more generally adapted to Government budgeting and Government accounting than they are? I mean, setting up of capital accounts and depreciation reserves and preferred charges and so on. Why would this not be a good idea?

Mr. GORDON. I think, Senator, the answer to your question really relates to two issues; first, the issue of full disclosure. Should we provide all the information necessary to enable people to analyze the Federal budget in terms of business categories? This we are trying to do and I think we are improving it every year. I think we have done it in the special analysis to which you have called attention.

Senator JORDAN. I am all for that.

Mr. GORDON. Now, the other question you raise is the question of whether the Federal Government should not simply adopt——

Senator JORDAN. Not altogether, but move in that direction.

Mr. GORDON. One reason, certainly, that it has not, I think, is because the effect of such a move would be to reduce the apparent deficit or increase the surplus in the Federal budget. Some people would charge that such a move was not designed to improve the accounting methods but was designed to conceal the truth. I think this has been an impediment to the kind of movement you have referred to.

Senator JORDAN. Now, on another subject, the national debt at the moment is pretty close to 50 percent of the gross national product.

Mr. GORDON. A little less, that is right.

Senator JORDAN. A little less. Many people say, frankly, that the national debt should not be reduced so long as gross national product remains bouyant and increasing at a satisfactory rate. What is your opinion about that? Would you concur in the line of reasoning that says that there is a direct relationship. As we would have in corporate accounting; your fixed indebtedness related to your net worth is at a quite constant ratio. Would you address yourself to that?

Mr. GORDON. I do not think that that kind of corporate relationship is really applicable to the Federal Government, Mr. Jordan. I think the main reason can be stated very simply. The more rapid the increase in gross national product stemming from the private economy, private investment, and so on, the less will be the increase in the Federal debt, other things being equal.

As a matter of fact, in our present circumstances, I think that we are looking forward to a rapid increase in gross national product to make it possible to reduce the Federal debt by generating sufficient tax revenues at full prosperity to exceed budget expenditures.

Senator JORDAN. You do look forward to the time when reductions can be made in the national debt?

Mr. GORDON. I do, indeed.

Senator JORDAN. Do you have a target date?

Mr. GORDON. I think this is not wholly, but very largely dependent on our wisdom as a nation in achieving and sustaining a high and continuing level of prosperity. I think that if we do that, it will become increasingly possible to achieve reductions in the national debt.

Senator JORDAN. Have any thoughts been given toward establishing a target date for some reduction in the national debt?

Mr. GORDON. Only in the sense that, though we realize the shortcomings and imperfections of forecasting, both Secretary Dillon and I feel that it is a reasonable objective to anticipate eliminating the deficit in the budget by fiscal year 1967 or 1968.

As I said, 1967 now looks more likely. Eliminating it should mean we ought to go somewhat beyond that and produce a surplus in the Federal budget, which we could apply to reducing the national debt.

Senator JORDAN. I am glad to hear you say that, because it seems to me there is a growing school of support for increasing the Federal debt so long as it does not exceed a certain percent of the gross national product.

Mr. GORDON. That is a very unwise policy, Senator. It seems to me that the changes in the Federal debt are an outcome of the relationship between the behavior of the economy and the structure of the budget. And if the economy behaves as we hope it will, this will generate the kinds of revenue, the kinds of surpluses in the Federal budget that will make it possible to reduce the debt.

If you look at the whole postwar history, I think you will find that it is in periods of full employment, periods when the economy is moving along at a high level of prosperity, that we have generated surpluses in the Federal budget. Surpluses tend to be associated with prosperity because of the effect of prosperity on Federal revenues.

Senator JORDAN. I am glad to hear your response, because I am not one of those, Mr. Director. I hope that some day we can make substantial reductions in the Federal debt.

I thank you.

Thank you, Mr. Chairman.

Chairman DOUGLAS. I will waive my questions.

Congressman Curtis?

Representative CURTIS. I had posed this question with some premises: In light of your increases in goods and services for calendar 1963–64 by $2.5 billion, and other increases such as Federal employment——

Mr. GORDON. That comes within the term "services," Mr. Curtis.

Representative CURTIS. You call that services?

Mr. GORDON. Yes; a payroll is for purchase of services.

Representative CURTIS. Do you count the Federal debt, the increased cost of Federal debt, as a service?

Mr. GORDON. No, we do not.

Representative CURTIS. In light of those items that call for increases, and I might say you have a pool of roughly $193 billion spending authority compared to a $190 billion pool in 1964, you still project your expenditure level to be $500 million less than the $98.4 billion expenditure level of 1964. How do you reconcile that?

Mr. GORDON. Well, I sought to do that in my statement, Mr. Curtis. I think to run over them very quickly, the principal elements in the reduction of administrative budget expenditures are this reduction of $1.3 billion in the national defense category, a reduction of a little over a billion dollars in the total agriculture category——

Representative CURTIS. Now, wait. I know you went over those, but I am talking now about your other statement that your expenditures increase by $2.5 billion. This is not any decrease.

Mr. GORDON. For one thing, Mr. Curtis, you are comparing calendar years, not fiscal years.

Representative CURTIS. I understand that, but I already anticipated that, Mr. Director.

Now, let's stop. I think you throw in the difference, and that difference will be an increase. Sure it is a calendar year. That is why I had on record, from your own mouth, that the second half of a fiscal year is greater than the first half. The calendar year 1964 has this increase of the $2.5 billion rate in it, so we can anticipate the second half of the calendar year as even more than that.

Now then, please go back to the basic question. Why is it $2.5 billion greater when you project it $500 million less?

Mr. GORDON. I will be happy to.

For one thing, there are, of course, many other types of administrative budget expenditures besides purchases of goods and services. Secondly, this goods and services figure that you have given relates not to the administrative budget but to the national income accounts budget and includes some expenditures out of the trust funds.

Representative CURTIS. Oh, does it?

Mr. GORDON. Yes, indeed.

Representative CURTIS. Do you consider increased social security benefit payments as services?

Mr. GORDON. No, nor do we consider payments out of the highway fund——

Representative CURTIS. How much increase is there? I thought that was a pretty stable program, pretty well scheduled on out. Is there an increase there?

Mr. GORDON. Mr. Schultze points out to me, Mr. Curtis, that purchase of goods and services in fiscal year 1965 rises by $1.3 billion over the preceding fiscal year.

Representative CURTIS. Why is that figure not in the President's Economic Report, instead of putting in this one? Here we are trying to anticipate what is ahead of us and it is true that calendar and fiscal years are different. But this is relating it as an economic budget, I will read it again, because this is in conjunction with showing why the economy is going to move forward:

> Although the President's budget will call for a decline in administrative budget expenditures from fiscal 1964 to fiscal 1965,

those are fiscal years—

> Federal purchase of goods and services are projected to increase by $2.5 billion from calendar 1963 to calendar 1964.

Then you go on to say that this will be a smaller increase than those of the past few years. I will grant you, it is smaller that the big increases, but it is still a substantial increase.

Now, then, I understand you to say that the total of fiscal 1965 will be——

Mr. GORDON. $1.3 billion greater in purchases.

Representative CURTIS. Well, all right. It is the same thing, apples and apples, goods and services.

So you are saying then, apparently, that the expenditure level of the second half of fiscal 1965 is going to be less than the first half.

Mr. GORDON. We are not talking about expenditure levels, Mr. Curtis.

Representative CURTIS. I am. That is what I am trying to call attention to.

Mr. GORDON. You are talking about purchase of goods and services which is not the same as expenditures.

Representative CURTIS. Well, I am getting to expenditure levels. You said there were things that could make a difference. What is your goods and services increase from the second half, then? You say the total is $1.3 billion in the goods and services.

Mr. GORDON. That is right; that is the increase on a fiscal year basis.

Representative CURTIS. Then the question again comes to this: How does this total expenditure for goods and services relate to the decrease that you claim you are going to have in fiscal 1965, where you go from $98.4 to $97.9 billion. That is what I am trying to point out. You are claiming an increase in one place, I think, and a cutback in the other, and I am seeking to reconcile them.

Mr. GORDON. Mr. Curtis, I don't see the contradiction here. I am not aware of any statement that purchases of goods and services will decline from fiscal 1964 to 1965. As a matter of fact, we have said it will increase by $1.3 billion.

Representative CURTIS. That is the bulk of your expenditures; isn't it? Things you didn't include, like social security benefits, are going to go up, not down.

Mr. GORDON. It does not cover such things as loans——

Representative CURTIS. That was an increase of $700 million.

Mr. GORDON. I beg your pardon. That was a decrease in net expenditures.

Representative CURTIS. That is right. It is a $700 million item, but does not account for what amounts to almost a $3 billion discrepancy, because you claim a minus $500 million expenditure level in 1965. I have the figure here of $2.5 billion which I projected, and I think rightly so, on into the second half of fiscal 1965, because the second half is a little bit greater than the first half. So my presumptions, I think, are entirely sound and I am seeking to find out where this $3 billion discrepancy occurs. Now, you have given me a proper one, the $700 million which I was going to go into myself. That is one.

Mr. GORDON. What is the $3 billion discrepancy, Mr. Curtis?

Representative CURTIS. I am talking about expenditure levels and trying to find out what we are really going to spend.

You have given us $98.4 billion for fiscal 1964. You project $97.9 billion for fiscal 1965. You then state that goods and services are projected to increase $2.5 billion from calendar 1963 to 1964, which is the bulk of our expenditures.

Mr. GORDON. But we have given you the correct numbers for fiscal years——

Representative CURTIS. I understand, but I had previously established the fact that the second half of fiscal year expenditures is greater than the first half. You said it applied to this fiscal 1965. So I am not letting you out on that area. I am saying to you that this discrepancy still exists.

Mr. GORDON. Well, let me say, Mr. Curtis, I still do not see the discrepancy to which you refer. Obviously, if administrative budget expenditures decline by $500 million and purchases of goods and services within the administrative budget—and I am not sure they are all in that budget—increase by $1.3 billion, expenditures other than for purchases of goods and services must decline by $1.8 billion. We would have to analyze the budget from this point of view, which we have not done, because this question has not been previously raised with us, to ascertain each of the expenditures of a nongoods and services character which add up to this decline which is indicated arithmetically here.

Representative CURTIS. This goes back, Mr. Gordon, to my basic observation that these are the things Congress needs in order to have the budget serve its fundamental function, as a document to assist it in its appropriations procedures. The Ways and Means Committee, in trying to anticipate the problems in the debt management area, have to estimate these expenditure levels in relation to the taxes we are going to collect.

Mr. GORDON. Mr. Schultze has a table here.

Mr. SCHULTZE. It is a complicated matter, If you will turn to page 47, Mr. Curtis, you will find at least the makings of an answer to your question. Table 7 reconciles the cash budget with the national income accounts sector of the budget.

Now, you may recall, if you look at the very last line on that table at the bottom of the page, in the cash budget totals of payments are equal in 1964 and 1965; $122.7 and $122.7, the same number in both fiscal years.

If you look at the very first line under "Expenditures," you will find that the total national income and product accounts goes up by $2.4 billion. The items in between explain the difference between the two.

There are two major differences. One of them is on the very last line of adjustments. It is technical, but the national income and product accounts budget is based upon deliveries of goods. Take the case of defense purchases, for example—these represent outpayments by the Defense Department.

Representative CURTIS. Even though the goods have not been delivered?

Mr. SCHULTZE. In many cases payments are made before goods are delivered. Progress payments are the key example.

Now, when you have expenditure items which are going down, as in the case of defense, payments go down before deliveries do as a general proposition, reflecting a decline in progress payments. This is one adjustment between the cash and national income accounts budgets.

The second one is the first line of adjusting items, which represents the difference in net loans. Loans are much less in fiscal 1965 than fiscal 1964.

Representative CURTIS. You are now talking about the sale of loans——

Mr. SCHULTZE. Net expenditures on loans.

Representative CURTIS. That is a bigger figure than the $700 million?

Mr. SCHULTZE. No, sir. I am saying that you combine the impact of the sale of assets with the loans themselves—loans are not included in the national income and product account. They are not included there as an expenditure item.

If you look at net loans, which are gross outflows minus receipts from regular repayments plus sales, those go down significantly between 1964 and 1965. There are also other minor items, sales of land and other used assets.

Representative CURTIS. That is all very helpful. I would appreciate any further data you could put in the record on the reconciliation of the expenditure level of $97.9 billion. I well understand the sale of assets and, indeed, I am happy to see them increased.[1] I still think proper accounting would require that they be entered as a revenue increase and then it would not conceal what I think does occur, that expenditures actually have gone up. The increased revenues from the sale of assets tend to hide it because it is a single entry.

You have been very forthright. The budget sets these out. I am not saying that you cannot find it. It is there. But to those who are trying to look at the expenditure levels and trying their best to get them down, this tends to distract attention.

One other thing I would like to have you discuss, which was going to be supplied further in the Ways and Means Committee hearings last November. In regard to the statement of the effect of continuing resolutions upon expenditure levels, what part of the fiscal 1964 budget was theoretically affected by them?

Last November, you said that you were going to undertake a study to see if you could come up with a figure. I still would be interested in seeing what that impact is, because I know there is a grave misunderstanding between the popular views of Congressmen, including the chairman of the House Appropriations Committee, and the statement that you made before a committee then and a revised statement made here.

I think there is apparently misunderstanding between your version and that of the General Accounting Office, because I wrote to the Comptroller General to get his opinion of what the effect of the continuing resolutions is on the expenditure levels. I think this is most important if Congress is going to be able to follow these expenditure levels.

Mr. GORDON. We tried, Mr. Curtis. We did a good deal of brain wracking and soul searching to try to be responsive to that question. It is extremely difficult. We obviously had to put it aside temporarily while we were getting out the budget. We will turn our attention to it again. For the reasons that I think I summarized very briefly, it is extremely difficult, if not impossible, to identify the effect of the continuing resolution on expenditures.

We know, for example, of some cases in which the effect of the continuing resolution could work precisely the opposite way that it is

[1] See p. 139 for exhibit entitled "Three Measures of Federal Financial Transactions."

generally assumed it does work. It could allow a higher rate of obligations than would have occurred if the appropriation had been enacted by June 30.

Representative CURTIS. One example of that would be foreign aid, because our previous figure was $3.9 billion. That is true.

Mr. GORDON. Foreign aid is one. Federal Aviation Agency is another; Office of Emergency Planning is a third. There are a number of such examples when the continuing resolution would have allowed a higher rate than if the appropriation acts had been passed by June 30.

But the problem is full of traps of this kind and it is extremely difficult, if not impossible, to work this out.

Representative CURTIS. I know and I might say this, Mr. Director: I am not one who would defend the process of continuing resolutions.

Mr. GORDON. I would agree with you completely, Mr. Curtis. I do not think this is a good way to run the financial affairs of the Government.

Representative CURTIS. I do not, either, but I think Congress ought to know what it is and is not doing.

One thing I am anxious to do is to develop the machinery by which Congress could express its judgment of what the fiscal year expenditures should be. We have no mechanism now. In a very cumbersome way, we have developed the debt ceiling, but I do not particularly approve of that either.

I think it is most important that Congress express its judgment on expenditure levels in relation to revenues. This is a major policy decision which right now is largely in the hands of the executive department. That is the reason I want to examine this first.

Mr. GORDON. It is largely in the hands of the executive department, Mr. Curtis; but with respect to some very important types of expenditures, it is not in the hands of the executive department.

Interest on the national debt; CCC expenditures; public assistance. These are controlled by events over which the executive does not exercise jurisdiction.

Representative CURTIS. That is right. They have the right to revise their judgments, while the Congress does not.

Let me say this, because it is a matter of record: This is not to say that I do not think the basic flexibility of power should be in the executive. Indeed, I do. I think the executive must have this wide discretion in slowing down programs, expanding others, or in light of new events, to even freeze and stop. But I do think that Congress should direct its judgment to the total expenditure level for a fiscal year in light of the recommendations of the executive department. I think that the development of the debt ceiling technique—I know there is disagreement—was the discipline that brought expenditure levels for fiscal 1964 below the estimates given us in January of 1964.

Mr. GORDON. On that point, Mr. Curtis, although I know this is your view and I respect your judgment, I do not quite share it.

Representative CURTIS. I know that. We have had a dialog on this before, and I think we should keep it alive, because if it is not, then I am going to figure out some other way.

On the revenue estimates, I wanted to be sure the $88.4 billion receipts for 1964 assumes the cutback in withholding to 14 percent.

Mr. GORDON. That is correct.

Representative CURTIS. How much does that amount to? Without this cutback, the revenue figure would have been what, about $90 billion?

Mr. SCHULTZE. No, sir; $800 million.

Representative CURTIS. Oh, I was too high on the figure, was I not? The full year of the tax cut will amount to about $800 million——

Mr. SCHULTZE. Let me make sure we understand each other. It was $800 million from the extra 1 percent compared to the House bill.

Representative CURTIS. Well, what I was talking about was the impact on revenues for fiscal 1964 if the tax bill goes in, along with the President's recommendation that we cut back on the withholding. I am trying to look at revenue estimates.

Mr. SCHULTZE. I am sorry, sir. Then you are right; it would be $91 billion—no; $90.6 billion.

Representative CURTIS. Then that makes me feel a little bit better about your revenue estimates for 1965. I thought it was a considerable jump from $88.4 to $93 billion, but I thought there must be some of that tax cut in your revenue estimates of 1964.

Now, one final line of questioning. This relates—it is the same theme on all—to your charts which were in the budget message. You have, for our convenience, put them out as a special document: "Charts Relating to the Budget Message of the President."

Mr. GORDON. Yes; there are some charts you have there that were not in the budget message. I think there are some duplications, but they are not exactly the same.

Representative CURTIS. I have made some speeches on this and I relate to chart Nos. 4, 5, 6, 7. In the first, Federal employment per thousand population. I worry about your benchmark. You start from 1947. Is that a good optimum year to start from to give us a picture of employment as a ratio today? Maybe this is. That is a year after the war. Had we really cut back?

Mr. STAATS. We tried to wash out the World War II effect.

Representative CURTIS. You were trying to. Well, that is important, so I shall not quarrel with that point. I was concerned about the year.

The question I would ask though, is shouldn't Federal employment per thousand population decline if we have productive increases in the governmental sector? Certainly, in agriculture, we have increased our production tremendously in the past 10 years and there has been a 42-percent decline in employment.

Likewise, in other areas where we move ahead as productivity increases come in, the percentage of employment per thousand population declines. I would hope to get that factor interjected here, because otherwise, this can be quite deceptive as to whether we are doing well or not in reducing Federal employment.

It is particularly true in the postal service. Under the Eisenhower administration, great claims were made for productivity increases. I said "Where does it show up, then, in a decline in employment," because we had a continued increase. It relates to this very subject you have pointed out. Some of the agencies are going to have cutbacks, but it would seem to me that we should have a decline, if we are moving ahead with productivity increases at all in the Government.

Mr. GORDON. Of course, if you assume the same level of Government services over a long period of time, then as productivity increases, employment will decline. But of course, the level of Government services does not remain stable.

Representative CURTIS. Of course not. You say we have had productivity increases and here is where the decline will come. But since then, we have taken on these services. I want the whole picture, but I am saying that is a factor. Just taking the conclusion without breaking down the factors does not give us the picture.

Maybe you will say, "All right; from our productivity increases, we were able to reduce employment *x* hundred thousand, but in the meantime, Government took on these extra services, which will put that in line."

Mr. GORDON. That would be the fair way to do it.

Representative CURTIS. That is right. That is the breakdown I would like to see, and I hope it will be repeated time and again.

Mr. GORDON. I do not think this is misleading at all. I think most people find it interesting and enlightening to know what the proportion is between Government employment and the total population.

Representative CURTIS. I am not objecting to that.

Mr. GORDON. That is all this chart shows.

Representative CURTIS. I suggest that it would be much better if we attempted to include full statistics that bear on the point.

Now, on the next chart, "Public Debt as a Percent of GNP," I am very pleased to see that at least you have gone back to 1942. But 1942 is still a war year and hardly a good benchmark as the optimum ratio.

What I have tried to point out is that we should get the ratio of Federal debt to GNP during the peacetime years, when this country was growing most rapidly, to figure out what our optimum should be. Far from being near 50 percent, those figures are around the twenties.

Mr. GORDON. Go back into the 1920's?

Representative CURTIS. No; you could go into the thirties, twenties, and teens. I want to get the entire background to direct our attention to what the optimum should be. You used to use as the original figure, 1946, which was the peak of World War II deficit financing. At least now you use 1942, which was a vast improvement over the previous charts——

Mr. GORDON. I think you made that suggestion last year, Mr. Curtis.

Chairman DOUGLAS. Would you go back to 1890?

Representative CURTIS. No, I would do as this committee attempts to do in trying to evaluate benchmarks. I would go back to various periods to see what the relationship is. I still would not conclude from that, Mr. Chairman, that those ratios are still optimum. Things have changed, and maybe there are reasons today why the ratio should be greater. But I think we need to know what the picture is in order to come to that kind of judgment. This is an area I will ask this committee to study—what should be our optimum for the Federal debt, and debt management. This is only one criterion.

The same would apply, of course, to net public and private debt in relation to the Federal. The impact of the Federal debt on the private debt during the war period went down to minimum, as it should. So again, relating it to a benchmark of 1947, when we had a period of 4 or 5 years of cutting back in the private sector to throw all of our effort into the public sector to win a war, is not an accurate benchmark. Instead, we should try to develop a benchmark that is meaningful.

I know what it is. These figures and charts have been used to try to allay the fears of our people against the size of the Federal debt, and I am not one to draw the conclusions only from the points I have been making.

I think we need to study this. I think these are incomplete statistics and can only mislead the people and the Congress in coping with this problem.

Mr. GORDON. I think they are not misleading. I think the Congress knows and the people know, as you can tell from these charts here, that the big period of increase in the debt of the U.S. Government was during the Second World War.

Representative CURTIS. Well, of course.

Mr. GORDON. Nevertheless, it seems to me significant to look at the way postwar debt has behaved relative to other major forms of debt. This chart would tell essentially the same story if you start at 1950 or 1955 or even 1960.

Representative CURTIS. Here is what you miss, Mr. Director. In peacetime years, the ratio of public debt to private debt is considerably different. Likewise, the ratio of Federal public debt to local and State debt is entirely different. During the war years, the Federal debt always goes up. What we are trying to do, I hope, is relate it to optimum periods, and our benchmarks should show that. In my judgment, this is an unfortunate chart which shows after this high year, 1947, the height of World War II deficit financing, that far from decreasing, Federal debt has continued to increase. Certainly if the optimum years were the twenties or the thirties or whatever period we might refer to, we have done a very poor job in post-World War II in getting these ratios down.

Mr. GORDON. Mr. Curtis, do you have a copy of the budget in brief at your desk?

Representative CURTIS. Yes.

Mr. GORDON. Would you look at the chart on page 23?

Representative CURTIS. Yes.

Mr. GORDON. We have done lots of charts, you see, and each of them addresses itself to a different point. I think that the point you have just been making is fully reflected in the chart on page 23 of the budget in brief.

Representative CURTIS. Let me say this: It is 1942 which is a much better year but it by no means fully reflects the problem because it was a war year. What I would prefer to see us do, and certainly I would hope this committee would get into this, is to study these ratios over periods of years, see if we can come up with what we think are fair benchmarks, and so set our sights in relation to them. But this simply shows the period beginning in 1942, which is right in the war, on up, but does not give us any estimate of peacetime years.

I again say this: Our economy grew quite rapidly in the 1890's, 1910's, 1920's, and so on, outside of war. When we are talking about setting our economic sights in Government policy, I want us to relate it as best we can to what indications history might give us. I would not be content with that alone, because things have changed, but I think if we are wise, at least we will look to see what the past might reveal for us.

Thank you, Mr. Chairman.

Chairman DOUGLAS. Thank you very much, gentlemen. We appreciate your coming and your patience through a long morning.

Mr. GORDAN. Thank you, Mr. Chairman.

Chairman DOUGLAS. We will meet at 10 o'clock tomorrow morning. Secretary Dillon will be with us.

(Whereupon, at 12:45 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, January 28, 1964.)

(The exhibit, entitled "Three Measures of Federal Financial Transactions," following was submitted by Charles L. Schultze, Assistant Director, Bureau of the Budget, and was ordered printed.)

SPECIAL ANALYSIS A

THREE MEASURES OF FEDERAL FINANCIAL TRANSACTIONS

Reprint of Pages 328 to 336 and Tables 1, 2, 7, 17, 18, 19, and 20
From the Budget of the United States Government
for the Fiscal Year Ending June 30, 1965

Detail will not necessarily add to totals because of rounding

BUREAU OF THE BUDGET
January 1964

Special Analysis A

THREE MEASURES OF FEDERAL FINANCIAL TRANSACTIONS

Data on Government financial transactions are used for many purposes. No single set of accounts can serve all purposes equally well. As a result, various budget concepts and forms have been developed to meet different needs. The three measures of Federal receipts and expenditures most commonly used are: (1) the administrative budget, (2) the consolidated cash statement of Federal transactions, and (3) the Federal sector of the national income accounts. A reconciliation of these three measures is presented in table A–1.

Administrative Budget

The administrative budget covers receipts and expenditures of funds owned by the Federal Government—the general fund, special funds, public enterprise funds, and intragovernmental revolving and management funds. Although budget documents placed before the Congress have regularly included both federally owned funds and funds held in trust by the Government, only the former have been traditionally used to calculate budget totals.

For many years, the administrative budget served as the principal financial plan for conducting the affairs of Government. It represented a focal point for management and decisionmaking with respect to Government activities. As long as almost all Federal financial transactions were carried out with federally owned funds, the administrative budget provided adequate coverage.

In recent years, however, trust fund operations have grown rapidly. Several major parts of the Government's program are now carried out through trust funds, particularly those for labor, welfare, and highway activities. This means that the flow of financial transactions between the Federal Government and the public is considerably larger than is indicated by the administrative budget.

Consolidated Cash Statement

The consolidated cash statement of Federal receipts and payments is designed to show the total flow of financial transactions (excluding borrowing) between the Federal Government and the public. It is more comprehensive and complete than the administrative budget in that it includes the receipts and expenditures of trust funds as well as funds wholly owned by the Federal Government. Since the consolidated cash statement measures the Government's flow of cash to and from the public, intragovernmental transactions (transactions between budget and trust fund accounts) are excluded and payments are put on a checks-paid basis. The consolidated cash statement is useful for determining Government financing and net borrowing requirements and for analyzing the financial impact of the Government's overall activities.

Table A-1. RELATION OF FEDERAL RECEIPTS AND EXPENDITURES IN THE ADMINISTRATIVE BUDGET, CONSOLIDATED CASH STATEMENT, AND NATIONAL INCOME ACCOUNTS, 1963-65

[In billions of dollars]

	1963 actual	1964 estimate	1965 estimate
RECEIPTS			
Administrative budget receipts	86.4	88.4	93.0
Plus: Trust fund receipts	27.7	30.2	30.9
Less: Intragovernmental transactions	4.3	4.1	4.1
Receipts from exercise of monetary authority	*	.1	.1
Equals: Federal receipts from the public	109.7	114.4	119.7
Adjustments for agency coverage:			
Less: District of Columbia revenues	.3	.4	.4
Adjustments for netting and consolidation:			
Plus: Contributions to Federal employees' retirement funds, etc	1.9	1.9	1.9
Less: Interest, dividends, and other earnings	1.1	1.2	1.3
Adjustments for timing:			
Plus: Excess of corporate tax accruals over collections, personal taxes, social insurance contributions, etc	.6	−.1	−.2
Adjustments for capital transactions:			
Less: Realization upon loans and investments, sale of Government property, etc	1.5	1.1	1.0
Equals: Receipts—national-income accounts	109.3	113.6	118.8
EXPENDITURES			
Administrative budget expenditures	92.6	98.4	97.9
Plus: Trust fund expenditures (including Government-sponsored enterprise expenditures, net)	26.5	29.3	29.4
Less: Intragovernmental transactions	4.3	4.1	4.1
Debt issuance in lieu of checks and other adjustments	1.1	.9	.5
Equals: Federal payments to the public	113.8	122.7	122.7
Adjustments for agency coverage:			
Less: District of Columbia expenditures	.3	.4	.4
Adjustments for netting and consolidation:			
Plus: Contributions to Federal employees' retirement funds, etc	1.9	1.9	1.9
Less: Interest received and proceeds of Government sales	.6	.6	.9
Adjustments for timing:			
Plus: Excess of interest accruals over interest payments	.9	.8	.6
Excess of deliveries over expenditures and other items	*	−.4	.6
Less: Commodity Credit Corporation foreign currency exchanges	.3	.3	.1
Adjustments for capital transactions:			
Less: Loans—Federal National Mortgage Association secondary market mortgage purchases, redemption of International Monetary Fund notes, etc	.7	1.1	.2
Trust funds (including Government-sponsored enterprise expenditures, net) and deposit fund items	1.9	3.4	2.6
Purchase of land and existing assets and other items	.1	.1	.1
Equals: Expenditures—national-income accounts	112.6	119.1	121.5

*Less than $50 million.

Federal Sector of the National Income Accounts

The Federal sector of the national income and product accounts is designed to provide a measure of the direct impact of Federal fiscal activity on the Nation's current flow of income and output.

Like the consolidated cash statement, the Federal sector account is more comprehensive than the administrative budget in that it includes most trust fund transactions. However, in contrast both to the consolidated cash statement and the administrative budget, only those receipts and expenditures which directly affect the current flow of income and output are recorded. Therefore, the Federal sector of the income and product accounts excludes transactions involving purely financial claims and exchanges of secondhand or existing assets; such transactions represent neither the production of current output nor incomes earned in production, even though they have indirect effects on the level or composition of economic activity.

Further, both the administrative budget and consolidated cash statement count business tax receipts, like other receipts, as they are collected. In contrast, the Federal sector account records some business tax receipts, particularly corporate income taxes, as they accrue, on the grounds that the main economic impact of these taxes is more closely associated with the accrual of liabilities than with actual cash collections. Also, the Federal sector records most purchases of goods and services when delivery is made, while the administrative budget and consolidated cash statement count expenditures at the time of payment.

Relationship of Consolidated Cash Statement to the Administrative Budget

Certain adjustments are needed to derive the consolidated cash statement from administrative budget totals, as summarized in table A–1.

1. *Trust funds.*—In addition to administrative budget receipts and expenditures, the consolidated cash statement covers the financial transactions of Federal trust funds (including Government-sponsored enterprises). Accordingly, excise taxes that support the highway trust fund, employment taxes, deposits by States for unemployment insurance, veterans life insurance premiums, and other trust fund receipts are included along with the corresponding trust fund disbursements.

2. *Intragovernmental transactions.*—Administrative budget receipts include amounts paid into the Treasury by trust funds. (These amounts are also reported as trust fund expenditures.) Similarly, there are trust fund receipts, such as interest on trust fund holdings of U.S. securities, which are also reported as administrative budget expenditures. In consolidating the transactions of budget and trust funds, these intragovernmental transactions are eliminated from the combined receipts and expenditures since no exchange of cash with the public is involved in these operations.

Table A-2. INTRAGOVERNMENTAL TRANSACTIONS EXCLUDED FROM THE CONSOLIDATED CASH STATEMENT

[In millions of dollars]

Description	1963 actual	1964 estimate	1965 estimate
Administrative budget receipts which are trust fund expenditures:			
Franchise taxes from Government-sponsored enterprises	5	5	5
Dividends, interest, etc., from Federal National Mortgage Association	27	31	21
Reimbursements for expenses and services	62	65	67
Repayment of advances from unemployment trust fund and other	816	403	190
Total, administrative budget receipt items	909	504	282
Trust fund receipts which are administrative budget expenditures:			
Interest on trust funds	1,477	1,589	1,669
Contributions for military service credits			74
Payments to District of Columbia (including Federal grants-in-aid)	88	95	134
Employing agencies' payments to employees' retirement funds	947	1,003	953
Awards to Indian tribal funds	15	7	3
Advances to unemployment trust fund	−80		
Contributions to veterans' life insurance funds	6	7	6
Other	1	1	1
Total, trust fund receipt items	2,454	2,702	2,838
Deductions from employees' salaries for retirement	917	941	954
Total, intragovernmental transactions	4,281	4,147	4,075

3. *Exercise of monetary authority.*—These receipts are now mostly from seigniorage; that is, they represent the difference between the cost of the metal and minting of coins, on the one hand, and the actual value of the coins as money on the other. Seigniorage is included in administrative budget receipts, but is not a cash receipt from the public.

4. *Debt issuance in lieu of checks.*—In a few cases, Government expenditures are made by issuing bonds or notes, or increasing the value of bonds outstanding in lieu of issuing checks. Such transactions are recorded in the administrative budget as expenditures when the debt is thus increased, even though no cash outflow takes place until the debt instrument is redeemed.

For example, the administrative budget records interest on savings bonds when it accrues (and is added to the redemption value currently payable) rather than when it is actually paid. In computing cash payments to the public, interest payments are included only when the bonds are cashed. Therefore, an adjustment is made for the difference between the amount of interest accrued and the amount paid.

Table A-3. **DEBT ISSUANCE IN LIEU OF CHECKS, NET** (in millions of dollars)

Description	1963 actual	1964 estimate	1965 estimate	End 1965 outstanding
Accrued interest added to value of debt (savings bonds, etc.)	696	772	603	11,891
Treasury notes issued for:				
International Monetary Fund	255			2,922
International Development Association	14	14	−52	91
Inter-American Development Bank	70	25		150
Armed Forces leave bonds issued [1]	−1	−1	−1	6
Adjusted-service bonds issued	*	*	*	1
Excess profits tax refund bonds issued [2]	*	*	*	1
Total, debt issuance in lieu of checks, net	1,033	810	550	15,062

*Less than one-half million.

[1] Negative figures represent net redemption.
[2] Reported as refunds of receipts.

A second example involves transactions in special notes used to pay certain U.S. Government obligations. The Government has paid a portion of its subscriptions to the International Monetary Fund, the International Development Association, and the Inter-American Development Bank in non-interest-bearing notes. The notes are considered administrative budget expenditures and become part of the public debt when they are issued. However, they are not counted as a payment to the public until they are redeemed for cash, at which time they cease to be part of the public debt. Conversely, when the institutions return cash to the Treasury in exchange for notes, payments to the public are reduced by the amount of the cash receipts and a corresponding increase in the public debt takes place.

5. *Changes in outstanding checks.*—Administrative budget and trust fund expenditures are recorded at the time checks are issued. To reflect more accurately the point in time at which cash is actually in the hands of the public, an adjustment is made to place expenditures on a checks-paid basis.

Federal Sector Accounts—Definitions and Relationship to Other Measures

The national income accounts, as developed and prepared by the Department of Commerce's Office of Business Economics, is a dual-entry accounting system for making estimates of the current productive activity of U.S. residents.[1] The term "residents" is defined to include the Federal Government as well as State and local governments, corporations incorporated under U.S. laws (but not their foreign branches or subsidiaries), individuals employed in the United States proper, and U.S. citizens employed by the Federal Government abroad (civilian as well as military). "Nonresidents" include governments, individuals (other than employees of the Federal Government), and businesses in foreign countries, as well as in Puerto Rico, the Virgin Islands, and other U.S. possessions.

[1] The accounts are discussed in detail in the Department of Commerce's *National Income*, 1954 edition, pp. 143–149, and *U.S. Income and Output*, 1958 edition, pp. 53–57, and 99–101. Each is a "Supplement to the Survey of Current Business." Current estimates on a quarterly and an annual basis are provided in the *Survey of Current Business* and in the *Economic Indicators*.

The output side of the national income accounts depicts the total market value of the currently produced output of goods and services, classified by type of expenditures: consumer expenditures; gross private domestic investment in new construction, equipment, and inventories; Federal, State, and local government purchases of goods and services; and net exports. The total, obtained by summing these items, is called the gross national product (GNP).

The total value of the gross national product is balanced by an equal amount of gross income earned in producing the output.[2] The income side of the accounts portrays this total, classified by type of income; for example, wages and salaries, proprietors' income, corporate profits, rent, and net interest and certain other costs of production, such as depreciation and indirect business taxes. The income accounts also provide additional data showing various transfers of income from one sector to another, such as business gifts to nonprofit institutions and social security benefits from the Government.

It should be pointed out that national income data, although based on accounting statements of economic units, are statistical aggregates rather than accounting totals in the ordinary sense.

Federal receipts.—Federal receipts on a national income basis are classified into the following four categories: (1) personal tax and nontax receipts, (2) corporate profits tax accruals, (3) indirect business tax and nontax accruals, and (4) receipts from contributions for social insurance. Personal tax and nontax receipts consist mostly of individual income taxes, estate and gift taxes, fines, penalties, and charges for Government services. Corporate profits tax accruals represent the Federal tax liability incurred and accrued by resident corporations on their corporate earnings during the specified year or period. Federal corporation income tax collections do not necessarily concide with—and usually lag—accruals. Indirect business tax and nontax accruals consist primarily of excise taxes, customs duties, Federal receipts from rent and royalties, and other charges to business. Receipts from contributions for social insurance are composed chiefly of employment taxes, contributions to the retirement funds for Government employees, and deposits by the States to the unemployment trust fund.

