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JANUARY 1966 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

EIGHTY-NINTH CONGRESS

SECOND SESSION

FEBRUARY 1 and 2, 1966

PART 1

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

59-311 O WASHINGTON : 1966

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C., 20402 - Price 50 cents

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TUESDAY, FEBRUARY 1, 1966

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

The joint committee met at 10 a.m., pursuant to call, in room S–407, the Capitol, Representative Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Reuss, Griffiths, Curtis, Widnall, and Ellsworth; Senators Sparkman, Proxmire, Javits, Miller, and Jordan.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority counsel; and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order. Today we commence our hearings on the annual Economic Report of the President for the year 1966. I will include the agenda for the hearings at this point in the record.

REPRESENTATIVE WRIGHT PATMAN ANNOUNCES HEARINGS ON 1966 ECONOMIC REPORT OF THE PRESIDENT

Representative Wright Patman (Democrat, Texas), chairman, announced today that the Joint Economic Committee will hold hearings on the President's Economic Report, beginning Tuesday, February 1.

Hearings will be open to the public. The agenda for the hearings is given below:

Tuesday, February 1, room S–407, the Capitol, 10 a.m.: The 1966 Economic Report of the President. Council of Economic Advisers: Gardner Ackley, chairman; Arthur M. Okun, member.

Wednesday, February 2, room S–407, the Capitol, 10 a.m.: The 1967 Budget. Charles L. Schultze, Director, Bureau of the Budget.

Thursday, February 3, room S–407, the Capitol, 10 a.m.: Fiscal and monetary policy, 1965–66. Henry Hamill Fowler, Secretary of the Treasury.

Friday, February 4, room S–407, the Capitol, James G. Patton, national president, National Farmers Union.

Tuesday, February 8, room 2128, Rayburn House Office Building, 10 a.m.: Manpower, productivity, wages, and prices. W. Willard Wirtz, Secretary of Labor; Arthur M. Ross, Commissioner, Bureau of Labor Statistics.

Wednesday, February 9, room 1202, New Senate Office Building:
10 a.m.: Walter Reuther, chairman, AFL–CIO Economic Policy Committee.
2:30 p.m.: Elisha Gray II, chairman, Whirlpool Corp.

Thursday, February 10, room S–407, the Capitol, 10 a.m.: Panel: Price stability at full employment—Outlook and policy alternatives. Henry W. Briefs, Chairman, Department of Economics, Georgetown University; Neil H. Jacoby, dean, Graduate School of Business Administration, University of California, Los Angeles; Richard A. Musgrave, professor of economics, Harvard University; Robert Solow, professor of economics, Massachusetts Institute of Technology.

As I stated last week on the floor of the House, the President's report is a great state paper. It is the record of a remarkable expansion to high employment, of maintenance of sound wage-price policies to prevent spiraling inflation, and of steady progress in strengthening our balance-of-payments position.

We have learned much about our economy in the last 20 years since the Employment Act was put into effect. We are no longer as much at the mercy of economic forces beyond our control as we were at an earlier date. We have learned how to look ahead and identify emerging difficulties and we have learned much about how to apply fiscal and monetary policies to solve our economic ills. As a result, we are more sure footed on the path of economic growth, high employment, and a more abundant society.

But this is obviously no time for complacency and self-congratulation. There still are problems and they can be serious if we neglect them.

One is the price-wage situation. We must continue to hold the line against inflation. The administration has given much thought to this matter and has developed guidelines designed to protect us from the dangers of inflation. We will be most interested in hearing your analysis of the price-wage situation at this time.

Another problem is our monetary policy and the absence of procedures coordinating it with the general economic policy of the Government. Last month, this committee made an intensive inquiry into this question. I, for one, am profoundly disturbed by the fact that the majority of the Federal Reserve Board chose to go it alone, and to ignore the President and the executive branch of this Government. Moreover, the discount increase provides the larger banks with a good excuse for jacking up rates and increasing their profits. In addition to the rediscount rate which increased from 4 to 4½ percent, which was a 12½-percent increase, there were two additional alarming increases in that same statement: one was the increase on the rate of certificates of deposit of 90 days or more from 4½ to 5½ percent, which was an increase of 22.2 percent, and the other was the rate increase on certificates of deposit of 30 to 90 days from 4 to 5½ percent, which was an increase of 37½ percent.