Federal expenditures.—Federal expenditures on a national income basis are classified in the following categories: (1) Purchases of goods and services, (2) transfer payments, (3) grants-in-aid to State and local governments, (4) net interest paid, and (5) subsidies less current surplus of Government enterprises. The definitions of the categories have been developed by the Department of Commerce consistent with the framework of accounts covering the Nation's total economic activity.

1. *Purchase of goods and services.*—These purchases represent the value of the Nation's currently produced output bought directly by the Federal Government. They are reported in the national income accounts net of Government sales.

Purchases include the pay of active military and civilian employees of the Federal Government, employer contributions to retirement, insurance and other benefits for Federal employees, outlays on new

[2] "Gross income" includes capital consumption allowances and certain charges against production.

equipment and supplies for defense and other programs, new construction, research and development contracts with corporations organized for profit, expenditures for the purchase of commodities (even if the commodities are then donated or transferred, domestically or abroad), and generally, the administrative expenses of Government programs.

2. *Transfer payments.*—Transfer payments consist of expenditures by the Federal Government for which no current output or services have been rendered; in other words, they are payments to certain recipients for which no contribution to national production is made during the time period under consideration. There are two important criteria which must be met by an expenditure classified as a transfer payment: (a) the recipient must be an individual, an institution not organized for profitmaking purposes (a "not-for-profit" institution) or a nonresident (for example, a foreign government), and (b) the expenditure must also be in monetary form and not in commodities.

Examples of transfer payments are: veterans compensation, pensions, and benefits; retired pay to Federal civilian or military personnel; unemployment benefits; and old-age, survivors, and disability insurance; cash gifts and contributions to nonresidents; nonrepayable outlays for scholarships and fellowships; and research and development expenditures for contracts let to private individuals. Although such transfer payments do not directly enter GNP calculations, they do enter into the income stream and have an impact on national output; they are reflected in the GNP in another sector of the accounts when respent by the recipients.

For national income purposes, net interest paid to nonresidents is considered a transfer payment. All other transactions involving interest expenditures and receipts (that is, to and from residents) are reported in the net interest paid category.

3. *Grants-in-aid to State and local governments.*—Grants, for purposes of the national income accounts, are Federal payments to State and local governments (other than for interest on the public debt), including State and local educational institutions. Included in grants are almost all of the grants-in-aid and the shared revenues in Special Analysis I of the budget, except (a) outlays to nonprofit and privately owned hospitals, (b) outlays-in-kind such as commodities distributed to State and local governments, and (c) payments to Puerto Rico, the Virgin Islands, and other possessions. In addition, the national income accounts record as grants research and development outlays for contracts to public educational institutions. Like transfer payments and net interest paid, Federal grants-in-aid are counted in the GNP when respent by recipients—in this case, as purchases by State and local governments.

4. *Net interest paid.*—Net interest paid consists of the interest outlays to residents minus the interest received from this source.

5. *Subsidies less current surplus of Government enterprises.*—This category consists of two elements which are consolidated for analytical and statistical reasons: (a) subsidy payments to (resident) businesses, and (b) the "current surplus" (or deficit as the case may be) of Government enterprises.

(a) In principle a Government expenditure becomes a subsidy when it enables a producer to sell goods and services below the cost-price relationship determined by market forces or when it is a payment made to curtail production. By definition, therefore, subsidies are made only to businesses organized for profitmaking purposes (including farms). Examples of subsidies are Government payments to farmers for land retirement, certain outlays for the export of surplus agricultural commodities by business, payments to air carriers, and the operating differential subsidy of the Maritime Administration.

(b) Government enterprise is the term applied to those functions of the Government (usually appearing in the budget as public enterprise revolving funds) whose operating costs are to a great extent covered by the sale of goods and services to the public, as opposed to being financed by tax receipts. In short, Government enterprises conduct operations which are of a commercial nature. Because of this, part of their operations are reported in the business sector of the national income accounts and part in the Federal sector. The Federal sector covers the difference between sales and operating costs, interest expenses, and capital formation.

Relationship to the consolidated cash statement.—There are a number of important differences between the Federal sector account and the consolidated cash statement. These are set forth in table A–1.

1. *Coverage.*—With respect to coverage, the Federal Government part of the income and product accounts excludes the revenues and expenditures of the District of Columbia, which are classified by the Department of Commerce in the State and local government sector.

2. *Netting and consolidation.*—The Federal sector account records both interest paid by the Government and Government purchases on a net basis. Accordingly, interest received by the Government is excluded from receipts and subtracted from Federal interest payments. Similarly, receipts from sales of Government products are subtracted from Government purchases. Neither adjustment influences the surplus or deficit, for in effect, both receipts and expenditures are decreased by the same amount.

Adjustments for consolidation are needed to reflect in the income and product account a few transactions such as employer and employee contributions to Federal employees' retirement funds. Although these contributions are considered to be part of the total compensation of Government employees in the national income accounts, they are excluded from the consolidated cash statement as an intragovernmental transaction. Again, the deficit or surplus is unaffected by the adjustment, since total receipts and expenditures are both increased by the same amount.

3. *Timing.*—Business taxes are recorded in the national income accounts as they are accrued by the private sector, rather than when they are collected by the Government. The principal timing adjustments for expenditures are: (a) The Federal sector account records Federal purchases in terms of the delivery of goods and services to the Government, whereas cash payments for these deliveries may precede or follow; (b) the account also records as purchases guarantees of nonrecourse loans by the Commodity Credit Corporation at the time the guarantees are made, rather than when the collateral is surrendered; (c) interest on savings bonds and Treasury bills is treated as an expenditure in the Federal sector account when the interest is

accrued, rather than when it is actually paid out in cash; and (d) certain foreign currency activities of the Commodity Credit Corporation also require an adjustment—the Corporation facilitates exports of surplus agricultural commodities by paying dollars to exporters, in exchange for foreign currencies received for the exports. Expenditures in the Federal sector account are recorded only at the time these foreign currencies are subsequently used for Government programs. The consolidated cash statement, on the other hand, includes the dollar payments to exporters but excludes both the receipt and the subsequent expenditure of a large part of these foreign currencies.

4. *Capital transactions.*—Many capital or financial transactions which are included in the consolidated cash statement are excluded from the Federal sector account. These items consist primarily of loans, mortgages, and other financial claims. Also excluded are purchases and sales of existing assets, such as land and secondhand property.

Uses and Limitations

Each of the three measures—the administrative budget, consolidated cash statement, and the Federal sector of the income and product accounts—is useful for specific kinds of analysis, and the selection of which to use should be determined by the problem at hand.

The administrative budget provides a useful measure of the Government's operations which are financed by the Government's own funds.

The Federal sector account is especially suited for an analysis of fiscal policy. It was specifically designed to complement the data on private expenditures and incomes contained in the national income accounts.

The national income accounts, however, exclude a substantial volume of financial transactions through which the Federal Government significantly affects the capital and credit markets. Moreover, in financial markets, the flow of cash payments to the Government may be more significant than the accrual of tax liabilities. As a result, for purposes of analysis of the Federal impact on money and credit, the consolidated cash statement is generally more useful than the national income accounts.

For certain types of problems, no overall measure of receipts and expenditures will serve adequately. Since the various receipt and expenditure transactions have different economic effects, a given aggregate will have an economic impact which depends importantly on the composition of the total.

In addition, many Government transactions besides receipts and expenditures affect the economy. For example, a rapid expansion in new appropriations and in Government orders could stimulate a rise in business activity well before either the delivery of goods, the performance of services, or the payment for them. The management of public debt is a further factor which has a significant impact in the money and credit markets of the economy. Consequently, in evaluating the economic impact of Federal Government activities, there is no substitute for complete and detailed analysis of the Government program in all its aspects.

Table 1. **BUDGET RÉSUMÉ** (in billions of dollars)

ADMINISTRATIVE BUDGET AND TRUST FUND RECEIPTS AND EXPENDITURES

Description	ADMINISTRATIVE BUDGET FUNDS			TRUST FUNDS		
	1963 actual	1964 estimate	1965 estimate	1963 actual	1964 estimate	1965 estimate
RECEIPTS						
Individual income taxes	47.6	47.5	48.5	------	------	------
Corporation income taxes	21.6	23.7	25.8	------	------	------
Employment taxes	------	------	------	14.9	16.8	17.0
Excise taxes	9.9	10.2	11.0	3.3	3.5	3.5
Unemployment tax deposits by States	------	------	------	3.0	2.9	2.8
Estate and gift taxes	2.2	2.3	2.7	------	------	------
Customs	1.2	1.3	1.5	------	------	------
Federal employees retirement	------	------	------	1.9	2.0	1.9
Interest on trust funds	------	------	------	1.5	1.6	1.7
Veterans life insurance premiums	------	------	------	.5	.5	.5
Miscellaneous receipts	4.4	4.1	4.1	3.2	3.4	3.9
Interfund transactions	−.5	−.7	−.6	−.5	−.5	−.5
Total receipts	86.4	88.4	93.0	27.7	30.2	30.9
EXPENDITURES						
National defense	52.8	55.3	54.0	.7	.9	1.2
International affairs and finance	2.6	2.4	2.2	*	.1	.1
Space research and technology	2.6	4.4	5.0	------	*	*
Agriculture and agricultural resources	7.0	6.1	4.9	.5	.5	.4
Natural resources	2.4	2.5	2.6	.1	.1	.1
Commerce and transportation	2.8	3.2	3.1	2.9	3.4	3.5
Housing and community development	−.1	−.2	−.3	*	1.6	.5
Health, labor, and welfare	4.8	5.5	5.8	21.9	22.7	23.5
Education	1.2	1.3	1.7	*	*	*
Veterans benefits and services	5.2	5.4	5.1	.8	.6	.5
Interest	10.0	10.7	11.1	------	------	------
General government	2.0	2.2	2.2	*	*	*
Deposit funds (net)	------	------	------	.1	−.1	*
Allowance for attack on poverty	------	------	.2	------	------	------
Allowance for civilian pay comparability	------	------	.5	------	------	------
Allowance for contingencies	------	.2	.3	------	------	------
Interfund transactions	−.5	−.7	−.6	−.5	−.5	−.5
Total expenditures	92.6	98.4	97.9	26.5	29.3	29.4

CONSOLIDATED SUMMARY

Description	1963 actual	1964 estimate	1965 estimate
Cash receipts:			
Administrative budget receipts	86.4	88.4	93.0
Trust fund receipts	27.7	30.2	30.9
Intragovernmental transactions	−4.3	−4.2	−4.1
Total receipts from the public	109.7	114.4	119.7
Cash expenditures:			
Administrative budget expenditures	92.6	98.4	97.9
Trust fund expenditures	26.5	29.3	29.4
Intragovernmental and other noncash transactions	−5.4	−5.0	−4.6
Total payments to the public	113.8	122.7	122.7
Excess of receipts from (+) or payments to (−) the public	−4.0	−8.3	−2.9

*Less than $50 million. Note.—Detail may not add to totals due to rounding.

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Table 2. RECEIPTS FROM AND PAYMENTS TO THE PUBLIC (CONSOLIDATED CASH BASIS) (in billions of dollars)

Description	1963 actual	1964 estimate	1965 estimate
RECEIPTS FROM THE PUBLIC			
Individual income taxes	47.6	47.5	48.5
Corporation income taxes	21.6	23.7	25.8
Employment taxes	14.9	16.8	17.0
Excise taxes	13.2	13.7	14.5
Unemployment tax deposits by States	3.0	2.9	2.8
Estate and gift taxes	2.2	2.3	2.7
Customs	1.2	1.3	1.5
Veterans life insurance premiums	.5	.5	.5
Other receipts	5.6	5.7	6.4
Total receipts from the public	109.7	114.4	119.7
PAYMENTS TO THE PUBLIC			
National defense	53.4	56.0	55.2
International affairs and finance	2.2	2.5	2.4
Space research and technology	2.6	4.4	5.0
Agriculture and agricultural resources	7.3	6.3	5.1
Natural resources	2.5	2.6	2.7
Commerce and transportation	5.8	6.6	6.6
Housing and community development	−.3	1.3	*
Health, labor, and welfare	25.7	27.3	28.6
Education	1.2	1.3	1.6
Veterans benefits and services	6.0	6.0	5.5
Interest	7.4	8.1	8.6
General government	2.0	2.2	2.2
Deposit funds, net	−.2	−.1	*
Allowance for attack on poverty			.2
Allowance for civilian pay comparability			.5
Allowance for contingencies		.2	.3
Other undistributed adjustments:			
Agency payments for employee retirement	−.9	−1.0	−1.0
Deduction from employees' salaries for retirement	−.9	−.9	−1.0
Increase (−) or decrease in outstanding checks, etc.	−.1	−.1	*
Total payments to the public	113.8	122.7	122.7
Excess of receipts (+) or payments (−)	−4.0	−8.3	−2.9

*Less than $50 million.

Note.—This table shows the flow of money between the Government and the public on a cash (collections and checks paid) basis. For fuller explanation, see special analysis A (pages 328 to 336).

Table 7. FEDERAL RECEIPTS AND EXPENDITURES IN THE NATIONAL INCOME ACCOUNTS (in billions of dollars)

Description	1963 actual	1964 estimate	1965 estimate
RECEIPTS, NATIONAL INCOME BASIS			
Personal tax and nontax receipts	50.1	50.1	52.3
Corporate profits tax accruals	21.6	23.3	24.9
Indirect business tax and nontax accruals	15.6	16.5	17.3
Contributions for social insurance	21.9	23.7	24.2
Total receipts, national income basis	109.3	113.6	118.8
EXPENDITURES, NATIONAL INCOME BASIS			
Purchases of goods and services	64.4	67.8	69.1
Transfer payments	29.2	30.5	31.8
Grants-in-aid to State and local governments	7.9	9.4	9.7
Net interest paid	7.6	8.0	8.5
Subsidies less current surplus of Government enterprises	3.5	3.5	2.5
Total expenditures, national income basis	112.6	119.1	121.5
Surplus (+) or deficit (−), national income basis	−3.3	−5.5	−2.8

RELATION OF THE FEDERAL SECTOR IN THE NATIONAL INCOME ACCOUNTS TO RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

RECEIPTS			
Total receipts, national income accounts	109.3	113.6	118.8
Receipts not included in Federal receipts in the national income accounts:			
Realization on loans and other assets	1.5	1.1	1.0
District of Columbia government receipts	.3	.4	.4
Interest and other earnings	1.1	1.2	1.3
Receipt adjustments to consolidated cash basis:			
Employer and employee contributions to Federal retirement funds	−1.9	−1.9	−1.9
Accrual to cash and other adjustments	−.6	.1	.2
Total Federal receipts from the public	109.7	114.4	119.7
EXPENDITURES			
Total expenditures, national income accounts	112.6	119.1	121.5
Expenditures not included in Federal activities in the national income accounts:			
Loans, purchase of land, deposit funds, etc	2.7	4.6	2.9
District of Columbia government expenditures	.3	.4	.4
Portion of interest and other expenditures offset by receipts in the national income accounts	.6	.6	.9
Expenditure adjustments to consolidated cash basis:			
Employer and employee contributions to Federal retirement funds	−1.9	−1.9	−1.9
Accrual to cash adjustments	−.6	−.1	−1.1
Total Federal payments to the public	113.8	122.7	122.7

Note.—This table shows Federal receipts and expenditures on the basis used in the national income and gross national product statistics of the Department of Commerce. For a fuller explanation, see special analysis A (pages 328 to 336).

Table 17. ADMINISTRATIVE BUDGET AND TRUST FUND RECEIPTS, 1954–65 (in millions of dollars)

Description	Actual										Estimate	
	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
ADMINISTRATIVE BUDGET FUNDS												
Individual income taxes	29,542	28,747	32,188	35,620	34,724	36,719	40,715	41,338	45,571	47,588	47,500	48,500
Corporation income taxes	21,101	17,861	20,880	21,167	20,074	17,309	21,494	20,954	20,523	21,579	23,700	25,800
Excise taxes (net)	9,945	9,131	9,929	9,055	8,612	8,504	9,137	9,063	9,585	9,915	10,221	10,987
Employment taxes	283	579	322	328	333	321	339	*				
Estate and gift taxes	934	924	1,161	1,365	1,393	1,333	1,606	1,896	2,016	2,167	2,335	2,740
Customs	542	585	682	735	782	925	1,105	982	1,142	1,205	1,275	1,460
Miscellaneous receipts	2,309	2,562	3,003	2,760	3,200	3,160	4,062	4,080	3,206	4,435	4,053	4,113
Interfund transactions	−235	−181	−315	−467	−567	−355	−694	−654	−633	−513	−685	−600
Total administrative budget	64,420	60,209	67,850	70,562	68,550	67,915	77,763	77,659	81,409	86,376	88,400	93,000
TRUST FUNDS												
Employment taxes	5,100	5,587	6,905	7,192	8,233	8,446	10,728	12,404	12,561	14,862	16,777	16,996
Unemployment tax deposits by States	1,246	1,146	1,330	1,542	1,501	1,701	2,167	2,398	2,729	3,009	2,900	2,825
Excise taxes				1,479	2,026	2,074	2,539	2,798	2,949	3,279	3,478	3,504
Federal employee and agency payments for retirement	465	473	813	1,175	1,252	1,507	1,504	1,740	1,756	1,878	1,959	1,923
Interest on trust fund investments	1,193	1,178	1,212	1,324	1,350	1,323	1,337	1,414	1,433	1,477	1,589	1,669
Veterans life insurance premiums	426	441	441	452	485	478	482	504	501	494	501	499
Miscellaneous trust receipts	685	660	918	1,146	1,317	1,375	2,494	2,840	2,889	3,195	3,446	3,934
Interfund transactions	−18	−16	−12	−10	−11	−135	−908	−515	−528	−505	−488	−477
Total trust funds	9,097	9,470	11,607	14,301	16,153	16,769	20,342	23,582	24,290	27,689	30,163	30,872

*Less than one-half million dollars.

Note.—Figures shown in this table are net of refunds, but correspond to the net figures used in the same classifications for fiscal years 1963 to 1965 in table 13 (pages 62 to 67).

Table 18. ADMINISTRATIVE BUDGET AND TRUST EXPENDITURES BY FUNCTION, 1954–65 (in millions of dollars)

Description	Actual										Estimate	
	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
ADMINISTRATIVE BUDGET FUNDS												
050 National defense:												
051 Department of Defense—Military: [1]												
Military personnel	11,643	11,403	11,582	11,409	11,611	11,801	11,738	12,085	13,032	13,000	14,180	14,660
Operation and maintenance	9,162	7,931	8,400	9,487	9,761	10,378	10,223	10,611	11,594	11,874	11,870	12,278
Procurement	15,957	12,838	12,227	13,488	14,083	14,409	13,334	13,095	14,532	16,632	16,337	14,785
Research, development, test, and evaluation	2,187	2,261	2,101	2,406	2,504	2,866	4,710	6,131	6,319	6,376	6,943	6,580
Military construction	1,744	1,715	2,079	1,968	1,753	1,948	1,626	1,605	1,347	1,144	1,107	1,056
Family housing	------	------	------	------	------	------	------	------	------	427	680	660
Civil defense	------	------	------	------	------	------	------	------	90	203	150	150
Military assistance	3,629	2,292	2,611	2,352	2,187	2,340	1,609	1,449	1,390	1,721	1,400	1,200
Revolving and management funds	−367	−617	−598	−323	−643	−179	−416	−300	−99	−1,401	−367	−169
Total, Department of Defense—Military	43,955	37,823	38,403	40,788	41,258	43,563	42,824	44,676	48,205	49,973	52,300	51,200
058 Atomic energy	1,895	1,857	1,651	1,99	2,268	2,541	2,623	2,713	2,806	2,758	2,800	2,735
059 Defense-related activities	1,136	1,015	669	590	709	379	244	104	92	24	197	44
Total, national defense	46,986	40,695	40,723	43,368	44,234	46,483	45,691	47,494	51,103	52,755	55,297	53,979
150 International affairs and finance:												
151 Conduct of foreign affairs	130	121	129	157	173	237	217	216	249	346	316	315
152 Economic and financial programs	1,511	1,960	1,613	1,683	1,910	3,403	1,477	2,126	2,372	2,041	1,897	1,705
153 Foreign information and exchange activities	91	100	111	133	149	139	137	158	197	201	234	227
Total, international affairs and finance	1,732	2,181	1,853	1,973	2,231	3,780	1,832	2,500	2,817	2,588	2,447	2,248
250 Space research and technology:												
251 Space research and technology	90	74	71	76	89	145	401	744	1,257	2,552	4,400	4,990

See footnotes at end of table, p. 461.

Table 18. ADMINISTRATIVE BUDGET AND TRUST EXPENDITURES BY FUNCTION, 1954–65 (in millions of dollars)—Continued

Description	Actual										Estimate	
	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
ADMINISTRATIVE BUDGET FUNDS—Con.												
350 Agriculture and agricultural resources:												
351 Farm income stabilization and Food for Peace [2] [3]	1,689	3,486	3,900	3,430	3,284	5,297	3,602	3,800	4,576	5,517	4,746	3,750
352 Financing farming and rural housing	272	236	232	248	269	311	289	349	234	300	279	130
353 Financing rural electrification and rural telephones	217	204	217	267	297	315	330	301	303	342	219	216
354 Agricultural land and water resources	252	290	305	374	315	376	368	397	426	404	417	423
355 Research and other agricultural services	142	173	215	227	255	291	293	324	341	391	409	388
Total, agriculture and agricultural resources	2,573	4,388	4,868	4,546	4,419	6,590	4,882	5,172	5,881	6,954	6,070	4,907
400 Natural resources:												
401 Land and water resources	1,056	935	804	925	1,139	1,184	1,235	1,394	1,564	1,699	1,720	1,808
402 Forest resources	117	119	139	163	174	201	220	331	280	303	354	339
403 Mineral resources	37	37	38	62	59	71	65	61	68	71	107	113
404 Fish and wildlife resources	38	43	45	51	60	68	68	73	81	94	104	110
405 Recreational resources	33	35	44	59	69	85	74	91	94	112	122	138
409 General resource surveys and administration	35	34	36	38	44	61	51	55	60	73	76	80
Total, natural resources	1,317	1,203	1,105	1,298	1,544	1,670	1,714	2,006	2,147	2,352	2,483	2,588
500 Commerce and transportation:												
501 Aviation	186	179	180	219	315	494	568	716	781	808	875	912
502 Water transportation	370	349	420	365	392	436	508	569	654	672	708	717
503 Highways	586	647	783	40	31	30	38	36	33	41	45	42
505 Postal service	312	356	463	518	674	774	525	914	797	770	546	475
506 Advancement of business	−281	−343	5	119	170	234	265	271	427	366	426	455
507 Area redevelopment [4]					*				7	101	463	375

508 Regulation of business	45	38	41	45	49	58	59	67	74	84	89	94
Total, commerce and transportation	1,219	1,225	1,892	1,305	1,632	2,025	1,963	2,573	2,774	2,843	3,151	3,069
550 Housing and community development:												
551 Aids to private housing	−277	174	−67	−254	−126	732	−172	−44	−149	−537	−723	−1,041
552 Public housing programs	−401	−116	31	60	51	97	134	150	163	178	146	222
553 Urban renewal and community facilities	37	56	4	49	78	108	130	162	261	222	316	411
555 National Capital region	14	22	23	27	26	33	30	51	74	70	69	90
Total, housing and community development	−628	136	−10	−118	30	970	122	320	349	−67	−191	−317
650 Health, labor, and welfare:												
651 Health services and research	288	271	342	461	540	700	815	938	1,128	1,354	1,638	1,733
652 Labor and manpower	247	321	479	397	488	924	510	809	591	224	390	651
653 Public assistance	1,439	1,428	1,457	1,558	1,797	1,969	2,061	2,170	2,437	2,788	3,007	2,869
655 Other welfare services [3]	148	145	184	216	234	284	304	327	382	423	498	579
Total, health, labor, and welfare	2,122	2,165	2,462	2,632	3,059	3,877	3,690	4,244	4,538	4,789	5,533	5,832
700 Education:												
701 Assistance for elementary and secondary education	184	215	181	174	189	259	327	332	337	392	411	471
702 Assistance for higher education	44	43	44	110	178	225	261	286	350	428	404	442
703 Assistance to science education and basic research	6	11	20	46	50	106	120	143	183	206	260	302
704 Other aids to education	91	109	98	108	124	141	156	181	207	219	269	359
Proposed education legislation [5]	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	3	118
Total, education	326	377	343	437	541	732	866	943	1,076	1,244	1,348	1,691
800 Veterans benefits and services:												
801 Veterans service-connected compensation	1,731	1,829	1,864	1,876	2,024	2,071	2,049	2,034	2,017	2,116	2,126	2,120
802 Veterans non-service-connected pensions	700	801	884	950	1,037	1,152	1,265	1,532	1,635	1,698	1,743	1,777
803 Veterans readjustment benefits	789	879	943	977	1,025	864	725	559	388	−13	6	−290
804 Veterans hospitals and medical care	782	727	788	801	856	921	961	1,030	1,084	1,145	1,240	1,246
805 Other veterans benefits and services	339	286	331	266	242	280	266	259	279	240	248	229
Total, veterans benefits and services	4,341	4,522	4,810	4,870	5,184	5,287	5,266	5,414	5,403	5,186	5,362	5,081

See footnotes at end of table, p. 461.

Table 18. ADMINISTRATIVE BUDGET AND TRUST EXPENDITURES BY FUNCTION, 1954–65 (in millions of dollars)—Continued

Description	Actual										Estimate	
	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
ADMINISTRATIVE BUDGET FUNDS—Con.												
850 Interest:												
851 Interest on the public debt	6,382	6,370	6,787	7,244	7,607	7,593	9,180	8,957	9,120	9,895	10,600	11,000
852 Interest on refunds of receipts	83	62	54	57	74	69	76	83	68	74	90	90
853 Interest on uninvested funds	5	5	6	6	8	9	10	10	10	11	11	12
Total, interest	6,470	6,438	6,846	7,307	7,689	7,671	9,266	9,050	9,198	9,980	10,701	11,101
900 General government:												
901 Legislative functions	49	60	76	90	89	102	109	118	135	131	141	138
902 Judicial functions	29	31	38	40	44	47	49	52	57	63	68	72
903 Executive direction and management	11	12	12	12	19	21	20	22	22	21	24	24
904 Central fiscal operations	449	431	475	476	502	566	558	607	653	715	800	838
905 General property and records management	157	168	173	201	245	295	372	372	419	444	540	561
906 Central personnel management	93	96	304	602	84	95	84	140	153	142	175	106
908 Protective services and alien control	186	185	220	219	233	255	263	289	300	323	338	351
910 Other general government	253	183	278	100	69	86	88	109	136	139	154	148
Total, general government	1,226	1,166	1,576	1,738	1,284	1,466	1,542	1,709	1,875	1,979	2,238	2,238
Allowance for attack on poverty												250
Allowance for civilian pay comparability												544
Allowance for contingencies											250	300
Interfund transactions	−235	−181	−315	−467	−567	−355	−694	−654	−633	−513	−685	−600
Total, administrative budget funds	67,537	64,389	66,224	68,966	71,369	80,342	76,539	81,515	87,787	92,642	98,405	97,900

TRUST FUNDS												
050 National defense	146	164	143	93	344	229	256	196	366	679	867	1,231
150 International affairs and finance	101	45	−29	13	1	21	48	13	15	44	86	99
250 Space research and technology	---	---	---	---	---	---	---	---	---	---	*	2
350 Agriculture and agricultural resources	137	73	288	426	357	645	458	416	398	507	475	442
400 Natural resources	45	61	79	85	101	94	116	183	112	122	138	107
500 Commerce and transportation	−101	−97	−101	866	1,401	2,493	2,831	2,505	2,662	2,877	3,394	3,466
550 Housing and community development	−296	231	461	1,044	−295	1,263	1,439	−273	1,524	−36	1,628	456
650 Health, labor, and welfare	6,036	7,423	7,999	9,585	12,775	14,306	16,358	19,236	20,382	21,855	22,669	23,549
700 Education	1	1	1	1	1	1	1	1	1	2	2	2
800 Veterans benefits and services	779	628	606	608	671	651	673	811	733	835	642	495
900 General government	9	6	8	8	10	10	17	16	20	19	18	18
Deposit funds	−128	57	169	217	−29	−60	−78	203	−544	146	−116	−17
Interfund transactions	−18	−16	−12	−10	−11	−135	−908	−515	−528	−505	−488	−477
Total, trust funds	6,711	8,577	9,611	12,938	15,325	19,521	21,212	22,793	25,141	26,545	29,315	29,372

*Less than one-half million dollars.

[1] Former subfunctions 051, Department of Defense military functions, and 057, Military assistance, have been merged in this subfunction. Amounts shown for years prior to 1964 include estimated comparability adjustments not supportable by accounting records.

[2] This category was previously titled "Farm income support and production adjustment."

[3] The portion of the appropriation for Removal of surplus agricultural commodities, Department of Agriculture, which finances the food stamp program, has been reclassified from 351, Farm income stabilization and Food for Peace, to 655, Other welfare services.

[4] Amounts shown for 1963 through 1965 include the Public works acceleration program which supplements expenditures in various other categories.

[5] The amounts shown for expenditures under proposed legislation will subsequently be charged to subfunctions 701, 702, and 704.

Table 19. **RECEIPTS FROM AND PAYMENTS TO THE PUBLIC, 1954–65 (in millions of dollars)**

Description	Actual										Estimate	
	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
RECEIPTS FROM THE PUBLIC												
Individual income taxes	29,542	28,747	32,188	35,620	34,724	36,719	40,715	41,338	45,571	47,588	47,500	48,500
Corporation income taxes	21,101	17,861	20,880	21,167	20,074	17,309	21,494	20,954	20,523	21,579	23,700	25,800
Excise taxes	9,945	9,131	9,929	10,534	10,638	10,578	11,676	11,860	12,534	13,194	13,699	14,491
Employment taxes	5,382	6,166	7,228	7,520	8,565	8,767	11,067	12,405	12,561	14,862	16,777	16,996
Estate and gift taxes	934	924	1,161	1,365	1,393	1,333	1,606	1,896	2,016	2,167	2,335	2,740
Customs	542	585	682	735	782	925	1,105	982	1,142	1,205	1,275	1,460
Deposits by States, unemployment insurance	1,246	1,146	1,330	1,542	1,501	1,701	2,167	2,398	2,729	3,009	2,900	2,825
Veterans life insurance premiums	426	441	441	452	485	478	482	504	501	494	501	499
Other budget and trust receipts	2,508	2,834	3,249	3,171	3,730	3,851	4,766	4,905	4,288	5,641	5,678	6,432
Total, receipts from the public	71,626	67,836	77,087	82,105	81,892	81,660	95,078	97,242	101,865	109,739	114,366	119,742
PAYMENTS TO THE PUBLIC												
National defense	47,138	40,852	40,854	43,442	44,552	46,673	45,915	47,685	51,462	53,429	56,011	55,211
International affairs and finance	1,696	2,044	1,624	2,637	2,651	2,398	1,574	2,153	2,492	2,242	2,452	2,377
Space research and technology	90	74	71	76	89	145	401	744	1,257	2,552	4,400	4,992
Agriculture and agricultural resources	2,617	4,399	4,977	4,627	4,347	7,052	4,877	5,183	5,942	7,266	6,340	5,065
Natural resources	1,357	1,260	1,179	1,379	1,641	1,754	1,822	2,101	2,223	2,456	2,611	2,688
Commerce and transportation	1,137	1,148	1,796	2,200	3,060	4,545	4,819	5,107	5,487	5,777	6,601	6,588
Housing and community development	−1,009	305	396	842	−319	2,141	1,440	−103	1,691	−268	1,279	−40
Health, labor, and welfare	8,083	9,485	10,254	12,108	15,757	18,017	19,107	22,364	23,975	25,698	27,265	28,595
Education	327	378	344	439	542	733	867	945	1,052	1,214	1,302	1,641
Veterans benefits and services	5,042	5,114	5,328	5,448	5,828	5,910	5,907	6,187	6,092	5,971	5,950	5,525
Interest	4,620	4,664	5,115	5,266	5,884	5,350	7,233	7,257	6,940	7,427	8,120	8,596
General government	1,235	1,172	1,583	1,744	1,292	1,475	1,558	1,724	1,882	1,983	2,241	2,239
Deposit funds (net)	−128	57	169	217	−29	−60	−78	203	−544	−194	−116	−17
Undistributed adjustments	−348	−415	−1,145	−420	−1,823	−1,382	−1,114	−2,006	−2,289	−1,801	−1,753	−770
Total, payments to the public	71,858	70,537	72,546	80,006	83,472	94,752	94,328	99,542	107,662	113,751	122,704	122,690
Excess of receipts or payments	−232	−2,702	4,542	2,099	−1,580	−13,092	750	−2,300	−5,797	−4,012	−8,338	−2,948

Note.—This table shows the flow of money between the Government and the public on a cash (collections and checks paid) basis, which is explained in more detail in special analysis A, pages 328 to 336.

Table 20. **FEDERAL RECEIPTS AND EXPENDITURES IN THE NATIONAL INCOME ACCOUNTS, 1954–65**

(Fiscal years. In billions of dollars)

Description	Actual										Estimate	
	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
RECEIPTS, NATIONAL INCOME BASIS												
Personal tax and nontax	30.4	29.9	33.5	36.7	36.3	38.7	42.3	44.0	47.6	50.1	50.1	52.3
Corporate profits tax accruals	17.1	18.4	21.0	20.4	17.3	21.1	21.7	19.5	21.3	21.6	23.3	24.9
Indirect business tax and nontax accruals	10.7	10.4	11.2	12.1	12.0	12.3	13.9	13.6	14.9	15.6	16.5	17.3
Contributions for social insurance	7.7	8.3	10.5	11.7	12.3	13.8	16.7	18.0	19.7	21.9	23.7	24.2
Total receipts, national income basis	65.9	67.0	76.3	80.9	77.8	85.9	94.5	95.2	103.6	109.3	113.6	118.8
EXPENDITURES, NATIONAL INCOME BASIS												
Purchases of goods and services	53.9	45.0	45.2	48.3	50.5	53.9	53.0	54.9	60.1	64.4	67.8	69.1
Transfer payments	11.9	13.8	14.2	16.1	19.4	21.8	22.8	25.9	27.8	29.2	30.5	31.8
Grants-in-aid to State and local governments	2.8	2.9	3.1	3.6	4.5	6.0	6.7	6.6	7.3	7.9	9.4	9.7
Net interest paid	4.9	4.9	5.0	5.5	5.6	5.8	6.9	7.0	7.0	7.6	8.0	8.5
Subsidies less current surplus of Government enterprises	1.0	1.4	1.9	3.1	2.7	2.7	2.7	3.4	4.2	3.5	3.5	2.5
Total expenditures, national income basis	74.5	68.1	69.5	76.5	82.8	90.3	92.1	97.8	106.4	112.6	119.1	121.5
Surplus (+) or deficit (−), national income basis	−8.6	−1.1	+6.8	+4.4	−4.9	−4.4	+2.4	−2.7	−2.7	−3.3	−5.5	−2.8

Source.—Actual data for 1954–63 are based on the quarterly estimates published by the Department of Commerce. Data for 1964 and 1965 are based on estimates by the Bureau of the Budget in cooperation with the Department of Commerce.

JANUARY 1964 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, JANUARY 28, 1964

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

The joint committee met, pursuant to recess, at 10:05 a.m., in room 1114, New Senate Office Building, Hon. Paul H. Douglas (chairman) presiding.

Present: Senators Douglas, Sparkman, Proxmire, Javits, and Jordan; and Representatives Patman, Reuss, and Curtis.

Also present: James W. Knowles, executive director; Hamilton D. Gewehr, administrative clerk; and Donald A. Webster, minority economist.

Chairman DOUGLAS. We appreciate your coming very much, Mr. Dillon, particularly when you have been suffering from a very severe cold. In order to spare your voice, we would be very glad to have one of your associates read your statement for you. Then when the questioning begins, you can perhaps answer the questions.

I regret that I have a rather urgent appointment shortly after a half hour and I will be compelled to leave. Congressman Patman has a crucial vote in the House. I hope you will not regard this as impoliteness or lack of interest in what you are saying.

Before we begin, I am going to ask Senator Javits to make a statement which I believe he wishes to make.

Senator JAVITS. I thank the Chair. I did wish to make a very brief statement, Mr. Chairman, because it seems to me I would want to clarify my position on this side of the aisle as to being in favor of a tax cut.

It appears that on the first day of our hearings, Chairman Heller of the Council of Economic Advisers admitted that the President was relying chiefly on the tax cut to combat endemic unemployment. Subsequently, my distinguished colleague, Congressman Curtis, who is the senior Republican in this committee, issued a statement which related to the advisability of the tax cut. Although he is not against it, I understand, he had some reservations about it and I wish to clar ify my own position.

I am in favor of a tax cut, Mr. Chairman, have been since August 1962, when I believe it would have been far more effective. I believe, however, that the tax cut as presently proposed will not be adequate to reverse the economic slowdown that is likely to confront us as early as the third or fourth quarter of 1964, nor will it, without economic programs of a major character, make a real dent in the Nation's unemployment problem. To this extent, then, the tax cut is a delusion, much as I am for it to maintain our economic pace, which I think could lag without it. In other words, without the cut, our situation could get even worse than it is now.

In the face of this situation, President Johnson has no new programs to offer. On the contrary, he promises to cut the Federal budget for fiscal year 1965 to a level $500 million below estimated budgetary expenditures in the current fiscal year. Through the much vaunted "war on poverty"—which is substantially the same program as offered by President Kennedy except for $500 million requested in new obligational authority—President Johnson promises to make a substantial reduction in unemployment and at the same time make a meaningful increase in the standard of living of 30 million Americans with incomes less than $3,000.

The whole Johnson program represents an economic shortfall unless there is added to it in fiscal years 1964–65 the following:

A program of broadened manpower retraining (it is estimated that only 135,000 workers are scheduled for retraining for fiscal year 1964, which is 15 percent of what is actually needed). It is essential that we enlist the full resources of the private enterprise system in this manpower retraining program, which we have not done yet.

Accelerated construction of vocational and technical schools;

Incentives for plant modernization;

A tax incentive for exports;

The establishment of a Commission on Automation to make urgent recommendations in this critical area and to provide for the transition of workers and businesses to automation;

The enactment of a Federal fair employment practices commission;

The modernization of our antitrust laws;

The accelerated use of labor-management-public committees provided under section 205(b) of the Manpower Development and Training Act of 1962;

Programs to bring the war on poverty to the neighborhood and private enterprise level.

These would, in my view, represent a more effective effort to deal with the crucial problems which will confront the economy in the immediate future that the unrealistic fare so far suggested by the President.

Much as I agree with a tax cut, Mr. Chairman, I would be derelict in my duty if I did not outline what I think is essential in addition if we are not just to struggle to keep where we are in unemployment, and so forth, but to reverse the trend and to make a measurable dent in the unemployment picture.

Thank you, Mr. Chairman.

Chairman DOUGLAS. Thank you.

We are very glad to welcome you, Mr. Secretary. May I ask you to identify the assistant who is going to read your statement?

Secretary DILLON. This is Mr. Paul Volcker, Deputy Under Secretary of the Treasury for Monetary Affairs. He has worked on all these matters and he will read the statement.

STATEMENT OF HON. DOUGLAS DILLON, SECRETARY OF THE TREASURY, ACCOMPANIED BY PAUL A. VOLCKER, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. VOLCKER. Mr. Chairman and members of the Joint Economic Committee, the performance of the American economy during 1963 has already been reviewed in detail in the Economic Report. Consequently, I shall not dwell upon this past record today. Instead, I should like to explore with you some of the implications of recent and prospective developments for the broad range of financial and economic policies, both domestic and international, with which I am directly concerned.

UNFILLED NEEDS AT HOME

The current advance in business activity, now extending over 3 full years, has remained remarkably well balanced. But I think it is now abundantly clear to all that we cannot be satisfied simply to head off a new recession, or to continue with the current gradual expansion in output. For, despite the growth in the economy last year more of our citizens were unemployed during December than was the case a year earlier. We can and must do better.

The true measure of our task is not simply the 5½ percent of our labor force that is currently unemployed. In addition, we must provide jobs for the rapidly increasing number of younger workers who will be entering the labor force over the remaining years of this decade, and for those further millions who will be displaced from existing jobs by mechanization and automation.

A broad consensus has been reached among leaders in all sectors of our economy, and I believe within the Congress, too, that thoroughgoing tax reduction, lifting from the private economy the shackles of wartime tax rates, is the greatest single step that can be taken to speed the creation of new job opportunities.

Tax reduction is not a cureall. To overcome stubborn pockets of poverty, lack of adequate training for too many workers, and remaining barriers to equal employment opportunity will require the kind of coordinated and many-sided effort, by business and labor as well as by the Federal Government, by States, and by local communities, that the President has outlined for us. But tax reduction, with its stimulating effects permeating into every sector of the economy, must be the centerpiece of any effective attack on unemployment and poverty, for the more specific remedies for these problems can be fully effective only in a more buoyant economic environment—an environment in which a trained man can find employment for his skills and in which there are strong economic incentives for upgrading workers and overcoming barriers of race and color.

The tax bill as passed by the House and approved by a bipartisan 12 to 5 vote in the Senate Finance Committee provides particularly large reductions for those at the bottom end of the scale. Although most low-income families pay little if any income tax, those that do will obtain substantial relief. For families with total personal income of $3,000 or less and for individuals with personal income of $1,500 or less, including not only sources of income reported on tax returns but also social security and other transfer payments, taxes would be cut by an average of more than 60 percent. And many of the 1.5 million taxpayers who, under the bill, will no longer pay any income tax whatsoever are in this group.

Overall, the bill, as reported by the Senate Finance Committee, provides a net reduction in personal tax liabilities of nearly $9.5 billion, or about 80 percent of the total tax reduction provided. The great bulk of this money will move directly into consumer markets. Over $5.5 billion of the net reduction in personal tax goes to taxpayers with incomes of $10,000 or less. These people, 85 percent of all taxpayers, now carry 50 percent of the individual tax load. Under both House and Senate versions of the bill, they will receive 60 percent of the individual tax reduction. Consequently, the combination of rate reduction and structural reform will shift to the higher income brackets a somewhat larger share of the tax load. Taxpayers in the bottom income group, reporting earnings of $3,000 or less, will get three times the percentage tax reduction of those earning $50,000 and up.

Those who have suggested that the individual tax reductions favor the upper income groups forget that, by the very nature of our steeply progressive tax rate structure, any across-the-board rate reductions must inevitably mean greater increases in the after-tax incomes of those in the higher brackets. To achieve equal percentage increases in after-tax income would require maintenance of a rate schedule much as at present, running up to a top rate of 90 or 91 percent.

It would mean total abandonment of any thought of across-the-board reductions in our current excessively high rates. But this would be to abandon one of the chief objectives of this bill—a decisive shift away from the excessively high marginal rates that inhibit incentives and serve as a source or excuse for many of the distortions in our tax structure.

While drastically cutting these excessively high, war-born rate schedules, the tax bill gives its greatest proportional benefits to low-income individuals. It imposes a smaller proportion of the total tax liability on lower income taxpayers. And, in the Senate Finance Committee version, which in this respect is much to be preferred, the bill gives no further benefits to capital gains. For all those reasons, there can be no question but that the tax bill will mean a marked and healthy improvement in our income tax structure. It will not, by any means, remove all the inequities in our present tax law. I wish it had been possible to do more. But, even so, there can be no doubt that the present bill will mark a significant step in the direction of greater equity in our tax law.

Expectations that the tax program will be enacted have already helped to account for the strength of business activity in recent months. But expectations of tax reduction cannot alone provide the needed stimulus. Not until the bill is actually passed by the Congress and signed by the President can withholding rates be reduced and the new spending power generated for consumers, at a rate of close to $800 million per month, work its way through the market into expanded employment.

And not until then can our citizens plan ahead in the sure knowledge of greater after-tax returns for new investment and productive effort. That is why the President has been so insistent that congressional action on the bill be completed just as rapidly as possible.

TAX REDUCTION, THE BUDGET, AND FINANCING THE DEFICIT

The tax reduction program reflects a deliberate decision to rely upon the private sector of the economy to provide the motive force for the more rapid economic progress that our situation demands. The essential corollary of that decision—firm restraint on the total of Federal spending—is unambiguously stated in the President's budget. With expenditures in check, all the added revenues that will be generated by economic expansion during fiscal 1965 can be devoted to reducing the deficit and putting us securely on the path toward early restoration of budgetary balance. When joined with continued sound financing of our transitional deficits, this budgetary outlook offers assurance that neither inflationary excesses nor capital market congestion will impede our progress toward the achievement of full employment.

The events of the past year have clearly illustrated that we can soundly finance our budgetary deficit during an orderly advance in business activity without bringing heavy pressures on the capital market. Over $14¾ billion of new marketable Treasury securities maturing in more than 5 years, including $3¾ billion maturing in more than 10 years, were placed with individuals and institutional investors during calendar year 1963. On two occasions long-term bonds were sold through competitive bidding. And the further development and refinement of the advance refunding technique, which provides a means of encouraging investors to extend their commitments in Government securities with a minimum impact on the capital markets, greatly facilitated our accomplishment. The net result was a reduction of $3 billion in the outstanding 1- to 5-year debt despite the effects of the passage of time in bringing more issues into that category. Overall there was a further increase in the average maturity of our marketable debt to 5 years and 1 month, the longest for any December since 1955.

Debt maturing within 1 year was increased by $2 billion, reflecting the decision to concentrate much of our new cash financing in the bill market to help keep short-term interest rates in line with those abroad. This enlargement of the short-term debt was easily absorbed without creating excessive liquidity.

The entire increase in the debt was placed outside the commercial banking system. Commercial bank holdings of Government securities actually declined during calendar year 1963 by $3½ billion and their total holdings of Government securities today are only 1 percent higher than when the current expansion got underway.

Last year also saw a record volume of long-term credit flowing into the private sector of the economy and to State and local governments. This accelerated flow provided ample evidence that our progress in restructuring the Federal debt has not inhibited economic activity. Mortgage rates—perhaps the most significant of all interest rates in terms of their potential impact on private spending—actually declined, even while almost $30 billion of additional mortgage credit—by far the largest amount in any single year—was being made available on liberal terms to builders and homebuyers. Today, mortgage rates are as low as at any time since the recession year of 1958 and building activity is at new peaks—a sharp contrast to the pattern of tightening markets and declining volume characteristic of earlier postwar expansion.

Market yields on State and local government securities, while tending to rise moderately during the latter part of the year, averaged lower than during all but 1 of the past 7 years, while the volume of financing reached a new record of $11 billion. Rates charged by banks for business loans remained stable at the lower levels reached in the last recession, and new corporate bond financing remained available at rates very close to—and in the case of medum-quality credits somewhat below—the levels prevailing when the current expansion began.

It is against this background that we intend to continue to finance our future deficits in a manner that will avoid contributing either to a buildup of excessive liquidity in the economy or to unnecessary pressures on key market interest rates. In doing so, we are of course conscious of the fact that an expanding economy, benefiting from the stimulus of tax reduction, should generate still higher demands for credit from business and individuals, just as these demands have risen over the past 3 years. But, unlike the situation a year ago we can now look forward to a sharp reduction in the fiscal 1965 budget deficit, a fact that should help relieve the concern that has been expressed in some quarters that financing requirements will outpace our savings potential. With a surplus in trust accounts and the normal purchasers of the Federal Reserve, foreigners and others that regularly absorb Treasury securities, the residue to be financed in the market should be quite manageable.

While we face the usual large seasonal needs for cash during the first half of the coming fiscal year, a large portion will be offset by a substantial surplus during the second half of the fiscal year. Moreover, the volume of savings seeking long-term investment outlets has remained very large throughout the expansion period, and it should not be forgotten that the higher incomes generated by reduced taxes and rising levels of business activity will further enlarge this flow.

Interest rates and the problem of international capital flows

These market developments and appropriate debt management and monetary policies cannot, of course, be fully appraised without considering their relationship to our pressing balance-of-payments problem. In a world of convertible currencies and increasingly free capital movements among countries, no industrialized nation can expect to keep its own money markets entirely insulated from developments in the principal markets abroad. Certainly, developments during 1963, when swelling outflows of long- and short-term capital for a time threatened to undermine the dollar and bring unbearable strains on the international financial system, have pointed unambiguously to the need to achieve a reasonable balance between the costs and returns on capital in our market and those abroad.

The recorded outflow of U.S. capital in the second quarter of 1963 reached an annual rate of nearly $7 billion. As a result, the gradual, but steady, progress we had been making in other directions to restore balance in our international payments was overwhelmed. Prompt and effective action to stanch this capital outflow could not be deferred. Therefore, use was made of the traditional tools of monetary policy—including a rise in the Federal Reserve discount rate from

3 to 3½ percent in July—to bring our structure of short-term money market rates into better alinement with those prevailing abroad.

But the enormous volume of our savings seeking long-term investment outlets clearly indicated that any attempt to bring about the sharply higher levels of long-term interest rates required to restrain the outflow of long-term capital to more sustainable amounts would not have been practicable, and, in addition, would have necessitated a degree of credit contraction entirely out of keeping with our domestic economic situation. It was in these circumstances that President Kennedy on July 18 announced the proposed interest equalization tax. By increasing the cost of capital to foreigners borrowing in our market by the equivalent of about 1 percent per year, the effects of this excise tax in diverting foreign borrowers to other markets are closely analogous to an increase in the entire structure of domestic interest rates.

No one can be happy with the necessity of taking action of this type to restrain the outward flow of capital. But the need was clear; flotations of new foreign securities in our market had reached an annual rate of over $2 billion a year during the first half of 1963, almost double the already high rate of 1962 and more than triple the more normal volume of the years from 1959 to 1961. Moreover, there were no indications that the flow would fall back to earlier levels of its own accord. Quite the contrary; it gave indications of growing even larger.

The interest equalization tax is a transitional measure. The fundamental solution to the problem of long-term capital outflows must be found in other efforts at home and abroad. One essential is to strengthen our own economy, so that investment in the United States is more attractive for our own citizens and foreigners alike. More specifically, one of the important benefits of the tax reduction program will be to increase the profitability of domestic investment and to generate more outlets at home for our savings.

At the same time, the danger of massive demands from abroad converging on our market can be gradually relieved by improvement in the capital markets of other industrialized countries as they become more fully capable of meeting the financial needs generated by their own growth. In this connection, the Treasury has recently completed an intensive survey of European capital markets and provided it to your committee for publication. I am hopeful that this review of those markets will be useful in developing greater understanding of both the problems and the potential for progress.

BALANCE-OF-PAYMENTS IMPROVEMENT

The effectiveness of the moderate upward pressures on the short-term rate structure and the proposed interest equalization tax in curtailing the outward flow of capital was strikingly demonstrated during the second half of the year, when reductions in the outflow of private capital were largely responsible for the dramatic improvement in our payments position. The deficit on regular transactions, after reaching the clearly unsustainable seasonally adjusted annual rate of over $5 billion during the second quarter, dropped to a rate of $1.6 billion during the third quarter. While final data for the full year are still lacking, this third quarter rate appears to have been maintained or even slightly improved upon during the fourth quarter. The deficit on regular transactions during the entire second half of 1963 was the smallest for any equivalent period since 1957. For the year as a whole, despite the sharp deterioration over the first 6 months, it appears to have been reduced to about $3 billion, roughly $600 million below the figure for 1962.

Special intragovernmental transactions, which are excluded from calculation of the regular deficit, have had the effect of absorbing a portion of the dollars flowing into foreign hands. These transactions were in somewhat smaller volume than in 1962, because of smaller debt prepayments and smaller advance payments on military exports. Nevertheless, our overall deficit—measuring the increase in our liquid liabilities to foreigners and the decline in our reserves—fully reflected the sharp improvement in the second half of the year. If the special, nonmarketable, medium-term, convertible Treasury securities sold to foreign official institutions are considered a balance-of-payments receipt rather than a liquid liability, preliminary reports indicate that the overall deficit for 1963 should be about $1.9 billion, as compared to $2.2 billion last year and $2.4 billion in 1961. If the $700 million of these issues sold during the year are disregarded, the overall deficit would be about $2.6 billion. Thus, despite the sharp deterioration in the early months of the year, we were able in 1963 to maintain the pattern of improvement from the average deficits of $3.7 billion that characterized the 1958 to 1960 period.

These encouraging developments deserve mention. But at the same time, we must all recognize that the gains are still far too limited, and that temporary improvement is not enough. The need for resolute action on the balance-of-payments problem is no less a matter of national concern than it was 6 months ago. Action on the interest equalization tax must be completed without changes that would impair the effectiveness of the bill reported by the House Ways and Means Committee. The comprehensive program announced last July to reduce the balance-of-payments cost of our military and foreign aid programs must be pressed forward with undiminished vigor and resolution to realize the anticipated $1 billion savings on Government payments abroad by the end of this year. And imaginative and energetic efforts by business and Government to capitalize on our fine record of price stability and to expand export markets are particularly necessary if we are to move into early payments balance.

Also, 1963 saw a marked decline in the drain on our gold stocks. To some degree, this reflected the added supply of gold reaching world markets from the Soviet Union, as well as the continued usefulness of the informal cooperation among leading countries in dealings on the London gold market. But in addition, foreigners—and particularly private foreigners—chose to build their dollar balances at a more rapid rate. For the 12 months as a whole, our loss of gold came to $461 million, well below the average of $873 million in 1961 and 1962 and the much larger outflows, averaging nearly $1.7 billion, of the years 1958–60. This in itself is a sign of sustained confidence in the stability of the dollar and in the strength of existing monetary arrangements. But this strength can be preserved only if there is continuing evidence that our balance of payments is indeed under firm control.

The international payments mechanism

The prospect of the elimination of our deficit has, in turn, helped to focus attention on the potential problems that may arise over the years ahead in assuring an adequate supply of international liquidity once the United States is no longer supplying dollars on balance to the rest of the world. In order that these problems may be anticipated and the further evolution of the international monetary system guided along constructive and agreed lines, the same group of 10 nations that in 1962 agreed to supplement the ordinary resources of the IMF with the special borrowing arrangements took an important decision last October. They agreed to examine thoroughly the outlook for the functioning of the system and its probable future needs for liquidity, and to appraise and evaluate means for meeting these needs.

To this end, a working group of deputy finance ministers from each country has been established under the chairmanship of Under Secretary Roosa, and has been meeting periodically since October. These senior officials, each accompanied by representatives of their central banks, have been assigned the task of systematically examining the present system as it has heretofore evolved, assessing the possible magnitude and nature of the needs of the future, and developing possible approaches toward meeting these needs.

At present, this working group is still in the process of isolating the major issues in this vast and complicated area through the process of frank and full discussion, with each representative setting aside the details of his daily work so that he can participate intensively in this review. The group is also drawing upon the resources of the International Monetary Fund, the Bank for International Settlements, and the Organization for Economic Cooperation and Development, each of which is represented in the discussions by a senior official, providing further assurance of a thoroughgoing, realistic appraisal. It is expected that the state of more active negotiation, preliminary to the formulation of any specific recommendations which the deputies may decide to submit for review by the finance ministers themselves, will be reached during the spring.

Meanwhile, a parallel study of these problems is also going forward within the IMF, focusing particularly on those aspects related to the functions of the Fund itself.

In closing, I should emphasize again that, valuable as these studies of international liquidity will doubtless prove to be, their relevance for the present U.S. balance-of-payments situation is very limited. There is no prospect of somehow obtaining relief from the urgent necessity of eliminating our balance-of-payments deficit. The evaluation now underway is based on the prospect that our balance-of-payments deficit will in fact be ended. The responsibility inescapably rests upon us to make that assumption an accomplished fact.

Representative PATMAN (presiding). Thank you very kindly, sir. Mr. Dillon, did you notice the statement that came out of Switzerland yesterday about how they are dealing with the incoming deposits in banks and foreign investments?

Secretary DILLON. Yes, I did, Mr. Chairman.

Representative PATMAN. I believe the Wall Street Journal carried an article on page 11.

Secretary DILLON. I did not see that particular one.

Representative PATMAN. Also the New York Times and the Journal of Commerce. Without objection, I will place these articles in the record at this point.

I think they are worthy of consideration.

(The articles referred to follow:)

[From the Wall Street Journal, Jan. 28, 1964]

SWISS PROPOSAL TO CURB INFLATION BARS INTEREST ON SOME FOREIGN FUNDS—CONSTRUCTION OF SOME BUILDINGS WOULD BE BANNED FOR 1 YEAR; OTHER INVESTMENT RULES SLATED

(By a Wall Street Journal staff reporter)

LONDON.—Switzerland's Government announced it has drafted measures aimed at curbing inflation and protecting the purchasing power of the Swiss franc. The proposals include:

Effective January 1, 1964, no interest will be paid on any foreign deposits in Swiss banks. London banking sources believe this refers to Swiss francs deposited by non-Swiss residents and not to foreign currencies deposited in Swiss banks.

[In New York Swiss banking sources said that for some time Swiss banks have informally restricted deposits by foreigners in Swiss francs and interest payments on such deposits. However, they said they couldn't amplify on the Government's announcement until they see a copy of the order.]

The Government will be empowered to prevent if necessary any banking or financial firm from investing in Swiss stocks or mortgages.

Construction will be banned for 1 year of such buildings as movie houses, theaters, dancehalls, museums, private dwellings costing over 200,000 Swiss francs (about $46,000) luxury apartments, and gasoline filling stations; after a year a system of permits for such construction will be introduced.

The Government will be authorized to set limits for mortgage loans granted by banks, insurance companies, and other financial institutions.

The draft regulations will be submitted to an extraordinary session of the Swiss Parliament set for February 17.

Zurich stock market prices weakened sharply after the announcement, with the decline accentuated by month-end liquidation. There was no panic selling, however, and buying interest was active at the lower level. In the London foreign exchange market, the Swiss franc eased slightly against both sterling and the U.S. dollar, but offerings were on the light side.

[From the New York Times, Jan. 28, 1964]

SWISS MAP CURBS TO BAR INFLATION—PLANNING CONTROLS ON BANKS, FOREIGN FUNDS, AND LABOR

(By Richard E. Mooney)

BERNE, January 27.—The Swiss Government, in a move to contain inflationary pressures, proposed mandatory controls today on foreign funds, banks, imported labor, and a broad range of construction projects.

The aim of the proposed new legislation is to cool down the country's supercharged economy and maintain the purchasing power of the Swiss franc.

[In New York, the announcement led to a small decline in the Swiss franc in foreign exchange trading.]

For the man who sends his money to Switzerland for safekeeping, the new controls would be essentially the same as voluntary arrangements—gentlemen's agreements—that have existed between Swiss banks and the Swiss National Bank for some time.

But now, if the legislature approves, they would be mandatory for at least 1 year.

The almost sacred secrecy of Swiss bank accounts would not be changed. Also, convertibility of the Swiss franc into other currencies is not affected.

INFLUX CONTINUES

The program, partly new and partly a matter of putting teeth into existing programs, was disclosed by the country's Federal Council at a press conference today.

Switzerland has a 4-year-old boom that will not slow down. It, in turn, has produced an inflation that may seem small in comparison with much of Europe these days, but seems very large to the Swiss.

In the last 3 years, consumer prices have risen 10 percent, which is more than they had risen in the preceding decade.

Switzerland's international payments situation would be serious if it were not for the continuous influx of foreign money seeking refuge. Despite the fact that Swiss banks pay no interest on foreign funds, the money continues to pour in.

In this same contrary pattern, the measures that Swiss authorities have taken to combat their inflation so far have not included such standard devices as an increase in interest rates or a tight budget policy.

The Swiss National Bank's discount rate for loans to regular banks is, and remains, the lowest of any industrial country—2 percent—and Federal taxes on property and income, which are less significant than local taxes in this country, were cut by 10 percent only a few weeks ago, contrary to classic anti-inflation practice.

The "gentlemen's agreement" on foreign funds, which the Council proposes as legislation now, prohibits foreign deposits from earning interest in banks after January 1, 1964, and from being invested in any sector of the Swiss economy, or in shares or mortgages. But apparently there has been some leakage.

The proposed law would continue these banking prohibitions and expand them to cover any Swiss operatives who handle foreign funds, and would require henceforth that foreign funds be put into special "sterilized" accounts at the Swiss National Bank if they are not reinvested outside the country.

The new rules would affect all money entering the country since January 1. Funds that came earlier would be subject to the earlier rules.

Today's proposals affecting the domestic economy were as follows:

Credit.—Bank loan expansion would be subject to a law that continues another existing "gentleman's agreement" limiting the expansion to Government-fixed levels.

Building.—Some types of construction would be forbidden for 1 year, such as movie theaters, gas stations, convention halls, office buildings, and large homes over $48,000. Some other types would be subject to regulation, while hospitals, schools, water systems, and most housing would be unrestricted.

Labor.—The current ban on any increase in a company's payroll will be continued for about 6 months, with fewer exceptions, while a new and stricter plan is devised. It was indicated that the new plan might call for a reduction.

[From the Journal of Commerce, Jan. 28, 1964]

Swiss Hit at Inflation, Restrict Capital Inflow

(By Ed Tyng)

The Swiss cracked down heavily yesterday upon domestic inflation, fed largely by foreign money, by severely restricting capital inflows and placing new controls over their domestic economy.

Banks here got sketchy summaries of the new Swiss regulations, more drastic than any continental European country has yet adopted.

CURBS OUTLINED

According to these private summaries the new restrictions include:

1. Sterilization of incoming foreign deposits by requiring a 100-percent reserve against them, to be deposited in the Swiss National Bank, central bank of Switzerland.

This requirement is subject to an important "out" in that if any of such deposits are reinvested abroad, the amount of the required reserves is correspondingly reduced. This is likely, it is felt here, to increase Swiss demand for United States or British Treasury bills and other short-term money market instruments in foreign markets which yield a satisfactory return.

2. Credit ceilings are imposed upon banks and the borrowers which obtain money from the banks, as has already been done in France, Holland, and some other nations.

3. A limit has been imposed upon the amounts of bond issues which may be floated in the Swiss market, applicable to both domestic and foreign borrowers. Foreign borrowers have long been subject to a "waiting list" and the capacity of the Swiss market to absorb foreign issues has been limited. A limit upon domestic issues will be severely restrictive.

4. Limits also have been imposed upon construction within Switzerland. The building boom in that country has been one of the most potent influences upon material and labor costs.

According to reports received here, the new Swiss proposals are not yet law, yet have the effect of law under a new "gentlemen's agreement," of which the Swiss have so many.

The inflationary threat is particularly strong in Switzerland, as it is in France, Holland, and Italy, because Switzerland long since has exhausted her own labor force and now depends upon imported workers. Also, the cost of living has been going higher in Switzerland at a rate of 4 percent a year, which the Swiss regard as intolerable.

The overall effect of the newest Swiss action, which may be followed by other European countries, is believed likely to be helpful to U.S. dollars.

U.S. BORROWING

At the present time, the U.S. Treasury and the Federal Reserve Bank of New York are net borrowers of Swiss francs in substantial amounts, but, it is claimed, these borrowings have helped the Swiss economy by employing Swiss funds, both governmental and private, which otherwise would have sought employment at home, adding to inflationary pressures.

Under the construction limit regulations all new movie houses, dancehalls, beerhalls, and certain other buildings costing more than 200,000 Swiss francs are forbidden for 1 year—after that permits for specific undertakings may be granted.

The Government may fix rates and terms on mortgages. Anybody who violates the restrictions will be subject to a fine of 100,000 Swiss francs ($23,160).

As the substance of the new Swiss regulations was communicated by cable and radio here the Swiss franc weakened in the foreign exchange market to 23.16 cents from 23.17¼ cents on Friday.

Representative PATMAN. Is there any reason why we should not deal with this problem in a similar manner?

Secretary DILLON. Well, of course, the Swiss are dealing with the exact obverse of what our problem is. They are trying to prevent money from flowing into Switzerland because they have too much. Therefore, they are making regulations which make it unattractive for money to come into Switzerland and to stay there. They will not allow any interest to be paid on it, and they actually now go further and will not allow it to be invested in any form of Swiss security or investment.

So the foreign money just has to lie there barren if it is there.

We, on the other hand, have been faced with the problem of an excess outflow. I think we have taken appropriate measures, or are in the process of doing so, which are similar in purpose to what the Swiss have done, only ours seek to reduce outflow, not inflow. We have been trying to discourage the outflow by the interest equalization tax proposed last summer, and also by the change last summer in our short-term interest rates, both of which, as I point out in my statement, have had a very useful effect by bringing our balance-of-payments deficit back into more manageable proportions.

Representative PATMAN. Yes, sir.

About 2 years ago we passed a bill hurriedly in both Houses, and it was approved by the President, to permit banks to pay more than the going rate of interest on foreign deposits. How effective has that law been, Mr. Dillon?

Secretary DILLON. That law was helpful for a while. We believe millions of dollars more were held here than would otherwise have been the case. I do not think that the law is so effective right now, but only because, since it was passed, the Federal Reserve has taken steps to free banks to pay higher interest rates on all time deposits, particularly the modification of regulation Q that took place last summer. Since then, the rates they have been paying on foreign official deposits have been within the general framework of that general ceiling.

But should rates be pushed up against the ceiling again, this will give the banks the freedom to go higher on those foreign official accounts, as they did once before in an attempt to hold them in New York. So the law would be useful.

Representative PATMAN. The deposits you have mentioned are time and savings deposits, are they not, Mr. Secretary?

Secretary DILLON. They are time deposits largely; yes, sir.

Representative PATMAN. Yes, sir; and do you look upon the sale of these demand certificates as an evasion of the law against the payment of interest on demand deposits? I ask you that—let me make this statement in explanation.

If I understand it correctly, they actually put the deposits in the time account, but they give the person, the depositor, a certificate stating that he will have so much interest at a certain time. This certificate is negotiable and there is always a purchaser for it. Is that not in effect giving the depositor the interest on a demand deposit?

Secretary DILLON. No. I would not say so, because the point of avoiding interest on demand deposits was to avoid certain dangers to the banking system. Here, as far as the banking system is concerned, the certificates of deposit are certainly time deposits. The banks know when they will be called upon to pay and how much. They cannot be called on any sooner. It simply provides a mechanism whereby the time deposit can be switched between one owner and another. So I do not think that that is an evasion of the rule that the bank itself should not pay interest on demand deposits, although it does give a greater facility to the depositing corporation. Corporations usually make these deposits.

Representative PATMAN. May I suggest that the interest on demand deposits was passed like it was, making it unlawful to pay interest on demand deposits, for the reason you stated. But in addition, another argument was made at the same time we were passing the Federal Deposit Insurance Corporation Act, that it would require the banks to pay about one-twelfth of 1 percent into their fund to guarantee deposits. The fact that they were going to have to pay that fee was another argument given that they should not be required to pay interest on demand deposits. You remember that, too; do you not, Mr. Secretary?

Secretary DILLON. Since you remind me, I do now.

Representative PATMAN. How do you think a program right now looks in connection with the interest rate structure? I have noticed the market for bonds. They are within about three or four thirtyseconds of the top 4¼ percent. What do you see in the future when this market reaches 4¼? What will be the attitude of the Treasury at that time?

Secretary DILLON. Well, I do not know that that will happen in the immediate future. We think we can meet the task of handling our debt reasonably well this year without any specific changes in the law. We have just completed an advance refunding, some part of which was in exchange into a 21-year 4¼-percent outstanding issue, and that part of the offering was oversubscribed. So securities at that rate are still popular.

Last fall, extending up into early January, there was some moderate weakness in the general markets for corporate securities, for municipal bonds, and for Government securities. This was, to my mind, largely due to an extraordinary increase in the volume of securities that were offered. I mentioned that offerings reached new records last year. That was largely a result of this increase over what is usually offered in third and fourth quarters, when offerings usually, in past years, have declined, but this past year did not.

With the coming of January and cessation of that pressure of new offerings, there has been a turnaround in the bond market generally. The latest quotation by the Bond Buyer, which is one of the standard publications reporting rates for new municipal issues, is an average rate of 3.19 percent, which is, apparently, approximately the same as last August.

Representative PATMAN. That is municipal bonds.

Secretary DILLON. Municipal bonds.

Representative PATMAN. What about the long-term bonds?

Secretary DILLON. In corporate long-term bonds, also, in the last couple of weeks there has been a marked change. American Telephone & Telegraph Co., through the New York Telephone Co., sold a large issue of very high grade bonds early in January. Unfortunately for them, they just seemed to hit the bottom of the market. They were offered at a rate of 4.53. They immediately sold out. They are quoted now at nearly a 2-point premium and the rate is down to 4.45 in the market. There have been a number of new issues sold in the market, utilities usually, successfully at about this 4.45 rate. While that is still two-tenths of 1 percent higher than it was last winter—it was about 4¼ then—it is lower than it was during the late fall and it looks as if there is a stability in the market that is going to run on ahead. The general comments now are that fear of an immediate rise in interest rates—a fairly near term rise—was overdone, and if you read the market letters of most Government bond analysts, they seem to take the same attitude. The Government bond market has been a little better, too. So my feeling is that this great pressure of an extra volume of financing did unsettle the market for a while. It has now recovered, and I look forward over the coming months—we cannot see any further than that—to a period of general stability.

Representative PATMAN. Mr. Dillon, it appears to me that an effort will be made to take the ceiling off the 4¼-percent rate. Do you know of any effort like that that is imminent now?

Secretary DILLON. No; I have consistently taken the position that if that were necessary, and if the Treasury's financing were really hampered by that ceiling, we would ask that it be removed. Fundamentally, we do not think that it is sound legislation. But we do not see any necessity of asking for this or trying to have a change unless it turned out to be necessary. As of now, there are not any plans to make that sort of request.

Representative PATMAN. Yes, sir. My time has expired, but I wanted to suggest to you that I have offered what would be an alternative, I believe, to the entries. I have offered a bill to amend the Federal Reserve Act to provide for reserve support of Government bonds when market yields equal or exceed 4¼ percent. And, of course, I feel that Congress should give consideration to it as an alternative to increasing the interest rates.

Mr. Curtis?

Representative CURTIS. Senator Javits has to leave to go to the White House, and I yield to him.

Senator JAVITS. I thank my colleague.

Would you allow me, Mr. Chairman, just 2 minutes? I shall not be any longer. I cannot. They are giving Mrs. Lehman a medal at the White House.

Secretary DILLON. A very fine occasion.

Senator JAVITS. I just have one comment, Mr. Secretary. I am always most happy to see you and I do hope that you recover from your cold.

I am very glad to see that you did note the importance to the economy of removing the barriers to equal employment opportunity. I think that is most perceptive and I join you, of course, very strongly in that. It has been my longstanding effort.

I did want to ask you one question on the interest equalization tax. Do you feel that the almost total cessation of foreign long-term lending was attributable to the expected rate of the tax, or was attributable to the uncertainty as to whether there would or would not be a tax? In short, are we to anticipate that if there is a tax passed, this will result in practical cessation of long-term capital lending in this market?

Secretary DILLON. No; I would not think so at all. I think that the effect of the tax has been magnified considerably by the uncertainty. This was something that when the proposal was put forward, that we had not anticipated, because we had not foreseen the situation that has arisen—that the enactment would take so long. But I think that undoubtedly, particularly in the case of Canadian borrowing, where they have been uncertain whether there would be an exemption or would not, the uncertainty has had a very great effect.

And I think also in the case of European and Japanese borrowers, they still may have some hopes that the bill will not take effect. So I think that there will be some borrowing once the bill is passed.

Senator JAVITS. Well, the Secretary is well aware of my strong views on the use of a capital issues committee instead of the interest equalization tax. But I did think it was important to assess in the Secretary's view the effect of it.

Thank you very much and I thank my colleagues for yielding.

Representative PATMAN. Mr. Curtis.

Representative CURTIS. Mr. Secretary, as I have done before, I would like to submit a series of questions to you particularly in the field of debt management, which I am most pleased to see you have discussed in some detail. We have not had that kind of discussion in the prepared statements before.

If you would, I will submit a series of questions on that area, on the interest costs and on the very important subject of our balance of payments. I will make public, of course, the series of questions we ask, as we have done in the past. I think this is a good technique for extending the dialog on these very difficult subjects, on which it is rather hard to engage in questions and answers here.

Secretary DILLON. I welcome that.

(Subsequently, Representative Curtis submitted eight questions to Secretary Dillon. The question and the answers thereto follow.)

Question 1. It is argued that the smaller Federal deficit now budgeted will reduce the pressure of demand which might otherwise have made for higher interest rates. What is the expected impact upon interest rates of the budgeted proposal that the Government will reduce its own deficit by increasing sales of mortgages and other financial assets?

Answer. The smaller administrative budget deficit now foreseen for fiscal 1965, which will be fully reflected in smaller net cash needs than the fiscal 1964 total does indeed imply sharply reduced pressures of demand on the credit market from the Federal Government over the coming period. Sizable cash needs can be expected as usual over the final 6 months of calendar 1964 when revenues are seasonally low. However, with the deficit for the year sharply reduced, we can look forward to retiring a substantial portion of the debt added in that 6-month period during the first half of calendar 1965, and this temporary financing should not entail heavy market pressures. In other recent years, in contrast, little or no surplus has been available for retiring debt during the period of seasonally heavy revenues from January to June, so the financing required during the fall and winter necessarily became part of the longer range debt structure.

The increased sales of mortgages or other financial assets anticipated in the budget will, of course, tend to absorb funds that might otherwise have been available for other investment. But these sales will clearly not offset the favorable implication of the reduced budgetary deficit. The administrative budget deficit is expected to decline by $5.1 billion, and the cash deficit (which is a more accurate indicator of the Treasury's potential needs for borrowing from the public) is expected to decline by nearly $5½ to $2.9 billion. (Delay in the effective date for the reduction in withholding rates to March 1 instead of February 1, as assumed in the budget, will make the deficit somewhat smaller in fiscal 1964 and somewhat larger in fiscal 1965, but a large year-to-year reduction in cash needs wil remain.) Meanwhile sales of mortgages or other assets in Government loan portfolios are scheduled to increase by roughly $700 million between fiscal 1964 and fiscal 1965, or by only a small fraction of the reduction in Treasury financing needs over the same period.