Far from avoiding price increases, the discount action causes them. It triggered more borrowing because everybody's trying to get in under the wire before the Fed takes another step to tighten money still further.

It will add billions and billions of dollars to the annual cost of borrowed money for consumers, householders, and the Government. Surely, this will raise the cost of living considerably. It is a most serious problem, and we need to think more about it. The notion that we can deal with high prices by simply letting the Federal Reserve Board go ahead and raise discount rates, to my way of thinking, is a dangerous fallacy.

Finally, this administration has adopted a bold program to improve our society and the opportunities afforded to all our people and at the same time to win the war against the Communists. This social program has great importance for our future growth and development, and we want to hear your analysis of progress to date.

Chairman Ackley and Mr. Okun, we are very pleased to have you here today.

We also have the third member of the Council here, although I understand Mr. Duesenberry has not taken his seat yet. We are delighted to have him here as a guest, with the Council of Economic Advisers.

Senator Javits wants to make a statement.

Senator JAVITS. Mr. Chairman, I make this statement on behalf of the entire minority; for myself, Senator Miller, Senator Jordan, Congressman Curtis, Congressman Widnall, and Congressman Ellsworth.

Mr. Chairman, the administration's economic program exposes the American people to the twin dangers of serious inflation this year and a recession in 1967.

Recent increases in both consumer and wholesale prices—the greatest in many years, demonstrates that inflation already is a fact of life. The time to move against inflation is in its early stages.

The administration acknowledges the threat of inflation but refuses to concede that effective anti-inflationary measures are needed now. Its program is carefully contrived to give the appearance of restraint while carrying on the expansionary policies appropriate to an earlier period.

The administration has:

Seriously underestimated planned budget expenditures for fiscal 1967;

Promised large cuts in spending which are not cuts at all, but sales of Government assets that will have little effect in curbing overall demand;

Proposed revenue adjustments that largely affect the timing of taxpayments and which, by their very nature, will do little or nothing to restrain demand in the private sector;

Continued its critical attitude toward the Federal Reserve Board for its timely move toward monetary restraint last December.

The administration asks the private sector to hold the line while continuing to heat up the economy itself. To enforce "responsible restraint" by the private sector, it engages in implicit or explicit price and wage fixing and other forms of harmful interference with the workings of our economic system. The results of these policies will sap private economic initiative and inventiveness, impair efficiency and retard the Nation's long-term rate of growth.

In the absence of appropriate administration policies, speculative excesses will continue to mount and inflationary psychology, already taking hold among our people, will dominate economic decisionmaking in the year ahead. A recession next year is a likely reaction to present inflationary excesses. The tendencies toward recession will be strengthened since failure to take action to halt inflation now will force the administration to slam on the fiscal and monetary brakes later this year.

The administration's inflationary economic policy will have other serious consequences as well. The continuance of the policy can—

Severely harm that segment of our population least able to sustain economic injury, including the poor, social security beneficiaries, and other pensioners;

Intensify capital outflows from the United States, reduce further our already shrinking trade surplus and drastically worsen our balance-of-payments position;

Result in a breakdown of delicate international discussions on monetary reform and threaten the successful conclusion of the Kennedy Round of Trade Negotiations.

We regret the idea that the relevant choice is between guns and butter. Our private enterprise system is flexible and inventive enough to provide both in an atmosphere of confidence fostered by wise and creative Government policies. The critical issue today is between inflation and the stable growth.

Rapidly increasing civilian, military, and Government demands are beginning to strain capacity in a number of industries and to create shortages of professional and skilled manpower. As pressure mounts on the reservoir of employables and idle facilities, an opportunity is needed to make adjustments. The pace of advance should be maintained but not accelerated until the adjustments take hold.

This requires either an adjustment of the tax structure, some reduction in Federal expenditures, a less easy monetary policy or some combination of these actions.

The most certain way for the administration to protect the gains of the past and to insure social and economic gains in the future is by promoting a balanced and sustainable expansion without inflation.

Mr. Chairman, copies of this statement will be available at 10:30.

Chairman PATMAN. Thank you, Senator Javits. We are ready for Mr. Ackley to proceed now.

Mr. Ackley, you may proceed, sir.

Mr. ACKLEY. Thank you, Mr. Chairman.