Not only will net financing by the Government be sharply reduced even after allowing for these sales, but there is no reason for concern over pressure in particular markets. Mortgage credit in particular is amply available, and indications are that the supply of mortgages from new borrowers will not continue to increase at the recent pace. Moreover, there is a broad potential market for participation in Government-held mortgages and other loans. Finally, while the estimate for fiscal 1965 sales represents a realistic appraisal of present possibilities for such asset sales, there is no intention to press this paper on the market, should circumstances not now anticipated arise that would reduce its absorptive capacity, at the expense of curtailing a needed flow of credit to new borrowers.

Question 2. What are the legal and practical limitations faced by the Treasury in selling long-term bonds at a discount should it become necessary to offer the market yields higher than the 4¼ percent statutory ceiling?

Answer. Shortly after I took office in 1961, the Attorney General informed me, in response to my inquiry, that there is no legal obstacle to the sale of long-term Government bonds carrying a coupon of 4¼ percent at a discount, thus increasing the effective yield to the purchaser. Moreover, the sale of bonds at small discounts from par value is a common financial practice, and is done by the Treasury in adjusting the terms of its cash or refunding offerings to prevailing market conditions more finely than would otherwise be practicable. Consequently, sale of 4¼ percent bonds at a discount would be both possible, from the standpoint of law, and practical, from the standpoint of market familiarity and receptivity, should the need arise.

On the other hand, I have consistently taken the position that, in view of possible questions over the precise intent of the Congress in this respect, I would not undertake to sell Treasury bonds with an interest rate of 4¼ percent at any substantial discount without reviewing this matter with the Congress. To date effective debt management has not been hampered by this ceiling and, considering both our needs and likely market developments, I do not foresee a situation arising over the coming months that would require a review of the existing legislation. Should we find at some later date, however, that this situation changes, we would be prepared to request that this legislation be reviewed.

Question 3. What will be the effect upon interest rates if the tax bill results in less stimulus than is anticipated?

Question 4. What will be the effect upon interest rates conversely if the tax bill adds unexpectedly to the stimulus arising from other improved economic conditions?

Answer. The course of interest rates over coming months and years will be affected by many other factors in addition to the added stimulus from the tax bill. However, the stimulus from the tax cut, taken alone, can be expected, on balance, to add to private credit demands, and from that direction bring upward pressures on interest rates. The greater the stimulus, the greater these demands might be expected to be. At the same time, however, other forces will be working to balance these pressures, including the enlarged flow of savings to be expected as business activity and profits increase, and the reduction and later elimination of the Government's deficit—both of which should be speeded if the stimulus is greater than expected. Meanwhile, the course of monetary policy, in response to both domestic economic developments and the possible needs of the balance of payments, will also be an important influence.

The precise balance of these forces affecting interest rates under varying assumptions concerning the stimulus from the tax bill is difficult to predict. However, it is reasonable to anticipate that net upward pressures on interest rates are more likely in an economy closely approaching the limits of its productive capacity than if excessive unemployment and unused capacity remain evident. Consequently, a greater than expected stimulus from the tax program, if added to other expansionary forces, would be more likely to bring the economy to a point at which higher interest rates would develop, and, in that event, higher rates would help to maintain a healthy and sustainable balance between our capacity to save and investment.

However, higher rates need not be a necesary concomitant of an orderly and well-balanced domestic expansion, and, should the stimulus from the tax cut unexpectedly leave the economy well short of the goal of reasonably full employment, the possibility of higher interest rates arising from forces within the domestic economy would be reduced or nonexistent.

Question 5. Are the Treasury borrowings abroad in any way helpful in debt management or are they essentially limited to measures aimed at balance-of-payments problems?

Answer. Treasury borrowings abroad by means of sales of special issues of various kinds to foreign official institutions are designed to meet problems related to our balance-of-payments deficit. Specifically, by absorbing a portion of the supply of dollars passing into foreign hands as a result of our deficit on regular transactions, these borrowings have greatly facilitated the financing of that balance-of-payments deficit without excessive losses of gold or strains on the international payments system as a whole.

One incidental result of these foreign borrowings is to provide additional cash to the Treasury, thereby reducing the need to borrow in the domestic market by a similar amount. While substituting for other debt in this way, the volume and character of foreign borrowing is determined on the basis of balance-of-payments considerations rather than debt management requirements.

Question 6. To what extent is the Treasury and/or the Federal Reserve willing to hold foreign currencies for the specific purpose of establishing principles of a multiple-key currency system in the world? The question is particularly pertinent in connection with the recent purchases of Italian lire.

Answer. In view of the studies now underway within the Group of Ten and elsewhere concerning the appropriate further lines of evolution of the international monetary system, it would clearly be premature and inappropriate to comment in detail at this time on any role that larger holdings of foreign currencies by the United States might usefully play over the longer range future. We have suggested, at times, that one possible path of evolution toward a stronger and more flexible international financial system could be greatly facilitated by a willingness on the part of the United States to hold, within its own reserves, somewhat larger amounts of appropriate convertible foreign currencies, thereby reducing the need to transfer gold in settling balance-of-payments surpluses or deficits and providing another means for supplementing the aggregate supply of international liquidity as needed. But whatever role might develop for such holdings over the future, opportunities for acquiring such currencies will be rather limited until our own external accounts more closely approach balance and pass into surplus.

Before that time is reached, situations could arise with respect to particular countries that would not only permit the acquisition of limited amounts of certain foreign currencies by the United States, but also facilitate adjustments by our trading partners to changes in their balance-of-payments position. The recent acquisition of Italian lire, in a limited degree, may help to illustrate some of the potentialities of this possible line of development. However, those acquisitions must also be evaluated in the light of the fact that the United States has outstanding at the present time $200 million of indebtedness to Italy denominated in lire.

Question 7. In your formal statement before the committee, you indicated what the balance-of-payments deficit in 1963 would be if the special, nonmarketable, medium-term Treasury securities sold to foreign official institutions were counted as a receipt and disregarded altogether. Since the Commerce Department regards these securities as liquid liabilities when they carry the 4-day conversion feature, what would be the balance-of-payments deficit if they are regarded in this fashion?

Answer. The Department of Commerce now publishes figures for the overall deficit, after taking account of special intergovernmental transactions, on two bases:

(1) Including special, nonmarketable Treasury securities sold to foreign official institutions with an original maturity of more than 1 year as a balance-of-payments receipt whether or not the terms of the particular security would permit conversion into cash in a shorter period.

(2) Disregarding the receipts obtained from the sale of these special nonmarketable Treasury securities if they are convertible and, in effect, considering them as the equivalent of a liquid liability.

The special medium-term Treasury securities with a formal convertible provision were sold for the first time in 1963 and in sizable volume. They serve essentially the same purpose as debt prepayments and advances on military exports, or other inter-Government transactions that could be arranged in larger volume in earlier years. By the accidents of traditional balance-of-payments accounting, these securities with a formal convertibility feature did not fit neatly into earlier definitions establishing the dividing point between a balance-of-payment receipt and a liquid liability despite the basic similarities to other specal intergovernmental transactions, leading to the second calculation above.

On this basis, as indicated in my formal statement, the overall deficit for 1963 on the basis of the preliminary data now available appears to have been roughly $2.6 billion. Net sales of special nonmarketable medium-term, convertible issues amounted to $700 million, leaving a net deficit of about $1.9 billion when appropriate allowance is made for those issues.

Question 8. Do you foresee any circumstances under which the increasing sales of mortgages and other financial assets of the Government would tend to have an inflationary influence on the economy?

Answer. Sales of mortgages and other financial assets by the Government, thereby reducing the deficit and the need for Treasury financing, would ordinarily have little economic effect. To the extent that the assets sold might be less liquid than the Treasury debt these sales would, in effect, replace, the impact could be mildly restrictive. This might also be the case if sales of particular assets, such as mortgages, were to be pressed to the point that the capacity of the particular sector of the market involved to provide funds of that type for new potential borrowers was impaired.

While the sale of financial assets could not, in itself, have an expansionary or inflationary influence on the economy, the net result could be expansionary if additional spending for goods or services or for so-called transfer payments (such as social security benefits) were to be undertaken in step with, and as a consequence of, asset sales. In this theoretically conceivable combination of circumstances, the added expenditures would tend to increase aggregate demand either directly or by adding to consumer incomes, while the equivalent sale of assets would have only a mild offsetting effect on spending, if any, through its effect on the credit markets. A somewhat similar result would be achieved if funds released by the sale of assets were relent at favorable terms to borrowers who otherwise would have been unable to obtain financing.

However, since the levels of spending for goods and services, for transfer payments, and for new credit extension in the fiscal 1965 budget were established independent of the projected sales of assets, it is clear that these sales cannot be considered to have expansionary or inflationary implications.

Representative CURTIS. It seems to me that you are not anticipating any increased interest costs, except through the fact that the overall debt is increasing. The rate of interest seems to be assumed to remain about what it was. Am I correct? I think that is what the Director of the Budget Bureau said.

Secretary DILLON. Our estimates do allow for increased interest costs due to higher rates, because——

Representative CURTIS. Well, they do. Let's make that clear.

Secretary DILLON. I do not mean higher rates than today but higher rates than there were during the preceding fiscal year. For instance, when the Federal Reserve raised the rediscount rate last July to 3½ percent, there was a rather immediate increase of half of 1 percent in market rates. It took perhaps a month for that increase to work its way through the short-term Government securities market. But there were outstanding at that time a full series of 6-month bills which had been sold prior to that time at a lower rate which took 6 months to run off. And that interest fell into this fiscal year. In the same way, there were outstanding some 1-year bills. Those will gradually be replaced at the higher rate during the year, so during the first half of the coming fiscal year, we will be paying higher rates on those short-term instruments than we did in the fiscal year.

So there has been an allowance built in for that sort of an increase, which is——

Representative CURTIS. Well, I am very pleased, because I thought from a practical standpoint, it looked like you were going to have increased interest payments, apart from the fact that the debt itself is larger.

Secretary DILLON. Oh, yes; that is right.

Representative CURTIS. I possibly misunderstood the Director of the Budget Bureau when he said that they were not counting on increased interest rates——

Secretary DILLON. I think he meant increased rates from the present market rate. But the present rate will mean that there will be increased interest payments.

Representative CURTIS. That is right.

Secretary DILLON. There were some other issues that were sold at lower rates that will——

Representative CURTIS. This clarifies it to some degree, because you will remember you and I had a little dialog in November about the increased amount of interest payments, and I felt that that was something you could have anticipated back in January. I was afraid that possibly you were again going on the basis that you would not have to pay increased payments.

Perhaps that expresses it.

Secretary DILLON. No.

Representative CURTIS. Now, Mr. Secretary, the real matter that I want to get into is expenditure reform, which I think is the key to the tax cut. I am glad you say this is an essential corollary of that decision. For a long time, we who felt that it was could not get our point across. Some of us have been for tax reduction, I might say, sometime before the administration had advocated it.

Expenditure reform is, in my judgment, an essential part in this field of debt management and certainly critical in the balance of payments.

The minority, the Republican members of this committee, have recommended, originally to President Kennedy, and now to the Johnson administration, that we establish a Hoover-type Commission on Federal Expenditure Policy to examine this field and to develop the proper mechanisms in Congress to look at expenditure levels. We do not have that mechanism today to express congressional judgment on what an expenditure level should be for a fiscal year. We can only influence it indirectly through our control over appropriations, but that is new obligational authority for future fiscal years, as well as the current one.

As I have often emphasized, I do not think the great problem in expenditures or the art of budgeting is getting at the wasteful programs, because that is a matter of identification. Once we identify something that is wasteful or inefficient, I think we all agree to eliminate it. The real problem, though, is in establishing priorities between programs that we recognize to be desirable. But we also feel that we must live within our revenues. This is the reason for the suggestion of a Hoover-type commission to study expenditures.

I was really using this platform here to expose this idea a little bit more and I hope it will not be rejected by the Johnson administration out of hand, as I felt it was by the Kennedy administration.

Would you comment as to whether or not this might be a desirable thing to do?

Secretary DILLON. I do not think it was rejected out of hand by the Kennedy administration or that it would be now. It is something that the Bureau of the Budget has been considering. There is a question of timing involved as to when such a report could best be made, because I think if it is to serve the purposes that we both would like it to serve, we must very carefully insulate it from any partisan political feeling so that it would be clearly objective, as far as the country is concerned, in looking at the problem. I am sure you will agree with that.

Representative CURTIS. A Hoover-type commission would remove that from——

Secretary DILLON. I think it would, yes.

Representative CURTIS. The reason for the Hoover Commission type, too, would be to get the Congress into the act.

Secretary DILLON. I see what you mean.

Representative CURTIS. The need, I think, is to do this jointly—the Executive as well as the Congress—rather than merely an Executive commission.

Secretary DILLON. I do know that the Budget Bureau has been giving thought to the possibility of using a commission of some sort to improve budgetmaking process along the lines that you have mentioned, or to look at them and see if they can be improved. Personally, I think they probably can, and we have talked before about having greater control over unexpended balances, I think there are various things that probably could be done to improve the budgeting process, and certainly would be for anything that would do that.

Representative CURTIS. I am most anxious to establish, as far as Congress is concerned, some technique whereby Congress can exercise its judgment over expenditure levels for a fiscal year.

We on the Ways and Means Committee have to be concerned about that figure with our responsibilities in the field of debt management. We developed a rather cumbersome technique through the debt ceiling, but I do not like that, although I feel it is better than nothing. I would like to develop that now.

You state:

> The essential corollary of that decision—firm restraint on the total of Federal spending—is unambiguously stated in the President's budget.

Those are bold words, but I wish I felt that they were unambiguous. Let me say that the Budget and Accounting Act requires that the Executive include in its presentation of the budget for the future fiscal year, fiscal 1965, the reestimate of expenditure levels for the current fiscal year, which is fiscal 1964. I have been very disturbed by the fact that the last figure we had from the previous administration, the Kennedy administration, on the expenditure level of fiscal 1964 was given by yourself and the Director of the Budget to the Ways and Means Committee in November, or late October. It was debated on the floor in November and passed by the Senate November 21. But it was $97.8 billion. The President's message to the Congress, and this budget, have a figure of $98.4 billion. In other words, in less than 2 months, in the context of public releases by the President of expenditure reform—which would seem to be directed toward immediate reform—we increase the expenditure level of our present fiscal year by $600 million. I do not know how you could be more ambiguous.

I see my time is up, but I get another 10 minutes, I would like to have your comments on this increased $600 million increase in less than a 2-month period.

Secretary DILLON. Well, I would like to answer it briefly, because, of course, these estimates were prepared in each case, both last November and this time, by the Bureau of the Budget. We in the Treasury do not go behind their figures. We do know that they are made up of a lot of pluses and minuses in various different programs that are reflected in the total, whatever the total may be.

I think that one of the increases was that we felt that our estimate on interest had been slightly low. I think there was a small change there which rounded out to a $100 million figure, although it was not as much as $100 million.

The other changes, I think, are largely due to the Budget Bureau's estimate that previous appropriations, funds that are available from past years, in many instances are going to be spent at a somewhat faster rate than they had earlier thought. I would like to emphasize that both of the figures are estimates and you will have to wait and see on June 30 what the actual total is. Last year, I think we found that our expenditures were a little less than we had estimated. It came out that way when we finally got finished.

Representative CURTIS. That was under what I call the discipline of the debt ceiling, but I know that is controversial.

My time is up.

Senator PROXMIRE (presiding). Mr. Secretary, do you have a copy of the budget?

Secretary DILLON. Yes, sir.

Senator PROXMIRE. On page 446, there is a special analysis, L. I think it is very useful. I think it is the first time the budget has ever had an analysis of the effect of the budget on the balance of payments.

I notice there is a table on page 447 on the impact on our international payments of the various Federal agencies. The one agency that has had a substantial increase in payments is the Treasury Department. All of the other agencies, with the exception of the Department of Health, Education, and Welfare, have had a decline in payments. HEW has a relatively small increase.

Then we look at receipts from abroad, which of course would be unfavorable to the balance of payments, and all of them have an increase in receipts except the Treasury Department.

The Treasury Department has a substantial drop. I calculate, for example, that the Department of Defense net position on payments and receipts has improved about 20 percent, but the Treasury Department's has worsened about 70 percent. I notice on page 448, there is a one-sentence explanation by Treasury which does not satisfy me. It says:

> In the case of the Treasury, the increases are largely accounted for by interest payments on public debts and on non-interest-bearing notes representing part of past contributions by international organizations.

There is no mention at all of diminution in receipts.

I am sure you are deeply concerned with the balance of payments and the Treasury Department is deeply concerned with it. I wonder if there is any further explanation?

Secretary DILLON. Just offhand, one of a number of complex factors that the debts we have been getting prepayments on are being paid down and, therefore, the remaining debt that is owed to us is less, so the scheduled repayments and interest receipts we get on the debts still owed to us are constantly going down as these debts are paid off.

So we would expect that to happen.

Senator PROXMIRE. I might interrupt right at that point. You refer, then, to the very sensible and effective action that was taken by you and Secretary Roosa to persuade countries to prepay their debts. While it was helpful in the past, we are now in a situation where those payments have been made and we have to live with the situation and it will be a little more difficult in the future.

Secretary DILLON. The interest payment is a very minor part compared to principal repayment, but obviously, it is correct. Once you get a debt paid off, you do not get any interest back on it. So to the extent that you forego that interest, it is negative to your balance of payments. The idea of speeding up these payments was simply to help us through this difficult time before we got our overall payments in the balance. That is what it is for. We know we cannot live on that forever.

Senator PROXMIRE. Are there any policies the Treasury can follow which would help correct the situation? Because I think we are getting to a situation now where the Treasury makes payments that are substantially higher than the Agency for International Development, or foreign aid program other than our defense foreign aid. Its net position is getting pretty close to the net contribution of our foreign aid program abroad. Is there any policy in terms of not selling securities abroad or of not selling Treasury securities abroad?

Secretary DILLON. I do not think that makes any difference, because foreign dollars that are owned here and invested in securities here, which is what the bulk of them are, require interest payments to foreigners and whether those payments actually ever leave New York, they are entered as an outflow here, because they belong to the foreigners. Most of them do not ever leave New York, but that is what the biggest volume is. We have seen the figure of some $20 billion of liquid liabilities of the United States abroad. A substantial portion of those liabilities owed to foreigners draw interest. They are generally short term and as the interest rate on our short-term obligations has increased, this has increased the outflow there. It is not large in terms of our overall balance of payments, but that is the reason for it.

Senator PROXMIRE. That is a very interesting irony, then. One of the reasons for adopting policies to protect our balance-of-payments situation was to increase—one of the policies, I should say—was to increase short-term interest rates. But as we do that, we directly and explicitly, and the statistics are clear here, contribute adversely to our balance-of-payments situation, because holders of our securities abroad receive these interest payments. It is an increase of about 20 percent or so in interest on our short-term obligation that worsens our balance-of-payments position.

Secretary DILLON. That is an example of how complex this situation is. There is no one action one can take without having a reaction somewhere else and it is a question of looking at the whole complex of the actions and taking such actions as will, overall, bring the best results.

Senator PROXMIRE. What strikes me is that the theory that interest rate differentials are significant in the balance-of-payments transactions is questioned by, as we know—we have discussed this many times—several studies by Gemmill and Bell and others; on the other hand, there is no question that an increase in short-term Treasury obligations does result in this explicit, if relatively modest, but explicit adverse effect on our balance of payments.

Secretary DILLON. I think in another year or so, when we look back on results of what has happened in the last year or two, what happened last summer, we will have a lot more information. Certainly, as I have said before, all those who are directly concerned with this problem do feel that there is a reasonably close correlation between movements of funds and short-term interest rates, although there have been a number of people—you have referred to a couple of them—who doubt that.

Senator PROXMIRE. Now you said to Senator Javits that the effect of the interest equalization tax has been, I think you said "magnified" by uncertainty. This implies that the main effect of the interest equalization tax has already been felt in the third and fourth quarters of calendar 1963, and that perhaps in the future, when it is passed, if it is passed, and I hope it is—I will certainly vote for it—the effort may not be very great at all. In fact, it may even be a reaction from a situation, which has been overly discounted, as I imply from what you say.

Secretary DILLON. What I meant is that, when we originally proposed the interest equalization tax, what we claimed for it was that we expected it would reduce the overall outflow down to sustainable proportions—reduce the new issues down to maybe somewhere around $600 or $700 million a year. In the third and fourth quarter together, they were running at a rate well under that. The new issue total for the fourth quarter, while very preliminary, looks like something on the order of $70 million or less for the whole quarter. We do not expect new issues to stay down at levels as low as that.

Now, the third quarter levels were somewhere in the normal range, but that was a mixed quarter, because it had a lot of transactions in it that had already been consummated or were well underway before the tax was announced. Therefore, they were exempt from it and would carry through.

Senator PROXMIRE. So the flow-of-funds problem is going to be not as good in the future as it was in the fourth quarter and about the same as it was in the third quarter. Which means that the balance-of-payments situation in the future is not likely to be as favorable as it has been in the last 6 months.

Secretary DILLON. Not necessarily the balance-of-payments situation. In new portfolio securities, I do not think we can hope to do or continue to do as well as we did in the fourth quarter.

Senator PROXMIRE. Well, now——

Secretary DILLON. I do not think we want to, because that was nearly completely shutting out foreigners from our markets and that was not our intention. It was just to reduce their drawings on our market to a sustainable amount.

Senator PROXMIRE. There are many indications that prices may be beginning to rise in the wholesale area, the retail area, and so forth. I understand that the most recent figures suggest this. For 1963, we had the biggest price rise since 1958, although we are still very stable in terms of the long-term picture, much better than other countries.

If the stimulation of our economy from the tax cut is as effective as you and other proponents say it will be, and if we maintain the expansion we have had and inflation does begin to develop, would you feel that the way to combat this is by monetary policy?

In other words, by restraining the quantity of money, the supply of money, so that interest rates would probably rise?

Secretary DILLON. Well, that is one of the means that one could use. If there really should be inflation, it is one of the means that one would expect to be used—and I think it would be quite properly used—to combat inflation. I do not feel, however, that inflation need occur. I do recognize the fact that it is more difficult to avoid price rises when we have an economy that is operating at reasonably full capacity and with a lower level of unemployment. That has been our history in the past. It has been the history of the European countries more recently. It is the concern of everyone.

I recognize that, I recognize that we have to move into this situation with great care. But I do not think that that is any reason for wanting to have an economy that is not operating at full capacity or to continue with excessive unemployment. I think it is a risk we have to take and that we are perfectly prepared to take, but it is one that will require attention. It will require statesmanship on the part of business and labor, and we will hope that it would not require the use of monetary instruments. But they are there to be used if inflationary tendencies get out of hand. That was made very clear in the report of the Council of Economic Advisers.

Senator PROXMIRE. My time is just about up. I would like to ask just one more quick question.

It seems to me when you take all of these things, the factor of the interest equalization tax effect is not going to be as great in the future as it has been in the past, although it will be helpful in our balance of payments: this suggests higher interest rates. When you take the pressure of the tax cuts which perhaps is going to have some effect on prices, this suggests higher interest rates, plus the regular expansion of the economy which almost every economist is predicting, plus the sale of our mortgages which the Budget Office predicts in a substantial rate, plus the policy of the Federal Reserve Board not to monetize the increased debt—all of these things, it seems to me, are pushing in one direction and one direction only. That is higher interest rates. There are no factors that I know of on the other side, unless you anticipate that none of this is going to have much effect on the expanding economy. It would seem to me that every force of Government and of our private economy is pushing in the direction of higher interest rates.

Secretary DILLON. I do not think every force. I think you have pointed out some that are. There are others. The fact that the budget deficit is being substantially narrowed and that the call of the Federal Government on the markets for capital has been lessened acts in the other direction and makes that capital available for private expansion. I think that tax relief, the tax bill, will also serve to increase savings, and these increased savings will also be available.

I think there is a general feeling that the housing industry and mortgage sales are probably not likely to increase quite as rapidly as they have for the past couple of years, when the increase was fantastic. The annual amount of increase in mortgage debt has almost doubled in the last 4 years.

So therefore, there are a number of things that may work in the other direction and tend to hold interest rates in balance.

Generally, I feel that on a long-term basis, interest rates around what we have now—longer term rates—are certainly not on the low side. It is probably about average and may be in the higher ranges. Therefore, I do not see any long-term pressures moving rates upward.

I was very interested in the point of a lecture given just the other day by an expert in this field, Mr. Homer, of Salomon Bros. in New York, who wrote this impressive thousand-page book on the history of interest rates. He, looking ahead, says he does not foresee any rise in interest rates. He feels we may be near the peak of a short, cyclical tendency toward increase, which he thinks will be over in a few months, and that the nature of long-term forces is working in the other direction.

Senator PROXMIRE. Thank you very much.

Senator Jordan?

Senator JORDAN. Mr. Secretary, pursuing that line a little further, we had some testimony a while ago that the personal income tax reduction would probably be spent mostly in goods and services, up to 93 percent, I think, was the figure presented to us.

Now, with this tax cut being largely in the personal tax liability portion of the economy, and the fact that this constitutes about 80 percent of the total tax cut in the personal liability sector, and the fact that possibly 93 percent of this tax cut will immediately move into channels of trade for goods and services, are you not concerned with the sudden release of this tremendous purchasing power on an already buoyant economy, expanding at the rate of $30 to $35 billion a year in gross national product?

Secretary DILLON. No. I am not concerned about it from an inflationary point of view for this reason: We have never believed—and I think the point is rather generally accepted—that when you reduce taxes and put more funds in people's pockets, that the change in spending patterns is instantaneous. It takes a matter of a few months or a year or 6 months, whatever it may be, before this really works itself through into larger expenditures.

Over a period of time, it is quite true that we fully expect that the regular patterns will be followed and 92 to 94 percent of this extra income will be spent. But looking at this thing realistically, if the tax bill is passed rapidly, goes through conference rapidly, is signed some time in February by the President, and if the lower withholding rate then can become effective a week later, around the first of March, the first time that most people will realize it will be the middle of March or the first of April when they actually get paid and get a little more. I would not think that this would have a really substantial effect on the economy until 6 months or so later. On that basis, I think that the increased stimulus will be coming in just at the time when the expenditure control of the new budget is taking full effect. Therefore, I think the timing is very good.

Most of the criticism of this budget, or a good deal of it, has been that it endangers the prospects in 1965. I do not think that is true at all. I think that is when—next fall and winter in particular—the full force of the stimulus to the private economy will be making itself felt, and I think that is just the time to cut back on expenditures. I think the mix is just about proper and therefore will avoid inflation as much as possible.

Now, we do get back to this same question, which we have to admit is a fact, that with the economy operating at nearer full employment than we have in the last 5 years—more like those of Europe, and with a more acceptable or lower level of unemployment—the temptations and the problems of maintaining price stability become more difficult.

Senator JORDAN. It will exert an upward pressure on prices when that point arrives?

Secretary DILLON. We do not see any need for prices to go up, but judging from past history, you are correct; there are apt to be pressures toward higher prices. But, we think there is a better understanding in our economy now, both in business and labor, of the need for holding price levels. And also, international competition is much more effective now than it was a few years ago in holding prices down. I think that just happened recently in the case of the aluminum industry, where there was an attempted price increase here domestically and our largest aluminum company refused to go along with this, on the basis that world prices for aluminum did not justify it. So it is really foreign competition that held this price down. I think, therefore, that is bound to be of some help.

Senator JORDAN. Turning to another line of questioning, Mr. Secretary, you have indicated that while the loss of gold reserves has been much less than it was in prior years, yet in 1963, we did lose $461 million of gold. Has this trend been corrected to the point that we are not likely to lose any more substantial amounts of gold?

Secretary DILLON. As long as we have payments deficits, we are going to continue to lose gold. Therefore, the essential thing is to eliminate the payments deficit. Meanwhile, it is helpful to defend by every means we can our gold stock and keep it at an adequate level. I think we are trying to do that, and I think with some success, as the figures show. But you cannot expect that our gold stock will stay level if we continue to run payments deficits. That is why it is important to get at the fundamentals, which is the payments deficit.

Senator JORDAN. Can you supply the figure of the uncommitted amount of gold reserve at the present time?

Secretary DILLON. I can give you the exact figure for the record. It is about $15.5 billion.

(The following statement was supplied for the record:)

U.S. gold stock and statutory gold reserve requirements, Dec. 31, 1963

	Million
U.S. gold stock	$15,596
Statutory gold reserve requirements	[1] 12,973

[1] Reflects year-end seasonal peak in currency circulation and by Jan. 22, 1964, had declined again to $12,491,000,000.

Senator JORDAN. How much of that is pledged to the backing of Federal Reserve notes?

Secretary DILLON. Somewhere around $12 billion.

Senator JORDAN. Leaving a net free balance in the order of $3 billion?

Secretary DILLON. $3 to $3½ billion.

Senator JORDAN. And against that gold reserve, what are the obligations to foreign governments or banks?

Secretary DILLON. Our liquid dollar liabilities to foreign governments and private foreigners total something like $23 billion.

Senator JORDAN. $23 billion, against a net reserve of about $3 to $3.5 billion, which is being diminished at the present rate of $461 million a year?

Secretary DILLON. Yes; but, of course, the foreigners do not look at it quite that way. They look at it against our overall gold reserve. They have reason for that, because in the past, the President has stated that our whole gold reserve was available to protect the dollar and the Chairman of the Federal Reserve Board, as you know, has authority in emergency to waive the 25-percent gold cover and make this gold available. He has publicly stated for the record that he would do that if such a situation arose.

So I think that is the reason that foreigners continue to have confidence in the dollar and the dollar balance.

Senator JORDAN. That danger point has not been reached where it would be considered necessary to waive the 25-percent gold cover?

Secretary DILLON. No.

Senator JORDAN. Thank you, Mr. Secretary.

Senator SPARKMAN (presiding). Congressman Reuss.

Representative REUSS. Thank you, Mr. Chairman. I listened with interest to the discussion concerning the gold reserve requirement. At the time of our balance-of-payments hearings last November, Chairman Douglas invited a number of leading bankers to state their views on the desirability of modifying or repealing this requirement. The replies were included in the printed record of the November hearings. A reply from Mr. Jesse W. Tapp, chairman of the board of directors of the Bank of America, unfortunately came too late to be included with the others. I ask unanimous consent to have it printed at the end of the record of these hearings. (See p. 252.) Mr. Tapp states that, in his judgment, the gold reserve requirement—

> no longer serves a useful purpose but rather handicaps the Nation in pursuing its policy goals within the framework of today's national and international monetary institutions.

Mr. Secretary, I am very pleased to see you again. You last appeared here in July, and you will recall that members of this committee were very hopeful then that we would do something about the new issues problem, and also about the problem of long-term liquidity in the IMF. I am delighted that things have been done in both fields since then and I want to commend you for it.

You point out the very marked and happy improvement in our balance-of-payments deficit, mostly as a result of decreased capital flow, both in long-term and short-term funds. It is quite obvious how salutary has been the sword-of-Damocles effect of the interest equalization tax. That has practically dried up long-term new issue financing from at least most of the developed countries.

You also, however, assign a lot of the credit for our somewhat better capital position in the second half of 1963 to the raising of the rediscount rate last July from 3 to 3½ percent. That happened to be a move with which I did not agree, and, therefore, I am going to question you rather closely on whether it should get the medals which you apparently accord it.

While you point that that short-term capital outflows in the second half were less than in the first half, I ask you whether it is not a fact that the best quarter we had last year in terms of our short-term capital outflows was the first quarter, when our rediscount rate was 3 percent? Obviously, it is a fact, or I would not ask that question.

Secretary DILLON. Yes. I think it is. But what usually happens or has been happening in the past—I do not know whether it will occur this year, but it is a pattern that has developed in the past—is that short-term flows run very strongly to the United States during the month of January. This is a reflux of "window dressing" operations where those same funds ran out in December. So you often see a very bad December and a very good January.

If you break down those short-term flows, as no doubt you have, in the first quarter, they are made up of a very substantial inflow in

January, followed by a small outflow in February and an increasing outflow in March. So I do not think that that is particularly relevant for that reason.

Now, as I say, I do not know whether this will happen this year or not, because our December figures, the reasons for which I do not think are entirely clear to anybody until we get a better breakdown of them, indicate a much better balance-of-payments performance in December than usual. So it does not appear that we had this outflow—window dressing" outflow—in the same volume this year as we have had before, or something must have offset it. We are not quite sure what that is, so I do not know whether the reflux will recur again this year or not, but I would not be surprised if it did.

Representative REUSS. On this same point, I refer you to the U.S. Department of Commerce's Survey of Current Business for December 1963, in which, on page 13, the following is pointed out: "Nearly half of the $500 million shift"—between the second quarter and the third quarter, the shift being in the way of improvement—"was due to very short-term credits of about $120 million to Germany in June, which were repaid in July." This accounts for half of the improvement right there, does it not?

Secretary DILLON. That is right. This "window dressing" business that goes on between international banks does very much confuse our payments when you try to look at them on a monthly or quarterly basis. Over a long term, they wash out. But, as you quite correctly point out, that was a reason for a substantial part of the great difference between the second and third quarters. A substantial part of it was that one kind of transaction.

Representative REUSS. You see, the position of Senator Proxmire and myself and some others is that we do have a lot to lose domestically by raising the rediscount rate.

Therefore, we insist on a rather more clear proof of accomplishment than we usually get. This accounts for my somewhat jaundiced view of the alleged benefits of increases in interest rates.

Secretary DILLON. It is a difficult thing to prove, but certainly all of those who operate in the money markets feel that there was a very real benefit.

A thing which is not difficult to prove, however, is that the increase in rediscount rate and our short-term rates did not have any very marked effect, as we expected they would not, on our longer term rates. The mortgage rates were totally unaffected and municipal rates, after that flurry which I mentioned earlier, due to high volume of new issues, are now back to where they were in the summer. The new issue rate of the bond buyer is back to the about-same level as it was in August.

The rate for corporate new borrowing is maybe two-tenths of 1 percent higher than a year ago and that is the one area that is the least sensitive as far as business is concerned. Indeed, the volume there has increased and it has been higher than the year before.

So certainly the volume of credit has not slowed up. Its cost, where this was important, has not increased, even though the short-term rates did rise very markedly.

Representative REUSS. Are we not now getting into an unfortunate "here we go again" position? I note that the Continental countries, particularly those of the Common Market, are experiencing some inflationary pressures which are perfectly easy to understand in view of their saturated employment situation. I note that various leaders of those countries and of the Common Market itself are counseling higher interest rates as a cure for inflation. Are we not about to embark on another vicious circle? And would it not be much better if we made the strongest kind of remonstrance—by which I mean President Johnson to head-of-state remonstrance—to these European countries to use fiscal means of combating inflation? That is, tax a little more and spend a little less, rather than to do it the easy and somewhat thoughtless way of cranking up their interest rates, which will cause us to crank up ours, if we follow past practice?

Secretary DILLON. I am glad you mentioned that, because, in following the discussions the last few days or weeks in this and other forums on interest rates, I have not heard that particular problem mentioned. I think that is probably the most serious danger that we face, in terms or pressures for higher interest rates here—more serious than anything in our own domestic economy.

So far, any actions that have been taken have not had effects on international movements because they have not been taken by countries that are important in the international money market and the actions have been somewhat insulated. However, should there be really substantial changes in either the United Kingdom or Germany, which are money market countries, or possibly Italy—I am not so sure of the effect there; Italy is in a very substantial balance-of-payments deficit situation right now—but in these other two big countries, it certainly could put great pressure on us and potentially, I think, be unfortunate as far as the international monetary system is concerned. We certainly will do whatever we can to maintain the cooperation that we have had so far, and continue to point out in our continuing these contacts the problems that any such action would raise, including, if ever it might be felt appropriate, recourse to the President to help us in that regard.

Representative REUSS. I am delighted to hear you say that, because it is so easy for our European friends to say, "Oh, we could not possibly tax any more, and we have our domestic lobbies which will not let us retrench on expenditures; therefore, we are going to take the easy beggar-thy-neighbor way to fight inflation, which is to raise interest rates."

I really think this represents a very formidable threat. If we speak out to our friends and neighbors about Polaris-armed merchant ships, as we do, I certainly think we should not hesitate to speak out in favor of fiscal means of fighting inflation, rather than the old easy method of just raising the interest rate.

Secretary DILLON. I agree with you thoroughly.

Representative REUSS. Thank you.

Senator SPARKMAN. Mr. Secretary, I am sorry I was not here to hear your statement and to hear the questioning by other members of the committee. I have had the same problem so many of us frequently have; that is, of several committees meeting at the same time. You may be interested to know that this is the third committee over which I have been called upon to preside this morning.

I am very glad, though, to be here to hear this part of the statements you have to make. You always make a decided contribution to these hearings. I join with the others in welcoming you back.

Now, the questions I ask may have been gone over before. If so, you just tell me so and I will not insist on the answers.

What has been the effect of the measures that were adopted to restrain the outflow of capital from this country to foreign countries?

Secretary DILLON. Well, the interest equalization tax led to a marked falloff in new issues sold to Americans. The total, as I said, was running at $2 billion a year; that is, about $500 million a quarter, in the first and second quarters. In the third quarter, that figure dropped to about $180 million, but that amount was largely due to transactions which were already far enough along on July 18 so that they did not fall under the proposed tax.

In the fourth quarter, that total fell further to an estimated $70–$80 million, which was a very good result. We needed it to offset a very bad first half.

We do think that the result of the fourth quarter is probably a little lower than it will be once the proposed tax is in effect. We would think somewhere around twice that would be a more normal amount. But anyway, the effect was very dramatic.

Now, even in that fourth quarter figure, at least half was a payment of funds that had been committed before the interest equalization tax would take effect. And there are some substantial payments that will still take place. There is still $100 million that our insurance companies must pay on the loan that they made to Quebec to take over their private utility system; $50 million of that is due to be paid next month and the final $50 million in May. You will recall, that was a $300 million transaction.

There still are leftovers of that nature that are running along, so capital is still moving out, even though there have not been any sizable new issues reaching the market.

Senator SPARKMAN. But it still has had a telling effect and beneficial effect?

Secretary DILLON. A very beneficial effect.

Senator SPARKMAN. Let me ask you with regard to the tax measure. We have been quite prosperous for some time now and things have been moving up, with the exception of the pockets of unemployment and the pockets of poverty to which you refer in your statement. I am wondering, to what extent has the impact of the tax measure already been felt by our economy by reason of anticipation of its becoming effective?

Secretary DILLON. Well, I think it has had an effect on business planning and probably on some business decisions. When there is a close decision as to whether to move ahead with an expansion plan—whether to make it of a certain size or a little bigger, and you have to make the decision because you have to build it one size or another—I think that the obvious tendency of business executives would be to take that into account and opt for the slightly larger expansion or opt for doing something that they might have put off a little further into the future. Certainly, this would have been likely in the last few months when it began to look more clearly that we were going to have a tax cut of this order of magnitude in time, although the timing was not clear.

So I think there has been some effect there. I do not think there has been any significant effect in the consumer-spending field, which is the field that will have the most immediate effect on the economy, because I do not think individuals will even start spending the money immediately after the tax cut.

I think there will be some lag in that. I certainly do not think they would spend a tax cut before they got it.

Senator SPARKMAN. Last year when you testified about the tax measure, it was pretty far in the future at that time. As I recall, there was some questioning, some possible criticism that too great a part of the tax relief that was being given was being deferred to future years, probably into the third year. Now, there has been a good bit of rewriting since that time. Is it not true that a lot of that impact has been shifted to an earlier period? In other words, will there not be a decided relief during 1964, for instance?

Secretary DILLON. Yes. I do not really think much has been shifted. I think there has been a substantial compression. We had originally suggested that some of the tax cut take effect beginning in July of 1963, some more in January 1964, and then some more in January 1965. Well, no tax cut took effect in 1963; no tax cut took effect in January of 1964.

Senator SPARKMAN. It is anticipated to be, though, is it not?

Secretary DILLON. It is now recommended that the withholding rate be reduced as soon as possible after enactment of the bill to 14 percent. So when it does take effect, I think that what is going to happen will be that we will have in 1964 probably slightly more stimulus because of this reduction to a 14-percent rate than we would have otherwise had. But not very much more, because if you assume, as I said earlier, that the budget objectives cannot be met, which was that the reduction in withholding would take effect on February 1, which is just a couple of days away, and instead assume that it will take effect on March 1, which means the bill has to be passed and signed by the President sometime shortly after the middle of February—if we assume that, then there will be, from this cut in withholding rate, a total put into the economy of about $8 billion. If the House bill had taken effect, that figure would have been about $7¼ billion.

So you have $750 or $800 million more which, in the overall of the whole bill, is not a very large amount.

However, it will come more all at once, and so maybe in that way I think economists will think that it probably would have more of a stimulative effect, coming in over a shorter period of time, than it would over a longer period of time. I think that is really what has happened—that we have maintained our schedule of relief but it has been compressed now into a 10-month period of time, instead of over 18 months, as was suggested.

Senator SPARKMAN. Now, my time is getting short, so I want to ask you a double-barreled question. First, do you see any danger of inflation, and second, I have been interested in observing the stock market attaining new records almost daily, certainly on several different occasions recently.

Do you have any uneasiness regarding the stock market?

Secretary DILLON. No. I do not. It is at a very high price, high levels historically. But of course, our economy is higher. Also, with tax reduction, companies are going to have their earnings increased directly as corporate taxes are cut, as well as facing better business. So I think that there is no reason to be concerned about the market.

On the other hand, I think it was wise for the Federal Reserve last fall, when speculative tendencies appeared to be growing, to increase the margin requirements to hold down speculation in the market. I think that the best way to judge that the market is in a dangerous position is when there gets to be too much small speculation—uninformed speculation.

I do not think that there is a general feeling that that stage has been reached yet.

Now, as to inflation, I do not see any necessary danger of it at all with this bill, because as I have said before, when the real stimulus of this bill—the multiplier effect and the effect of added construction of new facilities on top of consumer demand—begins to take hold, this will be just the time that our expenditures are coming more under control. So there will be less stimulus to the economy—in fact very little stimulus to the economy—from the expenditure side of the Federal Government.

So I think this will offset the inflationary aspect that would otherwise be there.

Of course, this is just what we have aimed at. We have always said that we intended to rely on the private economy to do this job, and as revenues increased under that stimulus, we would hold down Government expenditures.

We have felt, I have felt, that we could reach a balance in about 1967 in our budget. I said that last year and I think the only difference is that more people are beginning to see that we meant what we said and that that is now possible. I think there are a lot of people who were skeptical a year ago and maybe some of them still are. But I think they are bound to be less skeptical because it is perhaps much easier to see now how it can be done than it was a year ago.

Senator SPARKMAN. Thank you, Mr. Secretary.

Congressman Curtis?

Representative CURTIS. I want to return to this essential corollary, firm restraint on the total Federal spending. Incidentally, I wish everyone in the administration agreed that it was an essential corollary. I know some of them sincerely do not think so. I think this is the reason it creates the ambiguity that I have been trying to point up in the budget message as well as the Economic Report.

I am concerned with this problem of inflationary forces. We certainly have abandoned the old theory of balancing our budget by creating surpluses in periods of economic upturn, cyclical upturn, that might be eliminated in deficit periods. We certainly have embarked upon a new theory.

The question is, Are Federal expenditures really being cut back in the sense of economic impact? I want to direct your attention to the fact that in this budget some of these so-called expenditure cutbacks are really not expenditure cutbacks under our system of accounting; they are actually the selling off of additional assets. I know there are about $425 million of additional VA bonds pending. This is actually an increase.

This is actually converting longtime investments into immediate expenditures, is it not?

Secretary DILLON. No; it is converting—I do not know quite how you say this—it is converting a long-term asset into a reduction of expenditures.

Representative CURTIS. I do not think it is a reduction at all. Actually it makes it look like that, but that is what I am directing attention to. When you sell off the additional $700 million of assets, that permits an increase of $700 million in current expenditures on the Federal Government's part—I am talking about the economic impact of real expenditures now. I think this is what we must direct our attention to when we consider the inflationary impact. Would you not agree?

Secretary DILLON. Well, I would. But I think that the most important figures there, of course, are not the administrative budget, which of course is the one that people like to direct attention to and are most used to. Economists all recognize, as you do, that the important budgetary effect from the point of view of the economic impact on the economy is shown in the national income accounts.

Representative CURTIS. Yes.

Secretary DILLON. There is an increase of just under $2.5 billion, as I recall.

Representative CURTIS. Exactly.

Secretary DILLON. I think on that, though, what that breaks down into—you would probably get the details from the Director of the Bureau of the Budget—is there will be some continuing increase as we slow down there during the first part of the fiscal year, but by the time we get over into this time next year, expenditures will be holding practically level and there will be little or no increase.

Representative CURTIS. That is what I have been trying to examine and I am submitting a series of questions to the Director of the Budget. This is one area of confusion, the calendar and fiscal years. Our revenues are collected largely on a calendar-year basis and then we have to convert them to fiscal year.

But on page 58 of the "Budget in Brief," the national income accounts expenditures shows purchase of goods and services—first, an increase of $2.4 billion, from $119.1 billion to $121.5 billion. It is this aspect that bothers me.

There is another thing about the budget that has ambiguity as far as expenditure levels are concerned. That is in the new obligational authority request, plus the carryover balances. The new obligational authority for fiscal 1964 will be about $102.6 billion. That is in the budget. The carryover balances, I think, were about $87.8 billion, unless that has been revised, giving a total of expenditures which the Executive can spend of $190.4 billion, of which he says he will only spend $98.4 billion.

But in fiscal 1965, the request for new obligational authority goes up to $103.8 billion. The carryover balances, found on page 62 of the "Budget in Brief," are $90.4 billion, increasing the pool of expenditures by $3.8 billion to a total of $194.2 billion. Nevertheless, the Executive tells us, and it is within his power almost completely, that he is going to spend $500 million less, or $97.9 billion. This creates part of this ambiguity, in relation to the national income accounts expenditure.

I would also point out a very small line drawn on the graph on page 62 of the "Budget in Brief" showing $1.3 billion expiring authority and interfund payments. I wish this was broken down so I would know what is the expiring authority. I have often thought

Congress ought to develop a rescission bill, along with our appropriation bills. This $1.3 billion may be what the Executive has simply decided to let expire. I wish that were a bigger figure. I wish we could know what it is.

Secretary DILLON. I think that is spread all through the Government. For instance, the Treasury appropriations are for specific things. In certain areas, if we do not spend those funds, we simply turn them back in.

Representative CURTIS. Exactly. This is a power of the Executive, again leading me to the conclusion that we need to develop some mechanisms to look into these things. But actually, I am afraid there is not firm restraint on the total of Federal spending. This is ambiguous. All the narrative statements made by the Executive, when placed side by side with these figures, are just not borne out.

I think Mr. Heller referred to this as an austere budget. Last year, it was referred to as a tight budget. The Director of the Budget Bureau has said that this is not a standstill budget, and believe me, I agree with him. The narrative in the President's Economic Report is that our expenditures are not going to increase as much. That I agree with. Thank goodness at least the increases are not as much.

But the point is that the expenditures are increasing, Mr. Secretary, and they are increasing from levels which were increasing double the amount of the previous years. The expenditure level of 1960, as I recall, was $81 billion. Here we are practically up to $100 billion without counting the trust funds.

When we count the real expenditures in the national income accounts, we have to include the trust funds. As you have pointed out—and I agreed—this has an economic impact. Not all of these, but one built-in trust fund, is constantly going up about a billion dollars a year. That is the social security.

So are our transfer payments, our grants-in-aid to State and local governments, and interest continue to go up. The Federal sector, as I see it in this budget, is certainly not going to diminish these inflationary forces that I think already are at play. In fact, they are going to be concentrated.

If my political judgment is of any value, it looks like this is going to be concentrated in the first half of fiscal 1965. This would mean from June through that important date in November we will have these expenditure concentrations. This, if done, along with this proposal of reducing withholding to 14 percent, will overheat the economy and produce a boom situation which is bound eventually to lead to a bust. If you would care to comment in general on that, I would appreciate it, or you may reply to the specifics at your leisure for the record.

Secretary DILLON. Yes; I would be glad to reply in general, which is just pretty much what I have said in the past. Certainly, the administrative budget, judged on the same basis we always judge it, is actually being reduced. That does not mean that Federal purchases of goods and services are being reduced, you are quite right. They are increasing. I think from what I understand, if you look at it from the quarterly rate, the increase will come to an end along about the first part of fiscal 1965. So there will still be some increase in fiscal 1965 on an annual basis, reflecting mostly the higher level at the end of fiscal 1964.

Representative CURTIS. Mr. Secretary, I have to be rude. I have a rollcall vote in the House.

Continue answering for the record, please.

Secretary DILLON. Certainly.

The problem is that when you slow down Government expenditures, you cannot stop them abruptly all at once. You cannot plan them so that they will take place in one quarter and not take place in another quarter. The Government is too big an operation for that. It takes a long time to slow it down. We started to slow down a year ago. Certainly the general expenditures in the nondefense area were held very tight and the goals that were set then are being met or exceeded. Even as long ago as last August, total Federal employment had not increased at all for 12 months. So that was an indication that this holdback and slowdown was already in effect.

One area that was still increasing rapidly and still is—defense expenditures and space expenditures—should also begin to reach a ceiling next year. Defense expenditures should actually go down. Space expenditures will increase for a while and then level off. They will be beginning to level off, I would say, about a year from now.

It is inevitable that the slowdown will not take effect all at once and, therefore, it is perfectly natural that some of the Government purchases of goods and services will certainly be increasing in the first part of this year and will not be in the latter part.

As to inflation, I come back to my main point. In answer to the question of timing, I have agreed with Congressman Curtis on discussions of this in the Ways and Means Committee that when the tax cut takes place, the full effect of stimulus will not be immediate and the multiplier effect will not take place immediately—there will be some time before this will take full effect. I think certainly there will be some stimulus this summer and there will be some stimulus next fall, but we would have had that stimulus sooner if we had acted on the tax plan sooner. I do not think that is a reason for not acting on it now, just because next fall happens to be an election year. We have to go ahead and cut taxes as rapidly as we can and that happens to be now. I do think that the full effect of this stimulus, the type that would push us toward possible inflation if we were not holding down expenditures, will not come for, say, a year from now. At that point, expenditures will be held practically level. So it is for that reason that I do not think there is any built-in reason to be concerned about inflation in this particular budget.

The only problem is the one I have repeated again and again, that as we come nearer to full employment of our resources, obviously, pressures on prices historically get greater and this will require greater statesmanship and greater effort to prevent price increases at that time, although we do have this stronger element of international competition also working, I think, at that time.

Senator SPARKMAN. Thank you very much, Mr. Secretary.

Senator Proxmire?

Senator PROXMIRE. I have just a couple of quick questions, and I apologize for detaining you, especially since you have a cold and have been very patient and gracious.

You made a very interesting reply when I asked you about the forces in the economy and so forth that would be pushing up interest rates and you said there were some counteracting forces. One of them you mentioned was savings as a result of this tax cut. My figures are that about 7 percent of this tax cut will be saved. If more is saved, then the stimulation of the tax cut is enfeebled and is not very much.

If 7 percent is saved out of a $9 billion personal tax cut, that is only $600 million. At the same time, the Government is selling $2.3 billion worth of assets. Now, this, when you compare the impact of a saving of $600 million available to purchase $2.3 billion, you can see that just these two transactions alone suggest the pressure on interest rates to rise.

When you consider all the other factors in the economy, the stimulative effect of the tax cut and so forth, and the pressure of the expanding economy naturally without a tax cut, it would seem to me that the overall effect on interest rates is likely to be up, especially in view, as Congressman Reuss whispered to me in an aside, especially in view of the makeup of Federal Reserve, unless you can assume that there is going to be a change in the Federal Reserve.

Secretary DILLON. No. I do think that there is one thing you have to bear in mind in this sale of assets. We have been very successful in selling them, but they have been sold in a way that did not disturb the economy. I think that would enter into our program again next year. I do not think that we would force them on the market at any price.

Senator PROXMIRE. I think it is a good policy to sell them. I see nothing wrong with it at all, especially if we know all about it as we do now.

I think it is very sensible. But I say this might have some effect on the interest rate.

Secretary DILLON. What I was trying to say was if it does, there are apt to be less sales, because I do not think you will try to force them on the market when the market is not receptive for them.

Senator PROXMIRE. To follow up Senator Sparkman's line of questioning, in view of the fact that we have compressed the tax cut now, for reasons over which the administration had no control, and it is going to be in a much shorter period and will therefore have a greater effect, isn't it more likely that we are likely to have a boom followed by a recession? One of the attractive aspects of the tax cut as originally conceived was that it was over a longer period, so you have a psychological impact on the future as well as actual in the present. But now, the entire tax cut will be in March 1, if the Senate bill goes into effect. There will be no further personal tax cut in the law, but there will be a corporate tax cut. That is not likely to be psychologically as effective.

Secretary DILLON. On the personal tax liabilities, the cut takes place in 2 years, just as it always has, but there will only be one reduction, as you say, in the withholding rate, which does give the major economic impact. That will take place by March 1, we hope.

I think that the answer to that is that the delay that has taken place has probably not been as costly as some of us were afraid it might be, because we were judging by past experience. We were afraid that the economy would run out of gas and would not continue to move ahead as well as it has. So I think that we have misjudged, to some extent, the impact of our own policies, fiscal and monetary, over the past 3 years, which have been expansionary and which within a few months will have kept this economy moving ahead for a longer period of time than any peacetime expansion, except one.

With that, we undoubtedly are coming to a time when we need additional stimulation to keep moving ahead. You cannot continue increases, yearly increases, the way we have been going, in rate of sales of automobiles, for instance, every year without some sort of an increased stimulation. So I think that we are in a position now where we can probably, where stimulation is very desirable. In fact, without stimulation, it would be extremely surprising to see this expansion continue.

Senator PROXMIRE. The difficulty, it seems to me, is that we are getting all of this at once. We had tax cuts over the past couple of years. We had accelerated depreciation, we had investment credit. Now we have a big tax cut, private and personal. We will have a little more of a business tax cut in 1965. Then we have nothing.

The history of this kind of action, based on 1954, at least, is that the stimulation follows for a year or two—1955 and 1956 were good years. Then, in 1957, we began to drift down. Now I notice you assume—not you, but the administration—the year for balancing the budget is 1968 or 1967. This assumes that the action we are taking now, which is stimulative now in 1964 and early 1965, is going to be quite different than our historical experience has been in 1954, and it seems to me from all these psychological factors, and so forth, not very encouraging. Especially when you recognize that we have had a pattern of business cycles in the country and we are now nearing the end of the usual period of business expansion. So that the assumptions of a balanced budget in 1967 without further tax cuts that would unbalance the budget seem to be a little off.

Secretary DILLON. You are quite right; we will have to have a longer period of economic growth than we have had. We can do that. Other countries have done it. Our recessions are milder than they have been in the past. We can go still further. We think that a lot of the benefit of this tax cut is going to be long run because of the increased incentives it provides, and that it will be a continuing incentive. In that fashion, it will be somewhat different from the 1954 result. I do think it will be different in quality and different in character. But certainly, you are quite right that 1967, fiscal 1967, is probably a testing time to see whether these theories work here as well as they have worked in other parts of the world. I see no reason why they should not. But the question will be whether our economy can continue moving ahead.

Senator PROXMIRE. Let me ask this one final question. I notice you put some stress in your statement on the equity of this tax cut, the fact that it is not a regressive tax cut. Yet the tables that have been put into the record by Senator Gore and Senator Russell Long and others suggest quite the contrary. They point out, for example, this one table I have before me, that the increase in after-tax income as a result of tax cut goes from 4.7 for the $6,000 category up to 141.9 percent for the million-dollar category. Then, when you also recognize the table that Senator Gore put into the record, which he says is from the Office of the Secretary of the Treasury, which shows that those with incomes—well, in the first place, it shows that 75 percent of those with incomes of a million dollars or more pay less than 30 percent in taxes and that the average payment is something like 16 percent—15.9 percent for those with incomes of a million or more.

It seems to me that the tax cut is certainly not a progressive tax cut and perhaps it may well be classified as regressive, unless there is some action taken by the Senate and House to provide a reduction in the sales taxes and the excise taxes.

Secretary DILLON. No. I do not arrive at that conclusion at all; quite the contrary. Those tables were, of course, all prepared in response to particular requests, designed to show particular things. There is no doubt that under our present laws, high-bracket income taxpayers with incomes of a million dollars or over pay low rates of tax. The primary reason for that is that the substantial part of their income is capital gains, taxed at a low rate. They do not have ordinary income in those amounts.

Under the Senate version of the bill, they will not benefit on capital gains at all, because capital gains rates are not being changed. I certainly hope that will not delay the passing of the bill.

Now, the other table was drawn up on a hypothetical basis. As far as we know there is no such fellow as this hypothetical individual with a million of ordinary income and nothing else who gets this very big increase of after-tax income.

Senator PROXMIRE. We might have Sonny Liston in that category this year.

Secretary DILLON. Turn this around and look at it the other way. Assume we abolished the lowest tax level, which is now 20 percent—completely abolished it—so that a taxpayer at that bracket paid no tax. Instead of paying $20 and keeping $80, he would keep $100. His after-tax income will have gone up 25 percent——

Senator PROXMIRE. That is the real trouble with this tax cut. Of course, there is nothing you can do about it, but the fact that the people who are really poor, whose incomes are low, are left out and have to be because they don't pay any income tax. This includes 80 percent of the people over 65, a majority of farmers, of course practically all the unemployed. The unemployed may be benefited indirectly by the tax cut, although many will not be, the old people will not be; the farmers will not be.; unless people buy more food. When you put that together with the impact of the tax cut, I think there is considerable question that unless you include excises in it, it is not a progressive tax cut.

Secretary DILLON. No; it is still that, because it shifts the burden, as I have pointed out, more heavily on to those with incomes of over $10,000 than is the case at present.

If you will allow me to finish what I started to say, this 25-percent increase in after-tax income is the maximum that can be given to the lowest bracket payer. If you try to do the same thing now for the man who pays at a 91-percent rate, which is the way that that table that you first cited was constructed, and you tried to increase what he had left, which is 9 percent of his income, by 25 percent, you would increase it by 2¼ percent of his income. The top rate would then have to be 88¾ percent. It is inherent in any attempt to cut these excessively high rates, which everybody, including labor economists and others, will agree are too high——

Senator PROXMIRE. I agree they are too high. I favored the Long amendment, which would cut them down to 50 percent.

Secretary DILLON. That has been left out of the bill by the Finance Committee. That is why I do not think this is regressive. But certainly, I agree with you that you cannot in the tax system give substantial benefits to people who do not pay taxes. You can help them by this tax cut. We think this tax cut will help them a great deal by stimulating the economy, which will make the whole economy more prosperous and give many of them other jobs and higher income so maybe they will become taxpayers. That way they will probably get their taxes increased because they paid nothing before and now they will pay some. But I think they would all be happy, if that situation arose, to have higher incomes on which to pay taxes.

Senator PROXMIRE. I have taken much too long. Thank you, Mr. Secretary; that was as an excellent presentation.

Senator SPARKMAN. Thank you, Mr. Secretary.

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

(Whereupon, at 12:20 p.m., the committee recessed, to reconvene Wednesday, January 29, 1964, at 10 a.m.)

JANUARY 1964 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 29, 1964

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

The joint committee met, pursuant to recess, at 10:06 a.m., in room 114, New Senate Office Building, Hon. Paul H. Douglas (chairman) presiding.

Present: Senators Douglas and Proxmire; and Representatives Reuss and Curtis.

Also present: James W. Knowles, executive director; Hamilton D. Gewehr, administrative clerk; and Donald A. Webster, minority economist.

Chairman DOUGLAS. This is the final hearing on the President's 1964 Economic Report.

We are very happy to have two distinguished economists with us this morning, Mr. Robert R. Nathan, of the Robert R. Nathan Associates, who is an old friend, and Mr. Walter D. Fackler, professor of business economics and associate dean of the Graduate School of Business, University of Chicago, with which I was formerly affiliated. We are very happy to have you both.

I would suggest that Mr. Nathan start off and then Mr. Fackler will follow, also that we, the members of the committee, try to restrain our temptation to intervene or interrupt, until after you have completed your prepared statements. Then we will have questions for you both and perhaps you will have a dialog between yourselves.

Mr. Nathan, will you begin?

STATEMENT OF ROBERT R. NATHAN, ROBERT R. NATHAN ASSOCIATES, INC.

Mr. NATHAN. Thank you, Senator Douglas.

Mr. Chairman and members of the committee, I am grateful for the opportunity to testify in these important hearings. A thorough and objective airing of President Johnson's Economic Report should be valuable to the administration, to the Congress, and to the public. The first policy messages from any new administration are particularly meaningful.

In his Economic Report to the Congress, the President expressed his pride in having voted, as a Member of Congress, for the Employment Act of 1946; reaffirmed his support of its mandate "to promote maximum employment, production, and purchasing power," and went on to say: "Nothing less than the maximum will meet our needs."

We should evaluate the Economic Report and related Presidential documents and messages of recent days in relation to this serious theme.

GOALS AND TESTS

President Johnson in his Economic Report struck a note which can hardly be overemphasized:

> That "new records" in output and employment are not enough;
> That 4 million unemployed and 13-percent idle factory capacity are intolerable;
> That the acid test of economic policy is whether we can make full use of our growing labor force and our rising productivity—our full potential.

And then he concluded:

> We have not yet met this test. New high ground is not the summit.

It is shocking in the face of pressing unfilled needs that unemployment in the United States has not fallen below 5 percent in any month for over 6 years. Additional time is being lost by part-time workers. Other resources remain persistently idle.

The Council of Economic Advisers estimates the present gap between potential and actual performance at $30 billion per year—and this after almost 3 years of expansion. Others estimate a substantially greater loss.

We have tolerated gaps of this size, and even larger, continuously since 1957. Yet, millions of families continue to live in poverty; we have severely depressed areas, large and small, in almost all regions of the country; we have vast slums and substandard housing facilities; we suffer inadequate medical facilities and shortages of teachers and classrooms. We must meet these and other unsatisfied needs at home.

In addition, we should contribute in far greater measure to the alleviation of desperate needs abroad. We should make our free enterprise economy an example to the emergent nations searching for economic systems and policies which will permit them to remove the shackles of poverty.

To reach these foreign and domestic goals, our use of resources and our rate of economic growth must be increased substantially. It is certainly clear that the employment prospects cited in the Economic Report—5-percent unemployment by the end of 1964 and the indefinite hope of 4 percent some time later—are not adequate for the great tasks ahead.

THE OUTLOOK FOR 1964

All the recent reports and messages of the administration hold forth favorable prospects for 1964. The expected expansion stems mainly from the stimulus of the large pending reduction in taxes. Moreover, the distortions usually associated with an extended cyclical recovery and with booms before busts are largely absent as we enter 1964. On the whole, there are few signs of weakness which could bring on a recession. Yet, residential construction and Federal purchases, especially the latter, which contributed much to the expansion of the last 3 years, will not be so stimulating in 1964.

Especially significant is the expected large decline in the contribution of Federal Government purchases to further expansion in demand. The increase in these purchases of some 20 percent was crucial in the vigorous but inadequate recovery from the first quarter 1961 to fourth quarter 1963. They are expected to be higher in 1964 over 1963 by less than 4 percent, and I might say less than that in real terms. They are expected to rise by less than half as much in 1964 as the rate in 1961–63.

In major degree, the stimulating effects of the tax cut are being relied upon to maintain the pace of our economic expansion.

The tax cut should stimulate a significant increase in consumer spending. In turn, expenditures for business plant and equipment should also rise and at a somewhat faster (and hopefully sustainable) rate than in the last few years. The response of business to the investment credit and the liberalized depreciation allowances of 1962 was disappointing.

Economists differ in their judgments concerning multiplier and accelerator ratios. Some believe that the business and consumer response to the cut in taxes will not be as great as anticipated by the Council of Economic Advisers. However, even the less optimistic conclude that production, income, and the number of jobs will be rising in 1964. But it will be far less than what we could and should accomplish and will still leave us with a large gap between actual and potential production.

What is most significant—and most distressing—is the fact that no one expects us to achieve or come near maximum employment in 1964. Nor is there optimism that we will achieve it in 1965. The Council of Economic Advisers expects the unemployment rate to fall to approximately 5 percent by the end of 1964 from 5.4 percent at the end of 1963. The Council frankly concedes that "attainment of the interim goal of 4 percent lies beyond 1964." Many of us feel that 4 percent is far too modest a goal—even as an interim goal. Progress toward fulfilling the legislated mandate of the Employment Act will be painfully and unnecessarily slow in 1964.

THE TAX REDUCTION

As the President stated in his budget message, his economic policies are based on his belief—

> that the primary impetus needed to move our economy ahead should come, in present circumstances, from an expansion of the private sector rather than the public sector.

This explains the emphasis on the tax cut and restraint on Federal expenditures.

Many who testified on the tax reduction bill expressed the view that the same fiscal stimulus could have been obtained and the public interest more fully served had there been greater reliance on increasing public investment expenditures rather than tax cuts to stimulate increased private expenditures. A combination of the two would have been preferable to the nearly exclusive reliance on tax reduction. However, that is water over the dam, and we must support the pending tax cut to get the stimulus so seriously needed. It should be promptly enacted, as recommended by the President, with provision for immediate reduction in the withholding tax to 14 percent and without reduction in the tax rates on capital gains for which we are grateful to the Senate committee for restoration.

Chairman DOUGLAS. I am not at all certain that we can hold it.

Mr. NATHAN. I hope so, Mr. Chairman. I think without the offset of the capital gains tax at time of gift or death, the cut in rates would be most unfortunate and undesirable.

It must not be forgotten that widely divergent views were expressed in the tax hearings about the composition of the tax cut. These differences have not been settled.

Those who seek more and more incentives to investors are dissatisfied with the cuts in top bracket individual and corporate profits. Taxes, even though the investment credit and accelerated depreciation provisions of 1962 were entirely incentive oriented. They contend that, if only these tax rates were reduced enough, investment would be sufficient to use all the savings forthcoming at full employment. On the other hand, investment will not be encouraged unless there is increasing consumer demand and larger use of existing facilities. The prospective tax reduction, the tax changes of 1962 and the rise in State and local taxes relative to Federal taxes over the postwar years, together have shifted some of the total tax burden from higher to lower income groups. This is not a healthy development, neither in terms of economics nor in terms of equity.

The tax bill about to emerge certainly is not a reform bill. I would strongly urge that this committee and other committees of the House and Senate undertake to study thoroughly and objectively the incidence and the economic and equity impacts of all public taxation in the United States—State and local as well as Federal—toward the end that tax reform might be given the attention it deserves.

HOW MUCH FISCAL STIMULUS OR RESTRAINT?

The Council has provided us with an excellent analysis of the basic economics of our fiscal policy, starting from the indisputable fact that with present tax rates, Federal tax revenues at full employment would increase by more than $6 billion per year. Past failure to offset this increase by larger expenditures or by tax reduction "has been a major factor in slowing expansions and precipitating downturns." The Council then goes on to say:

> To avoid these consequences, an appropriate expansion-promoting fiscal program would call for tax and expenditure policies that prevent a constrictive rise in the full-employment surplus.

The pending tax reduction, with its unprecedented peacetime stimulus, will remove much of the fiscal restraint that has made full employment and vigorous growth so elusive. But it is equally clear that unless private demand responds far more strongly than the Council expects, we will need larger expansion-promoting fiscal measures than those now planned if we are to achieve maximum employment.

Because of the reduced tax rates, the Federal revenue increase at full employment for the next couple of years will be nearer to $5 billion than to $6 billion, but a substantial full-employment surplus will again emerge at the levels of taxation and expenditure proposed in the 1965 budget.

To assure continuation of our economic expansion beyond 1964, a less restrictive fiscal policy will be urgently needed. If the projections for 1964 are proven accurate, we will enter 1965 with 5 percent unemployment, with the effects of the tax reduction largely integrated into our economic activity and the full-employment surplus rising rapidly. It is quite possible we may be faced with a faltering demand a year hence. The small increase in Federal Government purchases of $1.3 billion in fiscal 1965 over fiscal 1964 will be far too small to counter the restraint of the growing full-employment surplus.

It is possible that private demand will respond more vigorously to the tax reduction than is now forecast, but the Council has not been modest in projecting a big investment response. Also, it assumed an expansionist monetary policy. An investment rise much above that expected could be self-terminating and nonsustainable.

The rapidly rising full-employment surplus may pose problems for late 1964, but more likely in 1965. Assuming that the labor force continues to grow by more than a million a year and that productivity continues to rise at the current rate, it would require another roughly $50 billion increase in aggregate demand in 1965 just to reach the "interim goal" of 4 percent unemployment. That is by the end of 1965. It seems most unlikely than an increase of this magnitude could be achieved without a substantial increase in purchases of goods and services by the Federal Government. A $5 billion dollar rise in Federal purchases would be consistent with the growth of full-employment Federal revenues.

PUBLIC EXPENDITURE POLICIES

The President's proposed budget for fiscal 1965 does not appear to offer an expenditure program compatible with our increasing population, with our rising level of total production and income, with the war on poverty so dramatically declared by the President, and with the tremendous necessities prevalent in public facilities and public services. In these terms, the level of public investment and public services called for in the budget is definitely inadequate. It is inadequate also in terms of fiscal policy.

This certainly does not mean that the Government should be profligate with the people's money. President Johnson's promise to get a dollar's value for a dollar spent is welcome. No dollars should be spent by government—Federal, State, or local—for unnecessary purposes or in a wasteful or inefficient manner.

From all indications, President Johnson's budget has benefited materially from a careful and diligent effort to eliminate waste, to take account of obsolescence, and to screen military expenditures perhaps more carefully and critically than in recent years. These are not easy accomplishments. To the degree that waste and inefficiency have been eliminated in the budget, the country owes the President a vote of thanks.

The country is entitled to a constructive attitude toward the level of public expenditures as well as an intolerant attitude toward waste. President Johnson stated, "The economics of efficiency is in no way inconsistent with the economics of expansion." However, the budget appears to be on the lean side in financing expansion.

Here we are faced with questions of policy that are both political and economic. They are political insofar as they involve decisions to apportion resources between raising personal incomes of taxpayers and raising the standards of public services and facilities. These are matters of profound importance to the quality of our society, and they can be decided only through democratic political processes. But these decisions also profoundly affect the economy and therefore raise important questions of economic policy. For example:

(1) Many forms of public investment (schools, highways, harbors, resource conservation, water development, et cetera) are major factors in production and productivity;

(2) Public loans, grants, et cetera are major determinants in certain sectors of the private economy (especially housing);

(3) Certain kinds of government outlays (social insurance benefits, transfer payments for public assistance) can significantly alter the net income distribution and increase aggregate demand in the lowest income groups where the propensity to consume is highest and out of reach of tax reductions.

(4) Expenditures for foreign aid create a demand for U.S. capital goods and agricultural products which would not otherwise be activated.

(5) Public expenditures are in themselves a stabilizing factor in the economy, being more predictable and more susceptible of compensatory use in "counterbalancing private demand," as the Economic Report observes.

As a citizen, I am convinced that we must raise the quality of American life by public programs of education, housing, health, recreation, and welfare in larger measure. As an economist, I must remind you that we will achieve a fully employed economy sooner and sustain it longer if the expenditures of Federal, State, and local governments are used positively and purposefully to meet needs which the private sector cannot or does not meet. All-out war on poverty, for example, involving a variety of programs of public investment and services, would have far-reaching economic as well as social benefits.

As further fiscal stimulation becomes necessary—as it surely will—the choice between essential public needs and further tax reductions must be made. This committee would perform a most useful service to the American people if it were to devote at least part of its time for study and part of its report this year to a discussion of urgent public needs. The emphasis on the tax cut for more than a year has obscured our main deficiency of public policy—the inadequate level of public services and facilities. Responsible attention should now be focused on this problem not only in relation to the needs and aspirations of our people, but also in relation to the "maximum employment, production, and purchasing power" mandate of the Employment Act of 1946.

POLICIES AFFECTING DISTRIBUTION AND USE OF INCOME

If private demand could be sufficiently large and dynamic, full employment might be achieved without the fiscal stimulus associated with budget deficits. It is unrealistic, however, to deal with private demand as if it were unrelated to Government policies. Government expenditures, Government receipts, and other Government activities have important impacts on private incomes and on private expenditures, entirely apart from the influence of the net balance of Government disbursements and receipts. All Government policies and not just aggregate fiscal impacts should be used to achieve that level and composition of aggregate demand compatible with a satisfactory functioning economy.

Tax policy affects the distribution and uses of income. Income taxes can be shifted to modify their effect on various income levels. So can excise taxes which also can discourage specific categories of consumption. Taxes can influence levels of savings as well as levels of expenditures. They can stimulate investment. Tax changes can activate or dampen private demand.

The pattern of public expenditures also influences the distribution and uses of income. For instance, improved highways surely encourage the sale and production of automobiles. Larger allocations for education result in increased incomes to larger numbers who are better educated. Research and development expenditures speed technological change and affect jobs and equipment. Public assistance payments help the lowest income groups—and should help them far more.

Our social security measures, including sources of revenues and patterns of disbursements, importantly affect the distribution and uses of income. Unfortunately, the benefits under most of these measures are far too low today. In fact, some of the benefits are lower in relation to current earnings than they were a decade or more ago.

Whenever we deal with any of these policies which affect the distribution and uses of income, we are more conscious of their impact on the social groups directly affected than on the indirect effects on our economy as a whole. At any given time, for example, our rate of economic expansion may be affected significantly by a shift of income from consumption to savings or vice versa. Our economy seems more likely to generate an excess of savings over investment rather than a shortage of investment funds and that is why a fiscal stimulus is needed more often than a fiscal restraint. The need for a fiscal stimulus might well be reduced, at times at least, if we paid more attention to the effect of other Government actions on the distribution of incomes.

This committee should continue to study whether the persistent tendency toward oversaving in relation to investment requirements, and the consequent tendencies of the economy to level out substantially below full employment, have their origins in certain persistent imbalances in the distribution of income and in the resulting propensities to consume and invest.