I sincerely regret that copies of our testimony were not delivered to the committee yesterday, as they would have been had it not been for the weekend blizzard.

Representative CURTIS. We don't have them?

Mr. ACKLEY. You have them now, yes.

Representative CURTIS. Oh, I see. I beg your pardon.

STATEMENT OF GARDNER ACKLEY, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; ACCOMPANIED BY ARTHUR M. OKUN, MEMBER; AND JAMES DUESENBERRY, MEMBER DESIGNATE

Mr. Okun and I are happy to appear again before this distinguished committee. We regret, as I am sure you do, that Otto Eckstein, who shared in the preparation of our Annual Report, and who has made an outstanding contribution to the work of the Council, is not with us. But we are pleased to be joined by James Duesenberry, who will be sworn in tomorrow as Mr. Eckstein's successor.

We appear here on an auspicious date: this month marks the 20th birthday of the legislation establishing both our Council and the Joint Economic Committee. You have arranged for a notable anniversary program later this month; we congratulate you and your special arrangements committee for what we are sure will be a memorable occasion.

Our opening statement can cover only a small range of the topics covered in the President's Economic Report or in our own. This year the Council's report includes several innovations both in coverage and analysis. However, we intend here to focus on a few central questions of policy.

We first refer to some familiar policy issues on which the experience of the past few years throws considerable light. We suggest that these issues should now be considered as essentially resolved. We turn then to some new policy issues for the years ahead. We regard them as the main challenges of 1966.

OLDER ISSUES RESOLVED

1. Employability of the unemployed

The employment gains of 1964 and 1965 clearly demonstrate that our economy is capable of reabsorbing large numbers of unemployed into productive jobs without serious strain or inflationary pressures.

In 1962, after 5 years of high unemployment, it was impossible to be certain that the majority of the unemployed were readily employable. The possibility could not be ruled out that, in the interim, the character of job requirements at high employment might have changed more rapidly, or in different directions, than the skill composition or the industrial or geographic distribution of the labor force.

Since 1961, the Council has steadily maintained that a 4-percent unemployment rate could be achieved readily, and without excessive strain, through an adequate expansion of total demand; and that even lower rates are attainable in combination with policies of manpower development, training, education, and area redevelopment. The record of the past several years provides unmistakable support for this position.

Relevant evidence is found in the experience both of the highly skilled groups—who might have been a bottleneck for expansion—and of the low-skilled and depressed-area groups—whose employability might have been subject to particular question.

For example, in 1961 there were only 160,000 technical and professional workers unemployed, giving an unemployment rate for these workers of only 2 percent. In the 4 succeeding years, employment of professional and technical workers expanded by 1,178,000. Since the number of such workers unemployed fell only by about 25,000, it is clear that at least 1,150,000 of the newly employed professional and technical workers were new entrants into the labor force, or were trained or upgraded from among other employed or unemployed workers. In 1965, the unemployment rate of professional and technical workers was 1.5 percent. Although there continue to be specific shortages—such as teachers and medical personnel—our further expansion is not being restrained by any shortage of technical and professional workers.

The experience of the unskilled and geographically displaced is equally revealing. From 1961 to 1965, there was a net employment gain for "blue collar workers" of 2.6 million or 10.9 percent, and for "laborers, except farm and mine," of 380,000, also 10.9 percent, well in excess of the average employment gain of 8.1 percent. Employment of nonwhites increased 11½ percent, and of teenagers almost 20 percent. The unemployment rate of laborers fell from 14.5 percent to 8.4 percent; of nonwhites from 12.5 percent to 8.3 percent. The rate for teenagers declined from 15.2 percent to 13.6 percent, despite a net increase of 1 million teenagers in the labor force over this period. These rates are all too high. But we are confident that strong labor markets in 1966—along with active manpower policies—will again reduce these rates substantially.

In September 1961, 25 major labor market areas had unemployment rates of 7 percent or more (table 1). Many seemed to be areas of permanent distress, which no amount of general prosperity could erase. By September 1965, only 2 areas (both in Puerto Rico) had rates in excess of 7 percent. Not only did the average unemployment rate decline over these 4 years, but the wide dispersion of unemployment rates was greatly reduced, with 121 of the 150 labor market areas showing rates between 2 percent and 4.9 percent in September 1965.