PRICE AND WAGE POLICY

In his economic report for 1962 the late President Kennedy proposed wage and price guideposts for noninflationary wage and price determinations. The Council of Economic Advisers in reaffirming this policy formulation has been concerned less with the effects of wage-price-profit policy on income distribution than with its effect on prices. The Council emphasizes that there is no intention "permanently to freeze the labor and nonlabor shares of total industrial income." In practice it appears that wage restraints have been more faithfully observed than price restraints with a resulting tendency to shift income from wages to profits.

The United States is conspicuous among major industrial countries for declining unit labor costs in the recent past. The guideposts expressly assume that where industry or company productivity gains exceed the average, they would lead to lower prices. The Council is candid, however, in conceding that "large industrial enterprises thus far have not widely heeded this advice." Also, the President expressed his concern about "a series of specific price increases in recent months—especially in manufactured goods." As the Council has observed, the effect is to "cause profits to pile up" and to "become highly visible" and "constitute a lure for strongly intensified wage demands."

The tone here is one of major concern over inflation and of resignation to the likelihood of large wage increases occurring because they cannot be avoided. I should prefer a more positive policy expression based on the economic desirability of raising wages as a support to a rise in consumption, and of a lower level of prices reflecting higher break-even points, leading to large volume of profits based on higher volume of sales. This is a formulation of wage-price-profit relationships consistent with a policy of a fully employed economy. There is of course the danger that in industries with few competitors and with closely administered prices, attempts may be made to pass on higher wages in the form of higher prices. It is one of the responsibilities of the executive branch of the Government and of the Congress to search out appropriate means to restrain unjustified price increases by means short of controls incompatible with our economic institutions.

Actually, wholesale prices have been stable since 1958. Consumer prices have been rising slowly but steadily, averaging about 1.5 percent per year since 1958. Excluding services, consumer prices have increased less than 1 percent per year. Wage rate increases have slowed down and real wages per hour appear to have increased less than the rise in productivity in the past couple of years, suggesting a tendency for profits to increase relative to labor income. Profits have actually increased more than the published figures reveal, because some of the rise is concealed by the much inflated (nontaxable) capital consumption allowances.

We must pursue price stability. It is clear from the facts that responsibility for restraint rests primarily on business. Unless there are significant reductions in prices this year, the anti-inflation program of the administration will not assure the continuation of stable prices.

Attacking poverty: In his state of the Union message and again in his Economic Report, President Johnson declared unconditional war on poverty in America. His Council of Economic Advisers spelled out in a concise and forceful manner the blight of poverty which is still so prevalent in our country. I earnestly hope that his program, when it is presented in detail, will receive encouragement and support from the country and from the Congress.

Our poverty is nothing less than a national scandal. It is particularly distressing in view of the tens of billions of dollars worth of goods and services that could be produced and made available to fight poverty if only our idle manpower and idle plants were fully utilized.

One out of five families in the United States has an annual income of less than $3,000 per year. The Council estimates that $11 billion of goods and services would bring all these families up to the $3,000 income level. But as the Economic Report points out, this is not the correct formulation of the goal. The goal is to break through the vicious cycle of low living standards, low education, low productivity, and impoverishment that causes poverty to persist from generation to generation in this rich country. This will require a massive and long-term investment in education, health, housing, urban rehabilitation, and area redevelopment, and relentless programs to end the many discriminations that fence in the poor, keeping them in their poverty. But there are also direct steps which can be taken with little delay, including necessary increases in coverage of minimum wages, level and duration of unemployment benefits, larger public assistance allowances and bigger old-age pension benefits.

The all-out war against poverty is related to the campaign for maximum employment. Full employment will not in itself eliminate poverty in the United States, because much poverty is rooted in causes that full employment alone cannot reach. But there is scarcely an obstacle in the war on poverty which will not be more effectively surmounted in a full employment economy. And conversely, raising the standards of the economically depressed population will speed economic growth by enlarging both demand and output.

The recognition of the poverty problem by the administration is in itself a great step forward. The commitment of the administration to carry on a war against poverty is another huge step forward. The real challenge now lies in formulating policies and implementing the big programs essential for winning that war.

From this point of view, the relatively small amount of funds set aside in the budget to make a start is disappointing. It is true that much can be gained by orienting and focusing existing programs on these problems. Also, the costs of some proposed programs of great value—such as improving minimum unemployment insurance benefits and hospital care for the aged—do not appear as budget items. Nevertheless new obligational authority of one-half billion dollars and new expenditures of one-quarter billion dollars in the next 18 months seem very, very small in relation to the problem. It does take time to organize and man a war of this kind, but poverty has been waiting a long time and we should take as big and fast steps as possible.

Foreign aid: A complete chapter in the economic report is devoted to foreign aid, and I cannot let this opportunity go by without commenting briefly on this important and controversial subject. It is an area to which a substantial part of my time and energies have been devoted. I and my associates are registered with the Department of Justice under the Foreign Agent Registration Act because we are now serving as economic advisers to the Governments of Afghanistan, Italy, and Israel. We have served in similar capacities in or for a dozen or more countries over the past 15 years.

Chairman Douglas. Mr. Nathan, I don't want to interrupt. My wife and I went down to El Salvador during the Christmas vacation and I thought you were down there too.

Mr. Nathan. We are, Senator Douglas, but the oddities of the registration law are such that we don't register for El Salvador because we are under contract with AID rather than the Government of El Salvador. But we do have a team actually there.

Chairman Douglas. We heard very favorable reports of your work and the work of your associates there.

Mr. NATHAN. Thank you very much, Senator. We are trying to make a contribution. I think the results are rather encouraging.

Chairman DOUGLAS. Lest the spectators think you pay the bills, I must say I paid the bills for my trip.

Mr. NATHAN. It is a very nice place to visit, Mr. Chairman.

The gap in production, productivity, living standards, and even hope for improvement continues to spread between the developing nations of the world on the one hand and the United States and other highly industrialized countries on the other. For hundreds of millions of people the bleak future for themselves and their children, let alone the stark realities of the present, are hardly conducive to an interest in the principles of peace and in the elusive concepts of free men or free enterprise elusive to them. Freedom to starve or to remain deprived is not a wholesome force for peace and human dignity.

The continuing divergence of economic progress between the haves and have-nots cannot be permitted to persist. Even as we debate among ourselves about the efficiency of our foreign aid programs, we should renew the commitment on the part of the United States and seek the commitment on the part of other developed countries to speed the processes of economic development in the other parts of the world. In our own self-interest, we have no choice.

In the face of the gap between what we are producing and what we are capable of producing—more than $30 billion a year—it is inconceivable to me that anyone can seriously raise the question whether we can "afford" foreign aid. Clearly we can. Of course, we must spend the funds wisely and efficiently. We cannot afford to risk a future of peace and prosperity and freedom by turning our backs on hundreds of millions of human beings who live in misery and privation. We must be their strong allies and partners in the universal war against poverty.

From the point of view of the developing countries, development loans and grants from abroad, added to well-directed and disciplined use of their own resources, can make the difference between success and failure in the breakthrough to development. From the point of view of the developed countries, most particularly the United States, foreign aid provides an added market for our goods and an opportunity to expand our foreign trade in the future as development expands markets.

In the light of the probable returns, both political and economic, I cannot refrain from expressing deep disappointment that the budget asks no more for foreign aid in 1965, than was made available after the intemperate cuts of 1964. This posture, it seems to me, will slow down economic development and hinder our efforts to increase the flow of foreign aid from other developed countries.

Balance of payments: The chapter in the annual report of the Council of Economic Advisers dealing with our balance of payments is a highly lucid and objective analysis of the problem. Like the excellent report of the Brookings Institution, the Economic Report will help to counter the preconceived notions, emotional biases and misconceptions which have obfuscated this complex and controversial subject.

We have observed some improvement in our balance of payments in recent months. There is even hope for further improvement in the coming year and beyond. However, further progress will depend not alone on actions taken by the United States but also on the policies pursued by those nations which have been increasing their holdings of dollars and gold at a rapid rate.

Two principal points are worthy of the serious attention of this committee. First, as with the problem of inflation, we should not seek solutions by limiting, deliberately or unwittingly, the performance of our economy. Deflation and contraction of the American economy will not solve our balance-of-payments problem. We must find solutions which are compatible with full employment, price stability, and growth.

Secondly, it is incumbent on all the nations of the world to work intensively toward the development of an international monetary system which will be compatible with expanding trade and adequate liquidity. Certainly if we will mobilize the talents now available and take advantage of the experience we have had, such a system can be constructed toward the end that men and nations will enjoy increased opportunities for economic improvement rather than become shackled by arbitrary forces of a man-made nature.

Now, just a moment in summary.

The economic outlook for 1964 is favorable by past standards but is unsatisfactory relative to the goals set forth in the Employment Act of 1946 and relative to the unfulfilled needs of our Nation and the free world.

The pending tax reduction will certainly help stimulate further expansion in 1964 and delay or mitigate the dangers of a recession. Most of the fiscal stimulus comes from the tax cut, whereas most of the fiscal stimulus for the 1961–63 recovery stemmed from rising Federal expenditures.

Needed efficiencies and economies are reflected in the fiscal 1965 budget but the proposed low expenditure total also reflects inadequate funds for essential public facilities and services.

As President Johnson stated, the—

> fiscal program for 1964–65 will shift emphasis sharply from expanding Federal expenditure to boosting private consumer demand and business investment.

This shift will bring greater private luxuries to some and less of the essential public facilities and services to many.

The President's declaration of war on poverty is welcome and commendable. However, much larger funds will be needed if this war is to be waged effectively and successfully.

Our foreign aid activities need to be extended and even enlarged if we are to enhance the prospects for peace and freedom.

In general, the policies now proposed will not advance our economy fast enough in 1964 and may render sustained economic progress more difficult beyond 1964. The policy of restricting Federal expenditure will leave crying needs unmet. Also, it may be a difficult policy to reverse. Beyond fiscal 1965, in any event, we will need larger public expenditures to reach full employment of our resources, that is, I hope larger nonmilitary, not military expenditures, and the level of production of which our free economy is capable and to satisfy the growing needs of our growing population. Nor is the restriction of expenditures needed to fight inflation. We need not fight inflation with unemployment.

The task of reaching full employment has been made harder by the shifts in disposable income due to the changes in the structure of the composite of Federal, State, and local taxes. It will become still harder if we exercise restraint on wages without effective restraint on prices.

Though 1964 will be a better year, as the President himself stated, we are a long way from the summit and we must not stop short. "Nothing less than the maximum will meet our needs."

Thank you.

Chairman DOUGLAS. Thank you very much, Mr. Nathan.

We have with us also Mr. Walter Fackler. Will you proceed?

STATEMENT OF WALTER D. FACKLER, PROFESSOR OF BUSINESS ECONOMICS AND ASSOCIATE DEAN, GRADUATE SCHOOL OF BUSINESS, UNIVERSITY OF CHICAGO

Mr. FACKLER. Thank you, Mr. Chairman and members of the committee. I am grateful for an opportunity to appear here this morning to testify.

We are gathered here to discuss the goals of the Employment Act of 1946 and how present public policies might properly and effectively promote those goals. Incidentally, we shall have to discuss the President's Economic Report, presented to the Congress on the 20th of this month, since there is a fair amount of overlap between the contents of that report and the purposes of these hearings.

The Employment Act of 1946 explicitly requires the Federal Government to promote "maximum employment and purchasing power" in ways that are consistent with primary governmental responsibilities and in ways that "foster free competitive enterprise." By practice and common consent the act implicitly subsumes two other goals: a stable general price level (the control of marked inflationary or deflationary shifts in the average level prices) and economic growth (however defined). In practice, unfortunately, the President's Economic Report usually becomes an omnibus vehicle upon which is loaded a great miscellany of unrelated economic and social issues. In this jumbled cargo, the primary goals of the employment act becomes obscured, the focus lost, and the policy issues muddled. So it is with this year's report. I say this in resignation rather than in criticism, for I realize full well that seldom will any President (or his Council) fail to take advantage of free transportation for the political issues he chooses to promote. The custom, however, makes it difficult for the Congress or the public to apply the rule of relevance.

When I speak of this year's report, I refer to the whole package: the President's summary statement at the outset and the lengthy report of the Council of Economic Advisers which follows. The two sections are inseparable parts of a political document. To maintain that one part is political and the other professional is to foster another one of those numerous myths that plague economic policy. It would be preferable to call the whole thing the Economic Report of the President and let it go at that. The reasons for doing so have been cogently stated by Arthur F. Burns, a former Chairman of the Council of Economic Advisers, in his address before the annual meeting of the American Statistical Association on September 7, 1962:

> The hope was once seriously entertained that the President's Economic Report, or at least the portion for which the Council of Economic Advisers saw fit to

assume full responsibility, would provide appraisals of the state of economy and its needs, which could command, by virtue of their scholarship and practical wisdom, general acceptance. This hope has not been fulfilled.

However excellent this or that Economic Report of the President may be, it is by its very nature a political document. Its economic analysis might be flawless and its recommendations singularly free from partisan bias. That would not stop many citizens, however, from reading partisanship into its objective utterances. In fact, and if only because the President is the head of a political party as well as the head of Government, this kind of Economic Report has never been written and probably never will be written. Much the same applies to public statements by the Council of Economic Advisers. Although the Council consists of economic experts, it is also a political body. The Council cannot discharge its primary responsibility of assisting the President and at the same time express views that diverge significantly from the President's public position. At best, the Council's pronouncements are destined to be punctuated by silence on matters that justify the eloquence of candor.

To this quotation let me add that at worst the Council's pronouncements are apt to be political commercials commingled with, or masquerading as, objective statements of fact or scientific economic analysis. The best and the worst are both represented in this year's report.

I do not imply that this is a bad report. Indeed, it is a rather good report as these things go. It probably does not exceed the usual quota of either good or bad policy recommendations. In style it ranges from that of an auctioneer's chant in the Presidential message to a graceful and perceptive exposition of the process and problems of technological change in chapter 3. Despite the usual flatulence and irrelevancies, it covers certain key issues; for example, monetary and fiscal policy, in more than usual depth. And it does provide the Congress and the public with a mass of useful information on the state of the economy. It needs a guidebook, however, and to provide one is the purpose of this statement.

I propose to follow a path which touches upon four major topics relevant to these proceedings:

1. The economic outlook for 1964;
2. Fiscal and monetary policies appropriate to current economic conditions ;
3. The unemployment situation; and
4. The balance-of-payments disequilibrium.

Along the way I shall comment on some of the analyses and policy recommendations contained in the report. I shall ignore some sections of the report completely because the issues, while important, should more properly be discussed in another forum.

The economic outlook for 1964: At present, the economy is in a buoyant state. Economic forces are expansionary. Most of the leading statistical indicators, such as new orders, stock prices, construction contracts, the factory workweek, and others are rising or stable. Monetary policy for over a year past has been expansive. In every month except for one during 1963, the Federal Reserve System added to bank reserves or offset other factors tending to reduce bank reserves by substantial purchases of securities in the open market. Total purchases for the year amounted to approximately $3.3 billion. As a result, bank reserves available to support private deposits rose 3.8 percent, and the stock of money rose by over 4 percent during the year; the rate of increase accelerated in the second half. Anticipated increases in capital outlays by business are moderately expansive, and actual expenditures will probably become more so as the year progresses. Construction seems to be in a healthy state, and the automobile industry appears to be well on the way to a third big year in a row. There are no serious bottlenecks and imbalances, such as rapid inventory buildup, to deter or complicate further economic advance. The anticipation of a substantial, early tax cut tends to reinforce generally rising expectations.

In sum, the Council's forecast of a $623 billion gross national product in 1964 seems wholly reasonable to me, provided the tax bill is enacted. My own forecast, made in December 1963 was that GNP would expand with the tax cut to within the $615–$620 billion range, and I set $620 billion as the more likely outcome. At the same time, there are other economists who are even more optimistic than the Council. One of my colleagues, Prof. Irving Schweiger, predicts a vintage year with GNP rising to $630 billion for the annual average. He has been right often enough in the past for me to consider his views seriously. I prefer, however, to err on the side of caution.

Beyond 1964, I do not prognosticate. Economic forecasting is a treacherous game even for the near term. If economic events unfold during the coming year as we now predict, and hope they will, the economy may once again approach an inflationary threshold. The rate of unemployment will fall, but certainly not to a 4-percent level, and the susceptibility of the economy to another downturn will increase. This means that we should remain alert during the year to potential problems of imbalance and strain which may develop in 1965. But this does not mean that we should allow fears of potential inflation or minor increases in our biased, imperfect price indexes to precipitate silly or unfortunate policy actions. We can do without those sharp deflationary shifts in monetary policy that have sometimes caused reversals in the past. And we can well do without that carping, ineffectual exhortation at business and labor which again appears in this report and which has been used to delude the public and policymakers on previous occasions.

Monetary and fiscal policies: The administration is proposing a combination of fiscal and monetary measures which is being hailed as a great experiment: a tax cut when the Federal budget is already in deficit, coupled with some promised restraint in Federal expenditures and an expansive, or at least cooperative, monetary policy. Considering the present economic circumstances, this is an appropriate package. Despite the expansion since 1961, there remains considerable slack in the economy. The unemployment rate is still 5.5 percent of the labor force, and the economy will be able to respond rather easily to a substantial boost in aggregate demand—and without generating marked inflationary pressures.

I am greatly cheered to see the rather forceful and explicit recognition given in the report to the importance of monetary policy. Much prior discussion of the tax bill has taken place in a monetary and intellectual vacuum. Now we find President Johnson saying, "It would be self-defeating to cancel the stimulus of tax reduction by tightening money." I applaud. Up until now, the administration has promoted the view that tax policy could be used as a complete substitute for monetary policy—that for balance-of-payments reasons we could follow a deflationary monetary policy and offset that repressive force by tax reductions. I have argued vigorously, on the contrary, that tax and monetary policies can be substituted only within narrow limits—that for sustained and sustainable economic expansion, reasonable monetary expansion is a necessary condition. In short, monetary policy, within the ranges of expansion desired, must be complementary if the hoped for stimulus from a tax cut is to be fully effective. There are other passages in the report, I confess, that make me wonder how strongly the President and the Council hold to their new-found monetary wisdom. Pages 39 and 40 of the report place far too much solitary emphasis on the efficacy of fiscal policy alone as a regulator of total demand. Neither practical experience, nor empirical evidence, nor economic analysis supports such exaggerated claims. Yet withal, we should be grateful for small advances toward economic understanding. Perhaps we may avoid repeating the monetary mistakes of 1959, 1962, and 1931.

The key proposal in the monetary fiscal package is the tax reduction bill. Without question, tax reduction will serve as a shortrun economic stimulant. The amount of stimulus and the size of the full impact will depend upon timing, upon Federal expenditures, the supply of money, and private reaction to these and a host of other economic variables. Precise multiplier calculations should not be mistaken for precise predictions. What is important is that the tax bill will speed the climb of the economy, toward some reasonably high, or at least higher, level of employment. For this reason it deserves the prompt support of the Joint Economic Committee.

Because I support the tax bill, it should not be inferred that I agree with all the reasons which have been advanced on its behalf, nor do I believe its passage will produce, miraculously, the great flow of miscellaneous benefits urged in its favor. There has been an inordinate amount of puffery in the political advertisements for the tax bill. The Federal Trade Commission would crack down sharply on private advertisers who engaged in such false and fraudulent claims. The tax bill will not perceptibly affect our longrun growth rate; it will not cure our balance-of-payments deficit or juvenile delinquency; it will not eliminate future recessions; and it will not convince other nations of the advantages of freedom—to mention only a few of the benefits claimed for this tax elixir. The Joint Economic Committee might perform a public service by acting as a sort of political FTC; it could issue some cease-and-desist orders in its reports to the Congress. I fear, however, its sanctions are weak.

Chairman Douglas. I agree.

Mr. Fackler. As in the past, the Council of Economic Advisers advances the doctrine of "fiscal stagnation" as the key argument before the tax bill. According to this view, the present tax structure is highly repressive because it generates far too much tax revenue; that is, withdraws too much income from the spending stream, during an upswing of the economy, and it thereby damps down the recovery before adequate levels of employment are reached. Should the economy, peradventure, struggle to full employment, according to the argument, the budget surplus would become embarrassingly large and burdensome. The sluggish performance of the economy since 1957 is cited as symptomatic of this diagnosis.

Since drag of the tax system has to be analyzed in the context of other relevant economic variables—the money supply and Government expenditures, to mention only two—and since expenditures show a seemingly irrepressible tendency to rise to match income, the overall and overriding significance of the tax brake is not immediately obvious. Moreover, one cannot argue, correctly, on analytical grounds that deficits need not be inflationary, and at the same time argue, incorrectly, that surpluses at full employment are inherently deflationary, though they may be depending upon economic conditions and upon governmental financial and monetary operations.

As for the evidence since 1957, it does not support the fiscal stagnation thesis unambiguously. If the Council's argument is wholly correct, why did the economy expand more vigorously in 1963 than the Council expected? In their outlook for 1963, the Council forecast a GNP of $578 billion, taking into account the proposed tax reduction. In 1963, GNP moved up to a level, for the year, of $585 billion without the tax cut.

If we really want to explain the sluggishness of the economy since 1957, I suspect we shall have to look beyond fiscal repression, though it may have been a factor. In my own view, our concern with the balance-of-payments situation and our frightened monetary response to it in 1959 and again in 1962 were more significant, if not the critical, factors. Monetary deflation is not a formula for rising employment. I also submit that the expansive behavior of the Federal Reserve beginning in September 1962 may explain, at least partially, why the Council was surprised by the new highs reached in 1963. (I shall come back to problems of internal-external balance subsequently.) Suffice it to say here that there are a number of good reasons for supporting the tax bill, just as there are explanations other than the tax burden to account for rather feeble recoveries since the 1957–58 recession.

There is, however, a particle of truth in the Council's position, though it has been vastly exaggerated, and I should not want it overlooked. In a growing, dynamic economy in which incomes are rising, in which shifts in demand and the composition of output are taking place, in which expenditures are rising at all levels of government, we face the perennial and difficult problem of revising the tax structure to produce the necessary and desired amount of tax revenue over time. In other words, periodically we should reset and recalibrate our tax gages. The problem of finding and setting norms is a complicated one, as I pointed out in a paper for this committee in 1957—"Compendium on Federal Expenditure Policy of Growth and Stability." How to set the "tax dials" is an especially awkward problem for those who are fondly attached to the stabilizing budget concept—a budget which is balanced at full employment but which yields automatic deficits in recession and surpluses in periods of inflationary excess. Since the economy is growing and expenditures are changing, and State and local finance is operative, the Federal tax take cannot be adjusted with precision, and the calibration soon gets out of whack. Also, experimentation is not politically feasible. Consequently, solutions are bound to be rough and ready at best. The present tax bill represents such a rough and ready, and long overdue, tax adjustment, and it merits support on this ground.

A final word about the tax bill and its relationship to economic growth. Professional opinion has been strongly critical of the glowing growth claims. Whatever its other merits, the tax bill is not a growth measure. Before or after the economy has adjusted to it at a new level of output and employment, it will have only small effects on the distribution of income—see Norman B. Ture, "Distribution of Tax Deductions," paper for the National Tax Association, November 12, 1963—and no positive effect upon the proportion of output flowing annually into investment. If anything, it tends to favor consumption more than it does investment. To encourage consumption relatively more than investment is not a device for raising the annual rate of investment any more than a price increase will encourage sales and a price decrease will reduce sales.

In the short run, the tax cut will stimulate increases in both consumption and investment, but it will not tilt the annual rate of growth upward over the long pull. Once a full employment level of GNP is reached, there is no reason to believe the rate of advance will be significantly higher thereafter.

I shall dismiss the budget briefly because I have not had time to go into its details. Expenditure restraint is to be commended, as a political concession to insure the passage of the tax bill and as a measure of economic caution while we observe its effects. Federal purchases of goods and services will rise moderately in predictable fashion, even though the administrative budget proposes no expenditure increases. There does not appear, on the surface, to be more than the usual bookkeeping sleight-of-hand in the budget. The acid test will come in the future—in new spending authority and supplemental appropriations. Unless ways are found to retrench on wastes in present operations, notably in defense expenditure of a "pork barrel" type, the various new programs proposed will surely cause a signifi-can buildup of future expenditures. The timing should be watched carefully.

The Council's depiction of the unemployment situation seems to me to be essentially correct. Over the past several years we have witnessed a running debate on the causes of our chronically high rate of unemployment. Some people have argued that the high rate has been caused by structural changes in the economy and the labor force—changing technology, composition of output, imports, and composition of the labor force. Others have argued that the higher persistent rates, the difference say between a 4 and 5.5 percent or higher level, have been caused by sluggish economic recoveries and deficient aggregate demand. The Council has taken the latter position. So do I.

As the Council and others have pointed out, the higher rates, higher, say, than those of 1957, are reflected throughout most components of the labor force and are highly diffused geographically. The incidence of unemployment, to be sure, falls heavily upon particular groups—the unskilled, illiterates, nonwhites, teenagers, displaced older workers, and others—but this would be true even if the overall rate were reduced, as it could be, by adequate aggregate demand.

Though the evidence points to deficient total demand as the chief cause of the excessively high unemployment rates from 1957 to date, other factors may become more important in the future. I fear we may be moving into a period when the higher rates will be the norm rather than a deviation from the norm. The influx of 18-year-olds into the labor force is gathering strength. In 1965, the rate of labor force entry of 18-year-olds will jump sharply up and then rise at a faster rate through 1970. At the same time there will be little or no increase among other experienced male workers in certain age groups. The rates of unemployment among teenagers are always much higher than for other groups, and they may be rising more than for other groups. Rates are always much lower, on the other hand, for older experienced workers. Even if the lower 1957 rates of unemployment are achieved for each and every age and sex group in the labor force, the overall rate will rise significantly in 1965 and rise even higher by 1970.

I call your attention to the next page, page 11.

For convenience I might mention what the table contains. Column 1 is simply the unemployment rates that prevailed in 1957, the last year we had what we would call reasonably full employment; for that year, the overall rate was 4.3 percent.

Column 2 is the projected labor force for 1965.

Column 3 should say "projected 1965 unemployment." The 1965 is left out and that is why I call it to your attention. Projected 1965 unemployment at 1957 rates.

And 4 is the projected labor force for 1970. And column 5 is the projected 1970 unemployment at 1957 rates.

(The table referred to is as follows:)

TABLE I.—*Projected unemployment rates by age and sex*

	Unemployment rate, annual average, 1957 (1)	Projected labor force, 1965 (2)	Projected 1965 unemployment at 1957 rates (3)	Projected labor force, 1970 (4)	Projected 1970 unemployment at 1957 rates (5)
	Percent	*Thousands*	*Thousands*	*Thousands*	*Thousands*
Males:					
14 to 17	10.6	2,384	253	2,576	273
18 to 19	12.3	2,373	292	2,544	319
20 to 24	7.8	5,918	462	7,424	579
25 to 44	3.1	22,276	691	23,003	713
45 to 64	3.4	17,238	586	18,414	579
65 and over	3.4	2,266	77	2,284	78
Total	4.1	52,455	[1] 2,361	56,295	[2] 2,588
Females:					
14 to 17	11.0	1,417	156	1,558	171
18 to 19	9.4	1,609	151	1,770	166
20 to 24	6.0	3,130	188	3,939	236
25 to 44	4.5	9,831	442	10,232	460
54 to 64	3.1	9,424	292	10,714	332
65 and over	3.4	1,070	36	1,195	41
Total	4.7	26,483	[3] 1,265	29,408	[3] 1,406
Both sexes, total	4.3	78,938	[3] 3,626	85,703	[4] 3,994
Additional projected unemployment caused by change in age-sex composition of work force			232		309

[1] 4.5 percent.
[2] 4.6 percent.
[3] 4.8 percent.
[4] 4.7 percent.

Source: Manpower Report of the President together with a Report on Manpower Requirements, Resources, Utilization, and Training by the U.S. Department of Labor, transmitted to the Congress, March 1963, table No. 25, p. 88.

Mr. FACKLER. You will note that what is a 4-percent rate, 4.1-percent rate of unemployment in 1957 for males, grows to 4.5 percent in 1965 and 4.6 percent in 1970. The rates for females stay relatively constant. For the whole labor force, at 1957 rate of 4.3 percent it grows to 4.6 percent in 1965 and 4.7 percent in 1970.

Table 1 illustrates the possible effects of changes in only two dimensions of the labor force, age and sex. Realistic estimates of projected unemployment would have to consider other attributes as well. But the data do point to future difficulties.

What I am saying is simply this: while up until now the cause of high unemployment rates has been insufficient demand, we will be moving shortly into the second half of the decade when it may be increasingly difficult to get the unemployment rate down to former "full employment" levels by demand measures. For this reason, labor market policies designed to increase labor mobility, reduce discrimination, to open up foreclosed opportunities, to train and retrain the unskilled, and to speed the process of reabsorption after displacement will become more needed and more important.

Such labor market policies complement monetary and fiscal policies directed at achieving high employment. Adequate levels of total demand make labor absorption and reabsorption easier and faster. Employers resort more freely to hiring younger inexperienced workers when there are few experienced workers seeking work. Displaced and retrained workers find more employment opportunities open to them. Labor market policies, on the other hand, will push the inflationary threshold of the economy upward; in other words, make it possible to achieve higher levels of employment by total demand measures before bottlenecks and wage-price pressures make themselves felt. It goes without saying that public programs to expand job horizons should follow labor force trends, not run counter to them, and that they should supplement rather than substitute for the massive private efforts which are carried on almost unnoticed.

Before pushing on, I feel compelled to speak out upon two recommendations in the Economic Report. First, the exhortations about individual wage-price policies, including refurbished "guidelines" for wage determination, I think, are ill advised. Should inflationary pressures build up, they cannot be handled in this manner. Individually, neither corporations nor unions can know when particular price or wage decisions are consistent with overall price level stability—nor can the Council of Economic Advisers. Furthermore, they should not be asked to manage their affairs incompetently. Productivity guidelines simply provide no guidance in particular cases. The Council qualifies them to the point where they have no operational meaning—as indeed they must to avoid guffaws from their professional peers.

It is not enough to say, in essence, as the Council does, "Of course, the guidelines cannot be applied"; by promulgating them, the Council reinforces two myths in the public mind: (*a*) that particular price increases, rather than increases in the average price level, constitute inflation, and (*b*) that everyone is entitled to some average productivity increase in wages annually. In the process, they divert attention from the causes and appropriate cures for inflation, and they probably stimulate higher wage demands than otherwise might be made. I should have thought that the Council would have been happy to quietly drop this piece of hocus-pocus, but perhaps they reaffirmed it only at the request of the President, as he implies on page 11 of the report.

The unveiled threats of the President on page 11 "to draw public attention to major actions by either business or labor that flout the public interest in noninflationary price and wage standards" and to take punitive action is far from reassuring. We have had quite enough of such irresponsible banging on the economic machinery. If the President is really worried about wages and prices in the automobile industry, he should advocate the elimination or reduction of tariffs on auto imports. Such action would be consistent with our principles of more liberal trade and provide a very effective market discipline compatible with our free institutions.

The second recommendation I wish to remark upon is the proposal to increase the penalty rate for overtime through an industry committee system. The proposal is at present ill-defined, but even the proposal, let alone its implementation, is sure to increase employment—of lawyers, economists, statisticians, and survey workers. They may not raise the costs of production "unduly" but certainly their activities will put further strain on just those types of manpower where demand is already high, supply is rising only gradually, and prices are rising.

It is pertinent to ask, "Why did the President not propose an across-the-board increase in penalty rates?" The answer must be a recognition that there are many areas where the increase would surely increase costs unduly and not infrequently lead to less rather than more employment. The task of disentangling the impact of such a proposal in a given industry is complex. It will take time, effort, skilled manpower, and an understanding of the industry.

Presumably the increase is not thought of as permanent but rather as a special tool of raising employment in a time of too high unemployment. Clearly it would not be good policy in boom times since it would curtail output, raise costs, and contribute to the inflationary potential of a high-employment economy. Just as clearly, it would not be the kind of measure which lends itself to quick adjustment in a countercyclical fashion.

I do not mean, by emphasizing these practical objections, to imply conceptual agreement with what can be seen of the proposal. But clear economic analysis best waits upon a clear statement of what the President has in mind. Pending clarification, it is sufficient to remark that it seems curiously inconsistent to disavow one spread-the-work scheme in one sentence, and to embrace another such scheme in the next.

The balance-of-payments disequilibrium: The chronic deficit in our international balance of payments is one of our most vexing domestic problems. It is a domestic problem because it severely constrains our internal policies for stability and growth. It is also a domestic problem because it has precipitated a continual series of "corrective steps" over the past which do not correct, but which do create economic inefficiencies and waste.

The cause of the problem is simple enough to understand. The dollar is overvalued in terms of other currencies. After 6 or 7 years of substantial cumulating deficits and gold losses and even longer periods of small annual deficits, there can be no doubt as to the nature of the illness. At present fixed exchange rates we cannot export enough to cover both our imports and our large outflows of private and public capital including military assistance and foreign aid. Consequently, we have all the classic symptoms of overvaluation: recurrent deflationary monetary policies, high unemployment rates, uncompetitive export prices, complaints about low foreign wages (though these are always with us), and a high relative attractiveness of foreign investment as compared with domestic investment. For a good exposition of the problem see Harry G. Johnson, "An Overview of Price Levels, Employment, and the Balance of Payments," Journal of Business (July 1963, XXXVI: 279–289).

There are really very few avenues open to a country in our predicament. We could devalue the dollar (that is, raise the dollar price of gold). This would lower the prices of our exports and raise prices of imports. It would also upset international economic and political relations. To even suggest devaluation in Washington is to stand convicted of heresy.

The other possible cures for an external deficit are also politically unpalatable. One line of action would be domestic deflation to reduce our internal price level and thereby lower our prices in world markets. This is a clumsy, cruel device because it would take a prolonged wringing-out period of severe unemployment to be effective. Another possible cure is to place arbitrary restrictions on trade, specifically on imports, on foreign investment, and on foreign exchange transactions. These devices we publicly disavow as being against our liberal trade principles and a repudiation of the goals of our foreign aid program. As a last resort, we could subsidize our exports on a massive scale; to do this would violate not only liberal trade principles and our treaty obligations, but also what little virtue the American taxpayer has left.

In short, there simply is no way out of our balance-of-payments predicament. Having blocked off all direct policy avenues to international adjustment, we have turned to the indirect approach of exhortation, hope, and the curative powers of time. We hope Western Europe will be plagued by inflation and, that as a result, our export position will improve and the growth of imports will be retarded. In other words, we hope that eventually the current rate of dollar exchange will finally come to express a more realistic relationship to the facts of international life than it now does—in other words, we hope the problem will go away.

Given the sticky political difficulties of direct action, a passive strategy may be the only realistic alternative. Reasonable men will differ. Meanwhile, we are doing a host of things we say we should not do. We have used moderate doses of deflation, as in 1959 and 1962. We have restricted imports through reduction of tourist allowances and by various stern restrictions on military procurement and Goverment contracts. We have carried coals to Newcastle and beer to Munich. We have violated multilateral trade principles by tying aid and loans and by enforcing various rigid bilaterial arrangements. We have subsidized exports through Public Law 480. And we have restricted the free flow of foreign investment by suasion of various forms and hampered normal commerical operations by threats of political pressure. The administration, with sanction of the Council of Economic Advisers, even advocates a partial devaluation in the form of the interest equalization tax. This is simply a euphemism for multiple exchange rates—a Schachtian device we have condemned so vigorously when used by others. Under the proposed tax, the dollar would be worth less when used to import securities than when used to import bananas.

The most charitable thing one can say of the Council's position is that it is disingenuous. The glowing list of "steps" to correct basic causes will do nothing of the sort. The crux of the problem is that there is no automatic, effective equilibrating mechanism to bring payments into balance as internal and external conditions change over time as they always will. The Council asks the right question at one point, but they adroitly evade answering it in the following manner:

> In a world of relatively free capital movements, flexible changes in the mix of monetary and fiscal policies can serve to reconcile internal and external policy goals.

This is a dubious prescription for even temporary short-run shifts in our international payments position for it assumes that policies to keep short-term interest rates high without raising long-term rates will usually be successful. There is as much evidence against this proposition as there is for it. As a possible cure for a fundamental disequilibrium situation, that is, a marked overvaluation or undervaluation, the Council's prescription is palpably absurd. This answer given in an economic examination in any respectable school would receive a grade of F forthwith. The only other alternative the Council proposes is exhortation to surplus countries to accelerate movements to reduce their trade barriers. A fine thing to do, but hardly a reliable adjustment mechanism.

Ultimately, the United States and other major trading nations will be forced into devising a better international monetary system. We have allowed the same kind of rigidities to develop as those which grew up during the interwar years. It is simply impossible to promote freer multilateral trade within such a framework, even if the system could be made viable. On page 135 of the report, the Council explains what is sought ideally in an international monetary system. I suggest that a "floating dollar" (a freely fluctuating rate of exchange) may be the only realistic step toward that ideal system. There is a growing body of professional opinion to support this view.

CONCLUSION

I shall end my travelog here, and abruptly. My time has expired. On the path just traversed I have had to skip many interesting sights and avoid some popular side streets. I have tried to stick to important matters of direct pertinence to the goals of the Employment Act, and to put the policy issues in perspective. If this statement has helped clarify the policy issues and alternatives, and in doing so helps the committee apply "the rule of relevance," it will have served its purpose.

Thank you.

Chairman DOUGLAS. I want to thank both of you gentlemen for two extremely able and well-reasoned papers, the literary style of which has been much above average and which have been frequently spiced with wit and sardonic irony.

I would like to ask Mr. Nathan this question. The original theory of unbalanced budgets as an economic policy was developed to offset depressions, and to create additional monetary purchasing power which would build up total demand and hence cause a reduction in unemployment, I suspect that the original proposal for a tax cut was probably advanced by the Council in 1962 and carried out by the President in 1963 on the basis that they expected a recession to break out very shortly.

We have gone through 1963 without a recession in the conventional use of the term. Economic conditions are favorable at this time. The private forecasts not merely the governmental forecasts for 1964 are favorable. And the question is being raised by some, including some of my colleagues, as to whether this tax cut is not now coming at the wrong time, whether it will not overheat the economy in 1964 and then leave us in trouble in 1965.

I would appreciate it, Mr. Nathan, if you would address yourself to that, and perhaps Mr. Fackler would like to add some comments.

Mr. NATHAN. I would like very much to comment, Senator Douglas.

First, it is quite true that the earliest concepts of a compensatory fiscal policy did stem from the concern about depressions and getting out of depressed economic circumstances.

However, I do believe that in recent years, talk about stimulating fiscal policies or fiscal stimulus or the expansionary policies has been associated with growth as well as with cycles and full employment.

The confusion sometimes between basic growth and full recovery is complicated.

I believe that the tax reduction proposed in the President's report in January 1963, was more associated with concern about lagging growth and not achieving full employment than to offsetting a recession. If it had been a tax cut in relation to a recession, a logical proposal would have been to suggest a tax reduction to be triggered in someway with a declining economic activity.

My own feeling is that that proposal at that time was an appropriate one and I feel that it is entirely appropriate today.

Mr. Chairman, it seems to me that the forecasts for 1964 are largely optimistic because of the expectation of the tax reduction. I was one of those who submitted a forecast to two different columns, one in the newspapers, one in a magazine, and I read the results of the submissions by economists and it struck me that most of the people who forecast increases indicated that they did so in some degree because they expected the tax reduction and the positive expansionist response associated with that tax reduction. So that one cannot disassociate the favorable prospects for 1964 without the tax cut.

Now, secondly, some contend this is the wrong time for a tax cut and that it will overheat the economy? On this point, Mr. Chairman, I violently disagree. I think that even with a tax cut, no one whose forecast I have seen expects full employment in 1964—full employment in the sense of 4 percent or less of the labor force unemployed.

The President's Council of Economic Advisers, which can hardly be accused of being less than optimistic in a political year, forecasts only reducing unemployment to 5 percent by the end of 1964. My own feeling is that they are not likely to be proven far wrong.

Let us assume they have understated the prospect and let us assume unemployment falls to 4.5. To arrive at a 4.5-percent level of unemployment in December of 1964, will necessitate not a $30 billion increase in real GNP as has been forecast but something nearer $40 billion increase in real GNP. I venture to say, Mr. Chairman, that this would be a phenomenal result and would depend on a fantastic response of private spending to this tax cut.

My own feeling is that if people truly think that the tax cut is likely to bring inflation in 1964 and still leave us with 4.5 or 5 percent unemployment, then I think something pretty seriously is wrong in our society, that we would then have to take a very thorough look at our whole problem of inflation and stability and growth and full employment. I feel myself that we frankly need a little more stimulus in 1964 rather than less, and I think it would be a great tragedy if the tax cut were delayed or put off.

Chairman DOUGLAS. Mr. Fackler?

Mr. FACKLER. I agree with part of Mr. Nathan's analysis. I don't think that the tax cut will overheat the economy.

Now, I think what the people are worrying about is not the fact that we may not get down to much under 5 percent unemployment but whether or not there will be major discontinuities. We don't want an economy that surges and creates problems that will make the rate of advance unsustainable.

I think that is the issue involved, and, of course, there is that danger. But when you look at the $11 billion tax cut in a $600 billion GNP, the order of magnitude we are talking about is small; it doesn't seem to me that there is a very real danger of overheating. We do have an underemployed economy. I think it can take a substantial boost in aggregate demand without creating marked inflationary pressures, and bottlenecks, and so forth.

Part of the impact of the tax cut will actually build up gradually overtime, so I don't see any great discontinuities coming which will shove the economy ahead too fast and then cause it to collapse because of bottlenecks and surges. The problem is real, and the question is an important and valid one. But I think that I am willing to take a chance on it.

Chairman DOUGLAS. The second question I would like to address to both of you, granted that the tax cut and the resulting deficit financed by credit expansion will stimulate total demand, which is the more effective method of stimulating total demand, the tax cut or an increase in expenditures? Is it not true that an increase in expenditures has a higher multiplier by one unit than a tax cut? In other words, what proportion of the stimulus should come from the private sector through a tax cut and what proportion to an increase in governmental expenditures directed to the social needs which you mentioned?

You answer first and then Mr. Fackler.

Mr. NATHAN. I think that the issue of the tax cut versus more Federal expenditures or more Federal purchases of goods and services poses three elements.

One you have raised specifically, Senator Douglas, and that is which will have the greater stimulus. I think most of the analysts, at least those I know and can trust, feel that an immediate response to the multiplier will be greater with a rise in Federal expenditures than with a reduction in taxation. Both are stimulating.

Chairman DOUGLAS. Of course, the initial expenditure will go directly to people instead of its being a derived expenditure going to others.

Mr. NATHAN. Your initial response will be 100 percent through increased expenditures. The whole amount will be spent, whereas the derived increased income to the individual may not be all spent in the first stages as some will be saved.

Chairman DOUGLAS. There is an added initial impact.

Mr. NATHAN. There is an added initial impact by that margin, but in any case, both are stimulating, a tax cut or increased expenditures.

But there are two other points I would pose, Mr. Chairman. One has to do with the economic consequences other than through the multiplier effect, and that is the psychological response in terms of investment and consumption inducements. There are those who feel that if you will cut taxes, especially on profits or the higher incomes, you therefore offer a reward of a higher return for a given risk and you would then stimulate higher investment and higher economic activity.

Others argue that if you cut taxes on the lower income levels you will stimulate consumption, and that in turn will stimulate investment and total activity.

But there is a third point on which I suspect we probably will find great differences. That has to do with the political issue, the social issue, the human issue. I myself feel that in 1964 we are neglecting many, many public services through our inadequate classrooms, our needs for greater funds for more and better paid teachers, our need certainly for greater resources for higher education, our urban redevelopment requirements, and the like. In my judgment to put the whole emphasis on a tax cut to increase private consumption rather than to meet some of our crying public needs, is a serious mistake in terms of the use of the resources of our country. This is a political problem just as much if not more than it is an economic problem.

I personally would have much preferred some on the substantial part of the stimulus coming through increased expenditures rather than all through the tax reduction.

Chairman DOUGLAS. Mr. Fackler?

Mr. FACKLER. Well, in response to your original question, I think, it was: "Would the stimulus be greater from a given increase in Government expenditures than from a tax cut?" If you work with a very simple kind of model of the economy, it would be true the expenditure multiplier is larger.

In other words, if you isolate only taxes, expenditures, and consumption, then you have a higher multiplier from expenditures.

Chairman DOUGLAS. One unit higher.

Mr. FACKLER. In this model because there is the initial impact. Say the Government spends $5 billion more. There is $5 billion of income generated plus the subsequent multiplier effects, whereas, with the tax cut you don't have that initial impact, and so for each dollar of tax reduction or tax savings, a part will be saved and a part will be spent. So that the tax multiplier will be smaller.

However, if you want to complicate your economic model and make it more realistic, you have to take into account a lot of other things such as the induced impact of the two policies on private investment through acceleration and through changes in the tax rates. Also in computing any of these multipliers, you have got to try to figure out what the Federal Reserve Board is going to do. If they sit on the money supply and you have to finance deficits entirely in the open market, to the extent you take away private savings, transfer private savings into public use, you pinch down on investment and create some negative offsets to investment and multiplier computations. In a real sense there are many more variables than you can handle easily in an economic model.

Chairman DOUGLAS. Congressman Curtis?

Representative CURTIS. I want to join Senator Douglas in his overall remarks about both the papers. Both are exceedingly stimulating and certainly direct our attention to the issues involved.

Mr. Fackler effectively attacked every sacred cow I can think of. I was enjoying it when he was attacking those of the other side, but I was wincing when he was going after some of my own.

I would like to go back to Senator Douglas' original question to both of you, which I think is the key. He directed your attention on the question of overheating the economy to only one of the fiscal policies proposed by the President. I would call your attention to the President's statement in the Economic Report on page 7 which says:

"Greatest fiscal stimulus," and then he goes on:

> This will provide a net fiscal stimulus that will be three times as great in 1964 as in any of the years 1961, 1962, and 1963.

On the next page:

> Will in fact provide a greater net stimulus to the economy in 1964 than in any other peacetime year in history.

So I think we have to look at the fact that it isn't just the tax cut. Mr. Nathan, I think you will agree, and you have said, this is not in decreased Federal purchases of goods and services. There have been a lot of semantics used to divert the public's attention. This budget is not a reduced budget. This is an increased budget and the President says in his report, when he is talking about decreases, it is a decrease in the rate of increase. I admire your forthrightness in saying, as I think many in the administration said who apparently were overruled, that expenditures should be greater, but the expenditures are increased.

We have a continuing penchant toward easy money. We have this proposal of immediately lowering of the withholding to 14 percent. We have a continued apparent economic expansion in the private sector. So in light of this, let's direct our attention to this expenditure increase. You would have it greater, Mr. Nathan, but as I understand both of your arguments—and this is where I had one of my sacred cows attacked—you feel that the economy is underutilized.

Mr. Fackler, I thought chapter 3 of the Economic Report on automation and the problems of employment was excellent, but as I said in a letter I just wrote, after having set forth the problems that exist in the employment and the unemployment sectors, they disregard all their evidence and come to the same conclusion that you do. You still think it is inadequate aggregate demand. This just doesn't jibe, as I see it, with the facts that we see. As you go on to point out in the ensuing years of the decade, we are going to have to pay attention to the structural and frictional problems in the field of employment.

I think the very analysis that is done in chapter 3 indicates that that is the problem right now. I made these remarks for your response, and then Mr. Nathan's.

Mr. FACKLER. Well, on the question of the inadequate demand, I am talking about a situation that has generally prevailed since 1957. That was a peak year. We then had a little recession which turned around early in 1958. There followed a very short and what was called an abortive recovery. About that time we woke up to the fact that we had a balance-of-payments problem. We got all excited about it. We had a big swing from ease to tightness in the budget, and the Federal Reserve people tightened the monetary screws.

If you look at the record for 1959, what did Fed do? They deflated. Here we were running around talking about inflation and the money supply was going down and down—until the spring of 1960. In other words, the economy had no push. It was on a very short rein.

The economy recovered, and the Fed did the same thing again in 1962. From January until September we had a falling stock of money. We were told that we had to have tight money for balance-of-payments reasons, but the economy didn't go anywhere. Again it was on a very tight monetary rein.

Now, last year the Federal Reserve said they were also using tight money for balance-of-payments reasons, but they expanded every month. They behaved beautifully, and as a result we had a year in 1963, that exceeded our expectations.

But the point is we have been laboring under a rate of unemployment that has been high for a long time—a rate that would not have had to have been so high.

Now, as we are moving out of this period and into the second half of the decade, I think the problem of getting down to 4 percent unemployment is going to be ever so much more difficult. I tried to illustrate the shift by the table I put in in my statement on the changing composition of the labor force.

Representative CURTIS. My observations are that the keys in 1957 relatively were the same as they are now—very rapid economic growth, not measured in GNP and in the unemployment figures, which seem to be the basis for both of your conclusions, but measured in what I think are more realtistic terms of innovation; the new goods and services on the marketplace, the shift in labor force to the demands for higher skills, and the bottlenecks that exist all throughout the labor market where we lack the skilled people that we need.

Take the health field, for example. We badly need doctors, nurses, and technicians of all sorts. NIH is held back not because of money but because of skilled manpower. The very point Mr. Nathan was making in response to Senator Douglas' question—I don't want to misquote you—was that even with all of this stimulus, we are not going to hit at this high unemployment. I happen to agree because, first of all, you are not really talking about aggregate demand. You are talking about aggregate purchasing power as a synonym for demand, but it is not synonymous. That is one of the flaws in the argument. Increased purchasing power does not necessarily increase the demand. It can, but I think that you would question your own analysis of the unemployed when you say that even if you increase GNP with this stimulus, the greatest in peacetime history, you aren't going to hit at this unemployment figure.

Doesn't that suggest you are on the wrong track as to what is the problem?

Mr. NATHAN. Well, it depends, of course, on how one interprets this. I think Congressman Curtis, that there are structural problems. There is no doubt about it. We, for instance, have been working in the field in the Upper Peninsula of Michigan. The Upper Peninsula of Michigan is a distressed area. It is a problem area. You have the cutover timber problem there. You have had the economic conditions affecting the use of the iron ore there, changes due to technological circumstances. And this is a problem which is not going to be solved overnight. You have an exodus of young people. The population is less than it was 50 years ago, and the most dynamic and energetic tended to depart, and there is a whole series of problems associated with this deterioration.

You have similar problems in northern Minnesota, and in northern Wisconsin, in many parts of the country, and in the Appalachian Area.

There is also a question of adjustment through education, no doubt about this. But I do feel, Congressman Curtis, as I travel around the country and meet with business groups and work with other groups, that the inhibiting or limiting factors in our economic expansion are not so much this factor of the inability to mobilize labor as it is an inadequate market for the goods and services we could produce.

I personally am convinced that if we had enough rise in actual expenditures on goods and services by business, by labor and by Government, we would be able to get ourselves down below 4-percent unemployment, without really bumping too hard against this structural problem. This is my conviction and for that reason I say that if we are not going to fall below 5-percent unemployment by the end of 1964—and I hope this will prove wrong—we will be failing to do what needs to be done in stimulating adequate demand.

Representative CURTIS. My time is up. I understand the statement of your case and in order to move the dialogue forward I would say I hope I don't disregard the value of aggregate demand. Certainly it is easier to hit at structural and frictional problems if you have high aggregate demand.

Mr. NATHAN. More manageable.

Representative CURTIS. Yes. Our disagreement is one of emphasis. I do not think that you are ignoring the structural side. It is a question, though, of how serious it is in this kind of balance. It seems to me that the evidence, as we break into the component parts, is overwhelming.

Let's look at agriculture. I will conclude and then come back to give you a response. In the past decade the decline in employment has been 42 percent. Services have increased almost by about the same amount, over 40 percent. Here is a tremendous shift which indicates clearly to me that it is a structural aspect. At the same time, in agriculture we are producing until it is coming out of our ears. Aggregate increases of purchasing power won't do anything sizable toward moving these agricultural surpluses.

So, just taking the case study of agriculture, I think it clearly shows that the—the emphasis is structural and frictional, while the aggregate demand is really a minor thing.

Mr. NATHAN. I think it is a question of relative importance, too, Congressman Curtis. I have a feeling myself that the policies and measures for structural adjustments need to be given more attention. That is, the reeducation, relocation, transfer problems, and the like. But I think that with an enlarged aggregate demand, many of these problems will be much more manageable and we will find that there is greater mobility in the economy than we think does exist.

Representative CURTIS. My time is up.

Chairman DOUGLAS. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman. I, too, want to express my gratitude to both of you distinguished economists for a very sprightly contribution to our studies here. Since I agree with almost everything you say, Mr. Nathan, I will direct most of my questions to Mr. Fackler, 99 percent of whose material I agree with, too.

You, Mr. Fackler, say that you applaud President Johnson's strictures in the Economic Report against tightening money, and I certainly applaud your applause and want to give you some well-deserved credit which you modestly don't give yourself for educating the American public on this. I have been reading the materials in which you point out the deadening effect on the economy of over-tight monetary policy. And I think that the better ventilated view on this subject in this year's Economic Report is largely due to the observations of people like yourself.

I wish I could say that the man who makes money policy, Chairman Martin of the Federal Reserve Board, shared our views on this. Last week, when he appeared before the House Committee on Banking and Currency, I asked him whether he intended to tighten money to spite the tax cut. He indicated that he well might, even that it was likely. Then, when I asked him his reasons for doing this at a time when we have 5½ percent unemployed and considerable underuse of our physical resources, about the only specific reason he could come up with, and I don't think I do him an injustice when I paraphrase it, was that he is worried, as we all are, about our balance of payments, and points out, as you and I would, that a grand method of rectifying our payments imbalance is by increasing our exports. But then he adds that perhaps it will be necessary to tighten money in order that our export prices may be lowered or kept from increasing.

I would like your views on whether you think that is a sensible national policy for us to pursue.

Mr. FACKLER. Well, the problem, Congressman Reuss, with the Federal Reserve policy (and I think it is a dark cloud on the horizon, you know; maybe it isn't as big as a man's hand at the moment, but it is there) is the uncertainty as to what the Federal Reserve Board will do.

President Johnson may say we are not going to offset the stimulus of a tax cut with tight money. I hope that is an implied threat that he can make stick. But the problem with the Federal Reserve people in recent years (since we have had this balance-of-payments problem) has been a sort of mystique that they affect. They draw a cloak around themselves. They have the feel of the market. They even talk about the color and the tone, but they have no decision rules that anyone has been able to discern.

I followed some of the hearings and some of Mr. Martin's public statements. No one is able to find out what they are up to or why they are up to it. This is very disturbing. So I don't know what the Fed is going to do in 1964. It is one of those great uncertainties in the picture.

Now, we want the tax cut to be stimulative. We want the economy to move up without a great surge, to move up smartly and continuously through the year and on into 1965.

Now, if the Federal Reserve people all at once decide, for balance-of-payments reasons, that gold is more important than jobs, that they must tighten up again, they will have, not an immediate impact, but one that will certainly affect the economy 6 to 9 months thereafter. I hope that the Fed doesn't decide that any or all deficits have to be financed fully in the open market. I would like them to ignore the deficit. I just want them to expand moderately as the economy moves along and provide the transactions cash needed, and I hope they will do so. But that is a very unpredictable thing.

Representative REUSS. In your prepared statement you say:

> One line of action to cure an external deficit would be domestic deflation to reduce our internal price level and thereby lower our prices in world markets. This is a clumsy, cruel device because it would take a prolonged wringing-out period of severe unemployment to be effective.

Doesn't that factor speak volumes on the wisdom of the proposed course of action by the Federal Reserve?

Mr. FACKLER. That is right. If we really wanted to use deflation as the weapon and get our prices and costs down, it would take a catharsis because we would have to break down all wage contracts and leases and rentals and prices. In other words, to try to deflate the price level back to some previous level would be very difficult and painful. It is just out of the question.

Representative REUSS. So when Mr. Martin says he wants to help our export price situation by a tight money policy, what he is really saying, is he not, is that he proposes to create a situation in this country like that of a depression, when men are unemployed and factories sit idle? Finally, in desperation, businessmen cut their prices, foreign and domestic. This is the process whereby he would accomplish price reduction, is it not?

Mr. FACKLER. Or he might be thinking that there are substantial inflationary pressures likely to build up and, that he wants to hold down possible price increases, but it would be one of those two alternatives.

Representative REUSS. Turning to another subject, I was also interested in what you had to say about the format of the report. For some years now we have had the President speaking in magisterial tones in a short report, and the Council of Economic Advisers speaking much more discursively. You point out that this may kid the public a little, because the President is admittedly a politician. In its separate format, the Council of Economic Advisers tends to climb up in the ivory tower and make as if it were giving advice which takes no account of political realities. I think you have a good point there. However, I am at a loss as to the cure. If we meld the two reports and have a single report from the President and his Economic Advisers, we might miss out, mightn't we, on the very valuable detailed materials included by the Council? For instance, you have said, and I agree, that the Council's sections on foreign aid and international monetary system and the problems of poverty contain some invaluable material. I wouldn't want to lose it.

Can you suggest a compromise which might put the Council of Economic Advisers' advice in more honest vestments and at the same time retain the benefit of their intensely valuable monographs?

Mr. FACKLER. I don't think, Congressman Reuss, that it is really a matter of great consequence. I can't resist the opportunity to make my view of the report known when you give me a forum to let me do it. And there is some question of interpretation as to the intent of the employment act.

When Arthur Burns was Chairman of the Council, he did not have a separate report and yet we had these essays on the state of the economy, on the diffusion of well-being, and on various other topics. But it was called the President's Economic Report. There was a summary statement in the front, much the same as in this report, but the second part was not signed by the three Council members.

Now, I don't really mind if the Council members want to put their names on the line and say that the main body of the report is their professional document, separate from the President's. I think it is kind of silly, but I don't think that it is going to make a great deal of difference. The report should contain information on the economy. It also contains much more. For example, the foreign aid piece is misplaced here, as important as that topic is. How much aid, where, by what devices, and so on, should be debated and fully and thoroughly; but the issues have nothing to do with the goals of the employment act, which we are talking about here today—except indirectly as it affects the balance of payments. The Council does include material on foreign aid, appropriately, in the balance-of-payments chapter. Part of this is a matter of personal taste, I suppose.

Representative REUSS. You had kind words to say about the Council's supplementary section on the international monetary system. Well, if you are going to talk about the international monetary system, you have to talk, as they do, about the Triffin proposal. You couldn't really expect the President of the United States to forward a document to Congress containing his analysis of something as complex as the Triffin plan.

Mr. FACKLER. I really don't expect the President to send his own analysis anyway, but——

Representative REUSS. Therefore, to conclude, and my time is running out, would it be fair to say that your suggestion regarding the format of the Economic Report is that the substantive recommendations of the Council and of the President be made in a single document and that whatever supplementary monographs the Council cares to add, and many of them can be extremely useful, be submitted as the Council's work and so signed?

Mr. FACKLER. Appendixes. They could be included as appendixes. I think it is helpful to have a short summary statement in the front to highlight what is in the main body of the report. Busy people, you know, want to look and find out what policy recommendations are being made. It is very helpful to have a summary statement. That could be done whether or not one is signed as a separate report of the President and another longer one by the Council. The format could be made much the same.

Representative REUSS. And finally, since my time is up, would you agree with me that as Economic Reports go, since the first one in 1947, this one, the 1964 one, deserves quite high marks?

Mr. FACKLER. Yes. I think it is better than average. I think it really is. As a matter of fact, there are some good essays in here. For example, apart from a few dubious assertions, the piece on technological change is a nice perceptive, well-reasoned, graceful chapter. It could be lifted out as a sort of an independent essay on the nature of this problem. I found it very well done and very useful.

Representative REUSS. Thank you, Mr. Chairman.

Chairman DOUGLAS. Senator Proxmire?

Senator PROXMIRE. Mr. Nathan, you subscribe to the full employment surplus theory; that is, that we should have a surplus in the Federal budget only when we have 4 percent or less unemployment?

Mr. NATHAN. I don't know. That is a new concept to me, that we should have a surplus only when we have 4 percent or less unemployment?

Senator PROXMIRE. Yes. The theory being, of course, that a surplus is deflationary and that the——

Mr. NATHAN. A surplus is antiinflationary, contractionist. I would say if at less than 4 percent unemployment, Senator Proxmire, there is inflationary pressure, then I think whatever the budget is at that time should become constrictive, should become contractionist. It depends, for instance——

Senator PROXMIRE. Let me just revise this, then, by saying if unemployment exceeds 4 percent, you believe that we should not have a budgetary surplus. If it is less than 4 percent, it might be permissible to have a deficit provided there aren't any conspicuous inflationary pressures.

Mr. NATHAN. No. I am afraid I can't quite agree with that exactly. Let me try to put it this way.

Let us say that you have 5 percent unemployment and you are operating at a $10 billion surplus because private demand is quite vigorous. Then I would say you should reduce that surplus and, say, go down to an $8 or $6 or $5 billion surplus to get to 4 percent unemployment. In other words, reduce the surplus to become expansionist.

Senator PROXMIRE. This is really an academic discussion.

Mr. NATHAN. Let us put it the other way. I think the other side is just as academic. Let us say we are down at 3 percent unemployment and at 3 percent unemployment we have an $8 billion deficit. It is entirely possible. It depends on the private demand. If private demand isn't really adequate, you might very well have a several billion dollar deficit and still have only 3 percent unemployment. What you may then want for stopping inflation is not to jump to a surplus but to reduce the deficit down to $5 billion or $2 billion instead of $8 billion. What you want to do, in other words, is shift from a surplus toward a deficit or from a deficit toward a surplus, depending on whether or not you have inflationary forces at work. I would agree that when you tend to get to full employment and you have inflationary forces at work, the budget should then become more contractionist or restrictive than what it was before.

Senator PROXMIRE. I am getting at this. We have now about 5½ percent of the work force out of work. Professor Fackler in his analysis of unemployment trends and expectation, because of the increase in the teenage population and population that is not skilled because of automation, we can expect to have a situation in which we ordinarly might have a larger unemployment unless we have some forces in the economy that overcome it.

Now, under these circumstances it seems to me quite unlikely that any realistic action by the Federal Government with our $600 billion GNP and with the size of our Federal budget and revenue, and so forth, that any action that we can take it would seem to me is unlikely to get the unemployment rate below 4 percent.

Now, if this is true, then I presume that you would take the position that then we should accept the notion that we would have pretty much of a perpetual unbalanced budget and a constant increase in the national debt.

Mr. NATHAN. If at 4 percent unemployment our pattern of private expenditures and receipts and savings and investments requires a deficit, then I think we will and ought to have deficits.

Senator PROXMIRE. In other words, in your judgment as an economist, and I think a very good one, you feel that we should look at the spending and taxing policies of the Government primarily from the standpoint of the impact they have on the economy and not from the standpoint of the usual conventional judgment that most of us are more familiar with of raising enough money so that we can meet our obligations.

Mr. NATHAN. Well——

Senator PROXMIRE. Raising enough money by taxation so we can meet our obligations.

Mr. NATHAN. I would certainly like to see us raise enough money to meet our obligations, but if that then tends to repress the economy just because there isn't enough private investment or private spending, then we have to look at the aggregate of revenues and receipts, and if you need a deficit to get to 4-percent unemployment, which I do not accept as a goal, then I think we will have to have deficits.

Senator PROXMIRE. Now, one other thing to add to what the chairman has suggested on the impact of spending as compared with reducing taxes. It is not true that from a growth standpoint it may be that at least some Federal spending is likely to be more expansionary in the long run in the economy in that it increases skills, increases the productivity of our basic human resources more than a tax cut would be likely to? What I am thinking of particularly are our educational programs. So that in addition to the multiplier effect which is better, the investment in the human resources might make this route also more attractive.

Mr. NATHAN. I have no doubt that if we took a billion dollars and put it into education, assuming we can organize the resources to do it efficiently—I don't mean to just pour it down the drain and have beautiful schools and no teachers in them, and the like—but let us assume we could use this big educational sum efficiently. I think for the economy of the country, for the growth of the country, we would be better off than if we released a billion dollars into private consumption through tax reduction. There is no question that $1 billion in education would give us more growth than releasing that $1 billion for private consumption through a tax cut.

Senator PROXMIRE. I take it you conclude that this tax cut is going to have its prime effect this year and next year and in the absence of any other governmental policy, if everything remains the same, apparently there is no sharp change in taxation policy or spending policy planned by the administration at the present time, you would anticipate that we might have a recession in 1965, late 1965 or 1966.

Mr. NATHAN. This tax cut will have a continuing impact in the sense that there will continue to be less taxes, due to the lower rates, but once it has worked its way into the economy——

Senator PROXMIRE. You think it is not enough to do the job.

Mr. NATHAN. Yes. Unless private——

Senator PROXMIRE. And therefore that the expectation of Kermit Gordon, the Budget Director, and of Secretary Dillon that we would have a balanced budget with this tax cut in 1967 and 1968 you think is too optimistic.

Mr. NATHAN. I am inclined to think so, although I agree with Mr. Fackler, it is awfully hard to predict that far ahead in a precise way. If, for instance, these reductions in tax rates really worked to bring about a substantial increase in private expenditures, both by consumers and by investors, which investment expenditures were sustainable, then we could have prosperity and a balanced budget. I think Mr. Fackler said very appropriately, we don't want a big bump in inventory accumulation and a big bump in investment which is unsustainable; that is, it becomes excessive and we fall on our face again. That is what we did in the midfifties. If we can get a higher level of private expenditures that is sustainable, then it is conceivable that the stimulus from the tax cut would be enough, but I don't think it will be.

Senator PROXMIRE. It is conceivable but it just seems to me to be a long shot to say we are going to balance the budget with this tax cut in 1967 or 1968.

Let me ask, Mr. Fackler, you say that the Fed has followed in 1963 an expansive monetary policy. Wouldn't it be a little more accurate to say it has followed a less restrictive monetary policy and for this reason. GNP increased in actual prices because this is the pertinent figure, during 1963 by 5.4 percent. The money supply increased only 4 percent. Therefore, there was less money available in proportion to do the job of meeting all of the money needs in our economy at the end of 1963 than at the beginning. Therefore it would seem to me that since the increase in the money supply failed to keep pace with the increase in the GPN, that it still had a slightly restrictive effect although far less restrictive than the policies of 1962 and previously.

Mr. FACKLER. Well, you can put it in those terms, Senator Proxmire. I think a 4-percent increase is a reasonable increase in the money supply, and it was much faster than that in the second half. I don't think that the Fed can get in a situation where they have to increase the money supply by the same amount as GNP increases.

Senator PROXMIRE. I am not advocating that.

Mr. FACKLER. You might get an increase in the rate of money turnover and have severe inflationary pressures.

Senator PROXMIRE. I am inclined to go along with the Friedman thesis of a steady increase in the GNP although I am sure you don't necessarily buy that in toto, a steady increase of 3 percent or something of that kind. What I am trying to say is while you say it is expansive, we should at least add a qualification to that. It did not expand as rapidly as the GNP and therefore did not have a very vigorous push on the expansion of the economy during that year.

Mr. FACKLER. In part, you see, they were only offsetting this somewhat tighter monetary policy in 1962 when the monetary expansion was very much smaller. We could have had more expansion in the money supply in 1963 without its being inflationary, I think.

Senator PROXMIRE. Now, unfortunately my time is up. I would like to ask you this and maybe have a chance to come back.

You advocate an expansive fiscal policy, an expansive monetary policy. You say that the wage and price restraints which the President and the Council of Economic Advisers have been suggesting are pretty useless and the only suggestion you make for inhibiting an increase in prices is a reduction in tariffs on automobiles.

It is my understanding that they really aren't so competitive, the foreign automobiles. So you feel that inflation is inevitable, just relax and enjoy it?

Mr. FACKLER. No. But I think the economy is some distance from an inflationary threshold, and this particular combination of policies is not going to make for inflation in 1964. At the same time I think, as mentioned in my statement, that there is the possibility of inflationary problems building up in the course of a year. If the economy shoots up as sharply as some people think it might, inflationary pressures may develop later in the year. But those potential inflationary pressures shouldn't inhibit us from taking a course of action which now I think will be, on the whole, beneficial. Potential inflation is a risk we can take because if it does look like the economy is going too fast, we can always draw back.

Senator PROXMIRE. You see, the difficulty is we are using these overall unemployment figures and they are so unsatisfactory as your statistics show. Unemployment, if not confined, is very heavily concentrated among the unskilled, teenagers, minority groups, and in various regions of the country. In my State it is less than 3 percent. In other areas, certainly in areas where skills are concentrated, there is a shortage of labor.

Now, in view of this it seems to me a stimulus on top of the expansion of our economy could very well result in an increase in prices. And indeed, we are having an increase in steel prices, an increase in some other prices, without getting the unemployment level down even below 5 percent, let alone 4.

Mr. FACKLER. Well, one thing I think we have to watch is how we use those prices indexes. We should not be misled by a 1-percent increase in Consumer Price Index. The upward bias is probably greater than that. Unfortunately people do tend to watch these very imperfect measures and to get excited when they move a little bit—say that we have inflation. Some people look at the implicit price deflator for GNP which has some very large upward biases because of the way it is put together. I am not really worried about some minor, some small 1½ percent, increase in the Consumer Price Index. That seems to me inconsequential. If we started getting 3 percent in the course of a year, we would have something to worry about.

But we are always going to have the kind of unemployment problems you are talking about, the structural kind of thing. The question we are talking about here is the difference between, say, 4, or let us say 4½ percent—which would still be a reasonable goal if the norm is somehow rising because of structural causes—5½ percent. Let us at least try to eliminate that 1 percent extra unemployment and not be so worried about the inflationary potential that we are afraid to move. In other words, give the economy a little rope to run on and see what happens.

Senator PROXMIRE. My time is up. It is just, you know, that a huge proportion of our people are left out of the tax cut, 80 percent of those over 65, the majority of the farmers. They are going to have to pay the higher prices and get none of the benefits of the tax cut.

Mr. NATHAN. If we have higher prices.

Chairman DOUGLAS. There is one explanatory comment that I would like to make and then I would like to address a question to both of these gentlemen.

I notice that 4 percent has been adopted as the tentative benchmark for tolerable unemployment, and I have taken some ribbing because 10 years ago I suggested 6 percent. It has been said that that was an unduly high figure.

I would like to point out that the 6 percent included lost time within unemployment, and also it was based on unemployment within those who sought wage and salaried labor. It did not include the self-employed for whom there is no satisfactory definition of unemployment.

If you include lost time within unemployment, involuntary time within unemployment, and if you used as your denominator not the 72 million people in the work force but the 62 million who are seeking wage and salaried work, that is, excluding self-employment, you get a present figure of unemployment not at 5½ percent but of around 7½ percent, and therefore a 4-percent figure is really 6½ percent.

I merely mention that to indicate that there is no contradiction between these figures.

Now, the question I would like to ask is this. When I studied economics almost 50 years ago at Columbia under professors who were supposed to be the best of their time, I was taught that if you had unemployed labor and if you had idle capacity, capital, that the unemployed labor would bid for jobs at lower wage rates, that the employers in order to utilize idle capacity would reduce prices; therefore you would have a reduction in prices, and at lower prices a higher quantity would be demanded; that this would call for increased investments.

In those days we didn't think there was any difference between savings and investment. We thought they were identical. Savings were almost simultaneously translated into investment. But if there had been any excess of savings over investment, this would be absorbed by the increased demands of industry and that therefore under a competitive system, we would ultimately be in balance.

Now, I taught this theory for a great many years. I would like to ask you gentlemen what, if anything, is wrong with it.

Mr. NATHAN. Well, of course, I think if we wait long enough and pay a big enough price we will probably achieve balance. I don't think we are willing to pay the price any more; that is, wait and let demands and prices and wages respond and the willingness of people to accept lower wages and of business to take lower prices and to invest because profits then become more attractive. The cost of the burden of the hardship that is imposed by this process is something we are not willing to accept any more. This is why the classical economic theory was never really pursued when we finally came to fighting the business cycle. The business cycle derives from letting nature take its course. And it is true that if we wait long enough and have enough unemployed resources, wages would fall. The attractiveness to employers of added workers would be greater and the investment opportunities would then be better because of the drop in prices and costs. Prices would drop and this would stimulate demand. But this was a very harsh, costly process. The classical economists don't like what is being done today, but I think what is being done today in terms of compensatory fiscal policies and all these thorough documents, like the President's Economic Report, are in a real sense designed to avoid the harshness of letting nature take its course. The price one pays in unemployment, the price one pays in hardship, the price one pays in loss of production, is just too great.

Chairman DOUGLAS. Mr. Fackler?

Mr. FACKLER. I think Mr. Nathan really overstates the problem. It is true that the economy would adjust eventually if you had flexible prices, flexible wage rates, and you had a monetary policy that was stabilizing in character. The problem is that the real world isn't quite so simple. There are time problems; there are rigidities. And part of our problem of instability has been caused not from a lack of response of the system but because of stop-and-go monetary policy. In other words, because of a Government failure to provide a framework in which this price system could operate. So partly instability is a failure of theory and partly it is a failure of policy.

Mr. NATHAN. But partly it is a failure due, wouldn't you agree, to institutional barriers that have emerged in the economy which in turn can be traced to the hardships of laissez faire. Even labor leaders will admit that unions do pose a difficulty or a barrier against complete flexibility of wage rates. But on the other hand, they say that the price of less mobility or less elasticity which this imposes is a price well worth paying to preclude the extreme degree of exploitation which prevailed before there were unions. So that you develop institutions which preclude the automatic adjustment but which in turn are justified because of the hardships that the lack of these institutions permitted.

Mr. FACKLER. Well, that is possibly true. I think if we had—if we really could get at actual transaction prices and wages, we would see a lot more flexibility than appears on the surface in this economy. In other words, the economy does tend to adjust and react much more along the classical lines than some people are willing to admit.

Chairman DOUGLAS. Yet we had the persistence in England around 1924 to 1939, of an extremely high ratio of unemployment. We have had in the United States for the last 6 years the persistence of a very high ratio of unemployment which has really been understated by the official figures when you speak of involuntary lost time by those who seek wage or salaried labor. This is continuous.

Now, what has been wrong?

Mr. NATHAN. Well, I personally feel that we have distributional problems to be taken into account, Mr. Chairman, as I discussed in my statement, which I hope this committee will study more intensively. I think we can't ignore the wage-price-profit relationship and not just from the inflation point of view but what it does to demand, and what it does to consumption, what it does to investment, what it does to rates of return, whether these attract or discourage investment. I think we have got to take a good look at taxation, not just from the point of view of equity but also what it does to total demand, to consumption, to investment.

I think in the last dozen years, Senator Douglas, we have had a shift in tax burden to the lower income groups, especially when you take into account State and local taxes as well as Federal taxes. Maybe this will result in a stimulus to investment which will be sustainable due to a faster obsolescence and dissipation of machinery and equipment. I don't know. I have doubts. We can't ignore these distributive elements arising out of changes in taxation and its incidence, arising out of transfer payments, arising out of wage-price-profit relationships, because these may make it more difficult for us to have full employment without deficits.

Chairman DOUGLAS. I have a very brilliant colleague by the name of Viner who wrote a book review in which he said there was no distinction between savings and investment. Amounts saved automatically were transferred into investments in a very short period of time. This was before Mr. Keynes' treatise on money appeared.

Let me ask a factual question. Am I correct in my understanding that the corporations of the country have enormously increased their holdings of liquid assets, that is not invested in plant facilities, which is a large part of what the economists call, somewhat bloodlessly, "cash flow," and that these assets are held in the form of short-term governments, bank deposits, and the rest? Am I correct in that, Mr. Fackler?

Mr. NATHAN. Well, there are data published by the Federal Trade Commission and the Securities and Exchange Commission which do indicate a very substantial increase in the liquid holdings of corporations. There is one other set of data——

Chairman DOUGLAS. Now, may I ask this? Why is it that this is not transferred into an investment in plant?

Mr. NATHAN. Well, it depends on what motivates investments. If investment is motivated by ultimate demand and there isn't sufficient ultimate demand then there will not be sufficient investment to activate or use the savings that would be forthcoming at full employment. Look at page 285, if we may, of the Economic Report. Page 285 has a table called sources and uses of corporate funds. Let us look at the second line; namely, plant and equipment outlays. In the fifties, the internal sources of funds retained, profits—that is undistributed profits—depletion allowances, plus the depreciation of capital, were less by a fair margin than plant and equipment outlays. This means that business, corporations in the aggregate, went to the markets and borrowed your savings and my savings through the sale of stocks and issuance of bonds to finance their plants and equipment.

In the last 2 years our internal sources have been greater than the plant and equipment outlays, and 3 years ago it was about even. But interestingly enough, if I would direct your attention to one other line, called depreciation and amortization allowances which provide internal sources that are not taxable, that are attributable to so-called capital consumption, which allowances we have liberalized tremendously. In the midfifties, plant and equipment expenditures by corporations were double or more this depreciation and amortization total and today this depreciation and amortization allowance is about 90 percent as large as plant and equipment expenditures. What this means is that these gross savings of business are rising tremendously and much more rapidly than are plant and equipment expenditures. I do not buy the thesis of some people that it is because of Government that investment is lagging. They say if only the Democrats weren't in power, business would invest more. Or if only it weren't for David McDonald and Walter Reuther, business would invest.

I think this is just nonsense. We have to take a good look at why there isn't more plant and equipment investment in relation to these savings. We may find that with our new automation and pace of technology, and so forth, that the opportunities or the attraction for new plants and equipment expenditures, for new products, old product modernization, are just not there in adequate amount to use all these savings. If investment levels are too low, then, gentlemen, we are going to have to look forward to either one of two developments in the future. Either we are going to have to shift income distribution so that more is consumed, more expended for consumption and less saved, or we are going to have to look forward to Government investments to offset these idle savings. I don't find anything wrong with Government investment if it is sound, if it is efficient.

Chairman DOUGLAS. My time is up.

Congressman Curtis?

Representative CURTIS. That is the point. I don't think Government investment by its very nature can be. I don't know why people always turn to the political sector these days to solve these problems. We are politicians, and even our great civil servants—and I admire our civil service system—have to operate under a rigid system to prevent false politics. It is not a system well suited, I think, to going into investment.

I am very much interested in this exchange and would suggest that maybe some people pay a little more attention to what we put in our minority views on the Economic Report last year. Using the period 1947 to 1951 as a base, we showed that return per dollar invested was around 14 percent and today this has declined to around 9 percent. It is what you anticipate in return for the dollar you are going to save and risk that becomes a key.

Let me get back to my earlier discussion because I think we are getting this dialogue to a point where we could reach some conclusions.

I have suggested that this is overheating the economy. As I understand it, you both look upon it as heating the economy, but are not concerned about it because it will heat what you call unused capacity. Indeed, you probably want to apply the heat to that—if this metaphor will stand up. But is this really used or unusable capacity, not only in the labor but also in the plant sectors? I have said that what people have referred to as idle plant capacity is largely obsolete capacity, unwanted capacity. If that is the picture, then it is not going to provide the absorptive power of this heat that we put on it.

Let me examine another component in the labor field. It was very interesting that the President, in his Report, should point up this problem of overtime, and suggest that by putting penalties on overtime we might create more jobs.

Why is there overtime? It is because the skills that the management has are in such demand that they ask them to work overtime, as well as structural and institutional matters. But training and skill factors are also involved here. It is better for the company to pay the additional cost of overtime than it is to go out and retrain or locate someone unemployed.

Now, this also relates to what I regard as a very—using some of Mr. Fackler's adjectives—stupid approach in the depressed areas legislation. We go into a coal mining area where coal mining utilization of manpower has declined mainly because we can mine coal more efficiently. What do we do? We stimulate the construction industry which is already being overutilized. What happens? Do idle coal miners go to work. No. The carpenters and the bricklayers work more overtime. The important question is what is this unused labor capacity? Is it really usable? Would increased demand help—or rather increased purchasing power, because we are talking about how it will channel itself into demand. That is why I referred to agricultural products, because here is your big decline in employment—42 percent.

Relating this to plant capacity, I was pleased to see that McGraw-Hill, for the first time, asked some questions in their survey about the judgments of manufacturers as to whether this is unused, usable, or obsolete capacity.

The steel industry is an interesting case study. At the same time the steel industry was operating at 60-percent capacity, it was spending billions of dollars building new plants. This is not redundant, not to use existing capacity. In some instances they wanted to produce a thin sheet of steel to compete with plastics.

Increasing consumer demand wasn't going to be absorbed by that kind of idle steel productive capacity.

Do you think I am entirely wrong in thinking that by getting into the components of these two areas, we might resolve this difference? If my judgment is right, if this is so, wouldn't you agree——

Senator PROXMIRE. Would the Congressman yield for a minute? Senator Douglas has had to leave and unfortunately I have to go to the floor because I have got an amendment I have to put in on a supplemental bill, and they are waiting for me over there now, and I apologize, but you are in very good hands with Congressman Curtis who is a very fairminded man of great integrity, and I am sure he won't take advantage of the fact that he is the Republican now in charge of the committee.

Representative CURTIS (presiding). If I could take advantage, I might, but I don't have the ability.

Mr. NATHAN. On this point, Mr. Proxmire, you seem to be in agreement.

Senator PROXMIRE. Touché.

Representative CURTIS. To pinpoint the question again, do you feel that by making a concerted study in these two areas we might resolve this difference?

Mr. FACKLER. Well, on a number of points you are quite right, Congressman Curtis. The capacity measures are very, very poor; in them there is also some obsolete capacity, capacity that would only be used if demand were very buoyant. The point is that capacity itself would change very rapidly if we had a good boost from the demand side; it would pay people to expand capacity.

Representative CURTIS. Yes; but direct your attention, please, to the unused capacity. Take this steel plant, for example, that is capable of producing something that apparently isn't in sufficient demand. Their real demand is in the new area where they lack sufficient capacity.

Mr. FACKLER. It is quite possible with an increase in demand that particular steel mill might not be used; yet there might be some expansion elsewhere. Steel is probably not a good example because expansion of a steel capacity is a very slow process.

Representative CURTIS. Wouldn't the expansion be in the area of building new equipment rather than using what you are relying upon to absorb the inflationary forces—the unused or so-called idle capacity?

Mr. FACKLER. There would be greater use of existing facilities, and there would also be an expansion of new capacity.

Now, there is no reason why the economy couldn't stand a higher rate of investment.

Representative CURTIS. Well, then——

Mr. FACKLER. Without inflation.

Representative CURTIS. Sure.

Mr. FACKLER. We have got resources; we have got labor. To be sure there are going to be bottlenecks—you raised the bottleneck question. Bottlenecks are always going to be with us. But the point I come back to is this: We are talking about the margin, the difference between, let's say, 4½ percent unemployment or 5 percent unemployment and 5½ percent rate. There is still slack in the economy. Some of that slack we can take up. There are going to be particular areas, and this is going to be one of the problems, particular areas where there will be bottlenecks, shortages of skills you mentioned, and some selected price increases. If we look at particular price increases without looking at the price decreases that also take place; for example, in certain areas where existing capacity is now underutilized, if we ignore price decreases and just look at the price increases. we will think we have inflation—and wrongly.

Representative CURTIS. I agree with your argument there.

Mr. FACKLER. It is the "selection mistake" that worries me.

Representative CURTIS. But I think you continue to beg the question. You keep saying there is slack in the economy. That is the question: Is there? You identify it as slack through this very unfortunate gap theory. For the record, I might say that the very time it was advanced by Dr. Eckstein, it was contested—and I thought successfully—in the minority views. It was later contested by several papers, two of which were by Dr. Arthur Burns. But economists have continued to act as if this is a sound theory. I think everything that has happened since then reveals the unsoundness of the gap theory. But the semantics you used, Mr. Fackler, assume there is a slack. That is the question, Is there slack? Let's find out.

Mr. FACKLER. Well, one measure would be, as I pointed out in the statement, that if you look at where the unemployment is or the increase in unemployment, say, over 1947 rates, you find it spread all around the country. It hasn't been concentrated in particular areas.

Representative CURTIS. I thought it had. The President in his Economic Report calls it Appalachia. They are trying to set it in this legislation, and I disagreed with them, I might say.

Mr. FACKLER. I am saying the difference between—the increase in unemployment rates have occurred in all components of the labor force, most industries, and have been widely diffused geographically.

Representative CURTIS. The figure I gave you on unemployment or, rather, the decline in employment in the agricultural sector of 42 percent reveals that is not so. The increased employment, or rather the jobs going begging today, if we ever could find them all, would probably outnumber the people unemployed.

That is a questionable thing, but we were about to develop a statistic in the Bureau of Labor Statistics on available jobs unfilled. I don't know what has happened to that statistical study. They are still working on it, but it is very important that we begin to look at it. Well, rather than debate this here, I was trying to find out if you felt that a further examination into the components might resolve these differences as to whether or not there is slack in the economy at all.

Mr. FACKLER. You mean the economy is operating now at what you would consider relatively full employment?

Representative CURTIS. Indeed I would say so, but I am not satisfied. I think the drag on the economy is from a shortage of skilled labor while the tragedy is we have unused labor without these skills.

How do we bring these together? It is not an easy job because you don't take the unskilled worker and train him in these high skills that are in demand. I wrote a book on it to illustrate what I thought this process was, but I get very little debate on the subject. In fact, the administration and the neo-Keynesian economists continue begging the question. They say there is slack, and I keep asking them to examine it by going into the components.

Would you comment?

Mr. NATHAN. I would. I couldn't disagree with you on that, Congressman. I think the subject ought to be investigated. You have your strong convictions of the full or overutilization of these resources, and I feel like Mr. Fackler does, that there are idle resources. I think one has to really dig into this area and get away from subjective tests and to really dig down into realities. For instance, you think most of the idle capacity is obsolete. I don't, because I think you always have marginal capacity in use that isn't the most up to date. If all our idle capacity today were obsolete, Congressman Curtis, then I ask why hasn't there been a lot more investment in the last 2 or 3 years? Look at the investment credit. Look at the accelerated depreciation.

Representative CURTIS. First of all, my answer to that is we have had considerable investment. But the primary reason is that the return on the dollar invested and risked is not as good in this country as it is elsewhere. That is one reason why we have had our dollars invested abroad. And I think it is going to continue until we get at this very difficult problem of investment climate. You put your finger on it, motivation to invest. What is that? Let's examine into that in some detail. I happen to think that the Government intervention—I call it intervention—in many, many areas is one of the main reasons why there is a reluctance on the part of the investors to risk their dollars in certain areas.

Mr. NATHAN. Congressman Curtis, in response to what you said, I would make two proposals or suggestions.

One, I would strongly favor a much more intensive investigation of this subject of the unused capacity, whether we are up against capacity or not, both on the labor side or equipment.

Secondly, I would also offer a proposal that those who believe that investment is inadequate due to insufficient opportunity and not enough reward to accept risk, would agree to a combination of substantial improvement in the rewards to business along with an agreement to accept a compensatory fiscal policy if those rewards don't work. That would be a good combination.

I spoke last year before the American Bankers Association on tax policy and we got into this discussion of the gaps and incentives. I said to one of the association officials, would you buy a concentration of the whole tax cut on corporate profits, say, cut corporate profits taxes from 52 percent down to 30 percent, and if that doesn't work, if that doesn't induce enough investment, would you then agree to having an expansionist fiscal policy in the form of deficits to give you relatively full employment. He said, "No." He said, if 30 percent do not work, we should go to 20, go to 10, go to zero.

You see, one of the problems as you move toward the incentive-orientated measures of tax cuts, is that you may aggravate unemployment by increasing savings more than you increase investment. This is a possibility. But I would favor going the incentive route if at the same time there is agreement to pursue a fiscal and monetary policy which will assure us sustained full employment.

Representative CURTIS. I might say in regard to this question of taxes in relation to corporate profits, I have tried to point out that these are dealing almost in tenths of a percentage point. When you give a 5-percent corporate tax cut, as far as the return of investment to the invested dollar, we are talking in terms of maybe a full percentage point, but I think it is still a fraction. The real problem is when you see the shift from the 14-percent return to the 9 percent. This is dealing in whole figures. We also need to look to such factors as patent policies. How can a person who risks his money be insured, have some reasonable assurance, that he can recoup the amount of money spent in research and development and in innovation? The greater the risk, of course, the greater the innovation and the greater the potential for the society to move forward. We have taken, I think, a very unrealistic approach to return for really risk capital.

We can't resolve it here. All we can do is point up areas where we think we might be able to get some data or information which would bear on it. I certainly think motivation for investment deserves a great deal more study. It certainly needs to be taken out of the realm of demagoguery and kept as best we can in the field of economics.

Do you want to comment?

Mr. FACKLER. Yes. Could I make two comments? You raise a very valid and serious problem as to what constitutes full employment? What level of unemployment is consistent with price stability, or where, as I put it, does the inflationary threshold lie. Unfortunately there is a lot of theology in full employment concepts. Everyone has a magic number; 4 percent has been so ingrained in the theology for so long a time that 4 percent is automatically the number used for a reference point. Some people say 4 percent unemployment is much too high, and it should be 3 percent. Others say it is going to be higher as we now measure it, quite apart from Senator Douglas' measure. Maybe it is going to be very difficult by aggregate demand measures, by pumping up aggregate demand, to get less than 5 percent. I don't know.

And so I would second your proposal that we give it a lot more serious study.

But also I want to say since we don't know what the magic number is, let's try to find out in two ways. No only by the study, the kind of studies you mentioned of the bottlenecks and structural problems which will always be with us in a changing world, but let's find out by pumping up aggregate demand a little bit, to see if we don't reduce unemployment without inflation.

Representative CURTIS. We have been doing it.

Mr. FACKLER. We haven't been. We haven't had any inflation.

Representative CURTIS. Well, I suspect that what has held back the inflationary forces, and I have said it is the discipline in the foreign market, the competition from abroad. It has been coming out to some degree in unemployment. I can illustrate by a shoe company in my own district where they couldn't raise their prices any higher and——

Mr. FACKLER. That is part of the problem of an overvalued dollar that I mentioned in my testimony.

Representative CURTIS. That is possibly so, but it does relate to this problem. They couldn't raise their prices any higher, and they couldn't make any money, so they shut down the line. That let out a couple of hundred people. This is the discipline of the foreign competition, which can be a healthy discipline if kept within proper areas.

Well, let me respond with this one point, thought. I don't think this full employment figure of 4 percent is a static figure. I think that the more rapid the economic growth, the higher the incidence of frictional and structural employment is going to be. In other words, the more rapidly we innovate, the greater incidence of obsolescence both in skills and plant. We have got this cost factor. I have described our problems today as those of growing pains caused when I measure what I think is real economic growth, which is more in terms of new products and new services, more leisure time and more education. These are real developments in economic growth. We have grown tremendously in the past years during the very times that we have been describing our economy as slack. I think the incidence of unemployment that is frictional and structural is very high. We are beginning to identify it. The Manpower Training Act was directly geared to that. I had a considerable part in developing that and getting it enacted because I felt that this was the needed thing.

I think we could anticipate a great deal of this obsolescence of skills. In fact, it is being done more and more by companies and by unions. So that as you move forward you get some on-the-job training for the new skills coming into demand so that you don't have this high incidence of unemployment. But I think that the forces at play to create more unemployment are greater, the more rapidly an economy is actually growing, measuring it in terms of innovation. If our economy really were stagnant and going nowhere, a person could learn a skill at age 20, and it would last him for 45 years as a means of livelihood. Today you learn a skill at age 20, and in 10 years you may find that you have got a skill that is no longer in demand in the marketplace.

Mr. NATHAN. But you should also be able in an economy that is as vigorous and demanding as this to adjust and adapt your educational programs and other programs to parallel the changing demands with changing patterns of resources.

Representative CURTIS. Indeed so, and with regard to your remarks on education, the only comment I would make is that I wish there were—I want them in context with the tremendous increase that we have put into education in the past 10 years. We indeed——

Mr. NATHAN. Oh, yes.

Representative CURTIS (continuing). Have been doubling and tripling the amounts. And in my judgment it should be more.

Senator Proxmire is back, and I have more than used my time. I will conclude by making this observation. I think one of the greatest wastes of Federal funds today is the billions that we actually spend in the field of vocational education, without identifying it as such because it has on a military uniform. I would get a lot of that money that we are wasting in vocational education in the Military Establishment, turn it over to the private sector in vocational educational, apprenticeship training, and let the military say what their needs for skills are, and then let the private sector supply it. We have got billions of dollars being spent annually in this area.

Senator, I have more than used my time. I knew you were coming back and so I——

Senator PROXMIRE (presiding). I appreciate that very much. I will just take a couple of minutes. I did want to come back because I wanted to follow up a question I had with Dr. Fackler.

Dr. Fackler, you say that this is not a growth tax cut. By that——

Mr. FACKLER. Yes.

Senator PROXMIRE. By that I presume you mean the prime effect is going to be in the next year or two and that in the long run, the stimulative effect, at least the growth effect of the tax cut won't be significant.

Mr. FACKLER. When I speak of growth, and there is the semantic problem here that Mr. Nathan referred to earlier, I mean the compound rate of increase along a properly measured trend. Obviously if it increases output in the next year or two and gets the economy up to a notch higher, there will be an increase in the measured growth from some previous point of time. I am talking about a long-term trend, rate of growth over time once we get back to what I think of as full employment which is, I think, a little higher than present employment. At that point the tax bill will not tilt the growth trend upward.

I don't think the tax cut will bring about a 4.2-percent rate of growth, as a properly measured trend, over the long run, say between now and 1980 or 1975. The reason for it simply is this: If you really want growth, you would have to try to promote investment much more than consumption. The big tax cut in this tax bill is in the first bracket. If you look at the aftertax distribution of income after this cut, it doesn't make very much difference. It tends to be a little bit more generous to lower income groups, not much but a little bit. But will it do to change the proportion of our annual output that we devote to investment? And I would include public investment. I don't see how.

Senator PROXMIRE. Now, of course, we have to use our own sense of values to determine the relative importance of the economic impact and purely fiscal impact but did you anticipate as an economist that this tax reduction would result in, say, 5 or 6 or 8 or 10 years from now, everything else being equal, in reducing or increasing the deficit?

Mr. FACKLER. Five or six years from now? I don't think——

Senator PROXMIRE. Yes. When the full multiplier effect has worked its way out. Would a cut of eleven and a half billion dollars, whatever we end up with, in taxes result in a greater or lesser tax revenue when the full effect is being felt?

Mr. FACKLER. I would argue that only God and William McChesney Martin know the answer to that question, Senator Proxmire. Depending—if the expansion is financed by new money and we get up to what I think would be an adequate level of maximum employment and purchasing power, undoubtedly there is going to be a great growth in revenue at the new rates. The tax revenue, the losses of tax revenues from the tax cut will be made up, let's say, in 2 or 3 years, so that we could balance. I think it is reasonable to expect we could balance the budget. This depends not only on Mr. Martin but also on what happens on the Government expenditure side. So that——

Senator PROXMIRE. You see, this is so baffling and so difficult for those of us who don't spend our lives constantly working as economists because the theory seems to be that the way to balance the budget is cut your taxes, and increase your spending, and we always thought to balance your budget, any kind of budget, you do exactly the reverse. Increase your income and decrease your outgo. Now you are saying, because of the marvels of modern economics in a Nation that is as large as ours and as self-sufficient as ours, all you have to do to balance the budget is that perfect political nirvana which everybody wants, cut taxes, increase services. Just relax and recognize the greater wisdom of economists and you can have a balanced budget and everything else.

Mr. FACKLER. I think your skepticism is justified.

Senator PROXMIRE. Thank you.

Mr. NATHAN. What if, Senator Proxmire, somebody said that the way to balance the budget is first to get to a vigorous fully employed economy so that your revenues are maximized and your reliance on public expenditures for stimulation are minimized? But then the question is, How do you get to the fully employed economy? That is in essence the rationale of this tax cut. It hasn't been to reduce taxes and increase spending and have a balanced budget. Let's get to a fully employed economy, to a point where you rely less on spending and on tax response because of high levels of activity.

Senator PROXMIRE. This is why what my conservative bent tells me to do is, first try monetary policy because if monetary policy will exercise a little less restraint on the economy, then I know that a given tax level and a given level of expenditures are likely to result in a lesser deficit, in at least helping to solve our fiscal problem better.

My instinct is to try the method that has been used over the years much more freely than fiscal policy has been used to stimulate the economy, i.e., monetary policy.

Mr. FACKLER. I think your instincts are perfectly sound, Senator. If we tried the monetary policy, we could achieve the same result. Then we could also find out whether the full employment surplus is as big as that being calculated by the Council.

Senator PROXMIRE. Now, I just have one other question. I was fascinated by your analysis of the balance-of-payments thing. It was very straightforward and all too convincing, but it seems to me you are really throwing in the sponge. You say, well, there is nothing we can do. The balance-of-payments situation is just impossible.

Well, what happens to Congress when you do that is that every policy we have that affects balance of payments, including our defense policy, our foreign aid policy, and so forth, is conditioned by what it does to the balance of payments. We have some of the most eloquent and persuasive and important Senators who are confessing on the floor on major defense and foreign power issues that they have turned around, and they are voting now contrary to their other convictions because they feel the balance-of-payments problem is so very troublesome and so difficult.

I am inclined to think we ought to reduce foreign aid in some respects, but they think we ought to reduce it drastically or vote against it because of the balance-of-payments situation. They feel the same way on troops abroad. The balance-of-payments situation is really coloring and affecting our overall defense policies and other policies very, very seriously.

If a prominent economist such as you are addresses himself to this and says we just aren't solving this problem by any of these other methods including the interest equalization tax, it seems to me this is notice that you have to solve it by basically just saying we will pull our troops back, cut our foreign aid. Maybe this is the only way we can solve this because they say we simply can't let the United States of America, which is the financial bastion of freedom, as well as being important in many other respects, lose the confidence of the world in our dollar. If we do that, we won't be able to do these other things we want to do.

Mr. FACKLER. Well, you are summarizing my position. I think we are precisely on the spot where there is nothing we can do that makes good sense. Maybe we will just have to muddle through, you know. Maybe we can outlive the problem. Maybe by 1968 or 1969, I don't know, it will go away.

The tragedy of it, meanwhile, is we are doing a lot of things that are bad. It is very hard for people to recognize and face inevitability. Well, the balance-of-payments situation has some inevitable features; it is like being in this room. There are four doors and we can walk out that one or that one or that one or the one behind. When we look at the prospects of walking out the first door, we say, oh, no, the results are too horrible. They are inconsistent with our great position of world leadership. So we can't do that. Devaluation or floating the dollar is a case in point.

We can't walk out the second door because that it is not right, and so on. I pointed out the alternatives in my statement. So, we vociferously over and over and over repeat to ourselves, that none of the only alternatives available is acceptable. But we also cheat; we open one of these doors a little crack. When the Fed gets a chance, they put on the monetary screws for balance-of-payments reasons. We say we really believe in multilateral trade, not bilateral trade, but we tie all our aid. So we don't really believe in our principles. We open the "restrictions" door and peak out. And so it goes. We try to solve the payments problem by opening each door a crack, and by doing things we say are really unacceptable on political, moral, or economic grounds.

Senator PROXMIRE. Let's take just one device that was announced at the end of the second quarter last year and had obviously a constructive influence on our balance of payments. On the interest equalization tax there was a great improvement in the third and fourth quarters, primarily because it stemmed the capital flow. You say it is a shocking device. So what? It works. It seems to me it is perfectly appropriate and proper for us to discourage the investment of private capital abroad under these circumstances or at least to try and restrain it and dovetail it with our other interests. What is wrong with that?

Mr. FACKLER. Well, what is wrong with tariffs, then? They are wasteful, that is all.

Senator PROXMIRE. I am not afraid of a tariff if it can be justified. Just calling it a tariff doesn't seem to me——

Mr. FACKLER. There is a cost involved. A cost in having every American——

Senator PROXMIRE. What is the cost of this?

Mr. FACKLER. Every American on the average a little poorer off because we use our own resources less efficiently than we would if we didn't have these restrictions on trade and capital flows. There is a cost involved. You say let's take interest equalization tax. Consider the corporate treasurers. Even the threat of the tax, you see, has helped reduce the capital flow. Here is another cost, but to most people it is hidden: The large amount of time of talented people that is taken up doing things inefficiently for political reasons. Ask any corporate treasurer who is trying to manage a portfolio what he does. Well, he does a lot of things that he wouldn't do. He probably spends half his time doing things he shouldn't do so as to avoid political pressures—I am speaking of the international corporation that has worldwide operations. And he makes decisions for political reasons when he should be worrying about other things.

Well, now, these costs are hidden; they never come out but there are all kinds of costs of this type—to say nothing of the wastes from misallocation of resources generally.

Senator PROXMIRE. What is the cost compared to the cost of losing our position?

Mr. FACKLER. What position would we lose? We lose gold and we continue to lose gold. When the gold stock is finally down to the gold cover, then the Halls of Congress resound, and we change the law.

Then we have some more gold to flow out for a while. Finally, we may outgrow our difficulties.

Senator PROXMIRE. I am not worried about loss of gold. What I am worried about is what it is doing to my colleagues who are deeply concerned about it and whose attitudes toward the policies are affected, and we know they are.

Mr. FACKLER. I am worried about that, too.

Senator PROXMIRE. Mr. Nathan?

Mr. NATHAN. I was going to say we live in a world that isn't pure in any case. You are bound to pay prices for results. Take a look at this interest equalization matter. I don't think there is any country in the world in recent history that has permitted a capital outflow such as we have experienced without doing something about it. Why should we allow Germany and Japan to float dollar obligations in the United States because we have a better organized capital market than they have, and because we are seeking to keep interest rates lower through an expansionist policy, and let them come and drain out our dollars and gold, not for equity investments, but for dollar obligations. If they are not going to organize their capital markets, if they are not going to provide foreign aid adequately because they don't like to, then I see no reason why we shouldn't protect ourselves—if they are going to protect themselves, why in a sense don't we? It is true it isn't consistent with freedom, but when you are dealing with someone on the other side who has so illegitimately ignored your needs and noble purposes, you have to try to be a little rough on your own.

I, for instance, have sat and talked with an official of one of the governments or countries which has increased its reserves fantastically. I talked with him and said, why don't you assume a little more of the burdens of foreign aid? He said, our people think it is wasteful. I said, why don't you assume the burdens of defense in your own area or nearby? Well, he said, we want to cut our taxes.

This is a country which has accumulated foreign exchange reserves at a fast and large rate. I agree we cannot force discipline upon them, although I think we could pressure them a little harder than we do; but if they are going to behave like this, I say why should we be so pure. I myself think the interest equalization tax is wonderful, and I think we might even have a capital flow committee here which would literally preclude the outflow of capital on these fixed dollar obligations to developed countries.

Equity investment, I think, is a different matter. This has to do with efficiency of production, profitability, and the like, but I see no reason why we shouldn't restrain capital outflow for short term or medium or long term periods in large amounts on pure dollar obligational arrangements.

Mr. FACKLER. Is this consistent with our position of leadership to make the dollar less than fully convertible?

Mr. NATHAN. But the problem is, if you are dealing with people who won't cooperate with you, you have to protect yourself or else give up your position of leadership by giving up foreign aid or pulling back all our troops. We live in a world where we must sort of measure prices and take that which is least——

Senator PROXMIRE. Costly.

Mr. NATHAN. I think this is the tragedy. The real world we live in is not one that always adheres to high principles.

Representative CURTIS. I can't refrain because we have had the interest equalization tax in the Ways and Means Committee. I couldn't disagree with you more, Mr. Nathan. Why do we invest abroad? Frankly, because it is very profitable. One of the great things that we have developed is this financial market in this country which has brought in money that has benefited us all. Actually when the Dutch, for example, come over and float a municipal bond here, 70 percent of that bond was issued to be sold in Holland, but they didn't have the machinery to do it. I think it is a tragedy that we have done this kind of thing because of our failure to grapple with the real problems. One thing I will say to Mr. Fackler is that I think he analyzed it clearly, but I would like to end on an optimistic note. Maybe you don't agree with me, but the way out of this, as I see it, is to continue innovating in this country. New products, new services. Continue—I hope we can—increasing productivity so that we will catch up finally with labor costs and prices which moved ahead of productivity increases. This would, would it not, hit at the problem, you say? In other words, make our dollar worth what it should be in relation to the currencies abroad. In this way I think we can do it. That is why I come back to this basic question of motivation to invest. What is deterring it to my judgment more than anything else is the fiscal policy of the United States, which is a failure to understand the importance of balancing our own budget. I think that it will take a long time to develop that thesis, but I think that is the thesis that I would like to see.

One thing for the record, Mr. Fackler. I wanted not to be left in a position of arguing that 4-percent unemployment would be my goal or even higher than that. I think that by paying proper attention to frictional and structural unemployment, by anticipating, we can get that unemployment figure down way below 4 percent. I think it is about time we started working on it, but if we continue this policy of not even looking at what the unemployment is, and thus distracting our attention from developing the mechanism to anticipate this frictional and structural unemployment that we are going to have then, you are going to have your unemployment rate continue at a high level. That is why I have tried to argue against the demand theories. I would think that about now when every one knows that after each recession we have come to a higher incidence of unemployment than the previous one—this is post-World War II—and at the same time consumer purchasing power has continued to increase even during these recessions, consumer credit has gone up and corporate liquidity, as Senator Douglas pointed out, has gone up—I would think someone would begin to question whether this demand theory is sound. Isn't it the economists who are trying to get into the components who probably are the ones who are on the ball? I want to get the record correct on one request, Mr. Chairman. Daniel Suits, of Michigan State, had an article which appeared in the American Economic Review. The article demonstrates that private expenditures on plant and equipment have a greater multiplier effect, greater effect on employment, than the same amount of Federal Government spending. I would like to have a chart from that article of Dr. Suits put in the record at the appropriate place.

Senator PROXMIRE. Without objection.

(The chart referred to follows:)

Excerpt From "Forecasting With an Econometric Model," by Daniel B. Suits

Table 5.—*Selected multipliers*

Multiplicand	Multiplier for impact on—											
	GNP		Employment		Tax receipts		Social insurance		Government surplus or deficit (−)			
	Private	Total	Private	Total	Federal	State and local	Contributions	Transfers	Federal	State and local	Social insurance	Total
Plant and equipment [1]	1.690	1.690	0.115	0.115	0.586	0.058	0.038	−0.137	0.586	0.058	0.175	0.819
Federal purchases from firms	1.304	1.304	.089	.089	.458	.030	.030	−.106	−.542	.030	.136	−.376
Federal employment [2]	.692	1.692	.063	.263	.209	.016	.044	−.314	−.791	.016	.358	−.417
Federal personal income tax shift	−1.119	−1.119	−.076	−.076	.622	−.045	−.024	.091	.622	−.045	−.115	.462

[1] Additional expenditure of $1,000,000,000 of which ½ is spent for producers' durable equipment.

[2] Additional expenditure of $1,000,000,000 in Government wages to hire 2,000,000 new workers.

Senator PROXMIRE. Gentlemen, on behalf of Senator Douglas who had to leave, regretfully, and the other members of the committee, I am sure I speak his mind when I say this has been a most stimulating and helpful hearing. You men have contributed a great deal. You are the only witnesses we have had this year except the top officials of the Government on economic policy, and I think your contributions have been most helpful.

The Joint Economic Committee now concludes its hearings on the Economic Report. Thank you very much.

The committee stands adjourned.

(Whereupon at 1:10 p.m., the hearing was adjourned.)

(The following letter and statement were ordered placed in the record:)

BANK OF AMERICA,
Los Angeles, Calif., December 26, 1963.

Hon. PAUL H. DOUGLAS,
U.S. Senator,
Senate Building, Washington, D.C.

DEAR SENATOR DOUGLAS: I am sorry that I was unable to participate in the November 13 hearings of the Joint Economic Committee. In response to your request, I am enclosing a statement summarizing my views on the possible repeal of the 25 percent gold certificate legal reserve requirement against Federal Reserve note and deposit liabilities.

In effect, the enclosed brief statement supports the elimination of the required Federal Reserve gold ratio. In my judgment, this requirement no longer serves a useful purpose but rather handicaps the Nation in pursuing its policy goals within the framework of today's national and international monetary institutions.

Public misunderstanding of the role of gold in our economy is rather widespread, and a substantial educational program will be required before congressional action on this matter becomes politically feasible. I would hope the educational process could be started without delay.

Sincerely,

JESSE W. TAPP.

THE GOLD RESERVE REQUIREMENT

In my judgment, the 25 percent gold certificate reserve requirement against Federal Reserve note and deposit liabilities serves no constructive use at the present time. As a practical matter it does not limit the expansibility of the money supply. When circumstances require expansion of the money supply, the monetary authorities should not be prevented from expanding it, whether by a fixed gold reserve requirement or by any other arbitrary rule of thumb.

The international movement of gold is not the proper determinant of the money supply of a nation. That money supply, of course, should be held in check if inflation threatens, but gold movements constitute neither a faithful mirror of inflation nor the most effective bulwark against it. What is important is that the monetary authorities under all circumstances be permitted ample scope for flexible administration of the money supply, and not be bound by a rigid, limiting formula which would potentially subject our internal economy to stresses and strains engendered by sporadic flights of gold.

The 25 percent gold reserve requirement poses problems for the full execution of U.S. policy at home and abroad. Speculation against the dollar is fed by the illusion that the United States is running out of gold. This false view is engendered by the legal requirement apparently impounding some $12 billion of our gold reserve at the present time. Such speculation leads directly to losses of gold from the Treasury's stock, and also tends to worsen our balance-of-payments position.

A question will inevitably arise: When should the elimination or reduction of the gold reserve requirement take place? In a sense there is no "good" or "easy" time for this move. During periods in which the United States is building up its gold stock, the necessity to make this change is less obvious though still present; on the other hand, during periods in which the United States is losing gold, such a move is opposed on the ground that it might appear as a sign of weakness and thus precipitate a disorderly gold market. Surely, however, the possibility of such disorder is increased the nearer we move to the point where all of our gold is supposedly tied up by the Federal Reserve requirement; the more closely this point is approached, the greater will be our difficulties with those who fear or hope the worst for the U.S. position in the world. Even if removal of the gold reserve requirement under present conditions were to be misconstrued as an indication of monetary weakness, it would be better to face this fact while we still have a fairly large excess reserve. Removal of this requirement, however, would not be a demonstration of weakness, but of strength—an earnest of the pledges of both Democratic and Republican administrations that all of our gold stands behind our international obligations.

It is recognized, however, that misconceptions about the role of gold are widely present both in this country and abroad. A concerted educational effort is in order to promote public understanding of the fact that the dollar will actually be strengthened by the removal of the gold reserve requirement.

Of course, no one should be led to expect that lifting this gold reserve requirement will solve our international payments problems. Strong efforts along other lines will also be necessary to bring our international payments into a tolerably balanced position. The double program of lifting this gold requirement and of eliminating our balance-of-payments deficit should be pursued simultaneously if the United States is to retain its position of world economic leadership.

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