The lesson seems clear. The millions of "excess" unemployed were indeed employable, and the great flexibility and mobility of our labor force, and the ingenuity of our employers permitted their reemployment without severe strains or bottlenecks.

2. The gap between actual and potential production

Ever since 1961, the Council has contended that national economic policies should and could be aimed to secure the total output which the economy was capable of producing at high employment. The task of economic policy should not be seen merely as avoiding recessions or promoting recoveries, but rather as promoting full use of a rapidly growing productive capacity and avoiding the waste of unused resources.

TABLE 1.—*Unemployment rates in 150 major labor areas*

Unemployment rate	September 1961	September 1965
Total areas	150	150
Under 2 percent	0	17
2 to 2.9 percent	6	62
3 to 3.9 percent	19	38
4 to 4.9 percent	44	21
5 to 5.9 percent	34	7
6 to 6.9 percent	22	3
7 to 7.9 percent	14	0
8 to 8.9 percent	2	0
9 to 9.9 percent	1	0
10 to 10.9 percent	2	0
11 to 11.9 percent	3	0
12 percent and over	3	2
Average rate, 150 areas (percent) [1]	5.4	3.3

[1] Not seasonally adjusted.

Source: Department of Labor and Council of Economic Advisers.

In 1961, this difference of emphasis was particularly relevant, for the 1960 prerecession peak was clearly a submerged one—with output and employment far below the standards implied by the Employment Act. But in 1961 there was no easy way of telling how much the economy could produce at high employment, since that condition had not been achieved in several years. In its testimony before this committee on March 6, 1961, the Council of Economic Advisers presented its first estimate of potential output at high employment. At that time, the Council estimated that growth of the labor force and of productivity permitted a growth in our potential high-employment output of about 3½ percent a year. If such a growth trend were extended forward from mid-1955 when a 4-percent unemployment rate had been experienced, it would indicate the potential output at high employment for later years. Subsequent evidence led the Council to raise the potential growth trend to 3¾ percent, beginning in 1963, mainly because of the more rapid growth of the labor force.

Under this analysis, the "gap" between actual GNP and a potential GNP so estimated was almost $45 billion for 1961, $30 billion for 1962, and again about $30 billion for 1963. These staggering amounts were described by the Council as an avoidable waste of production, and the corresponding gap in incomes as an unnecessary sacrifice of economic well-being.

The experience of 1964 and 1965 clearly proves that, given adequate total demand, the economy has a remarkable ability to expand toward its potential. The labor force grows more rapidly in response to the incentives of good job opportunities; investment outlays are spurred, adding to productive plant capacity and productivity growth tends to be better sustained.

Estimates of potential output cannot, of course, be entirely precise. But the experience of the past 4 years demonstrates that estimates of overall capacity can be sufficiently accurate to provide an effective guide for policies aimed at balancing capacity and demand. At the end of 1965, the estimated gap was nearly eliminated, just as the unemployment rate was at last returning toward 4 percent. We can be more sure now than we were in 1961 that it is feasible to aim expansionary policies toward full use of potential. And we know now that the American economy has not lost its potential for growth, and that the benefits of that potential growth will be forthcoming if elicited by an adequate growth of overall demand.

3. The latent strength of private demand

In the period after the auto boom of 1955 and the plant and equipment boom of 1956–57, the private segment of the American economy was indeed sluggish. Personal saving was unusually high and business investment disturbingly low.

To be sure, the personal saving rate returned toward normal in 1959. Slow growth of investment, however, continued for 5 more years. Even in the recovery period of 1961 and early 1962—when a strong advance in investment would have been typical performance—the share of GNP devoted to capital accumulation rose little, remaining considerably lower than in the previous decade (table 2).

TABLE 2.—*Business fixed investment as percent of GNP*

1947	10.1	1962	9.2
1948	10.4	1963	9.2
1949	9.8	1964	9.6
1950	9.8	1965	10.4
1951	9.7	1964:[1]	
1952	9.1	I	9.5
1953	9.4	II	9.4
1954	9.2	III	9.7
1955	9.6	IV	9.9
1956	10.4	1965:[1]	
1957	10.5	I	10.2
1958	9.3	II	10.2
1959	9.3	III	10.4
1960	9.6	IV	10.6
1961	9.0		

[1] Quarterly percents based on seasonally adjusted data.

Sources: Department of Commerce and Council of Economic Advisers.

This dormancy fostered the uneasy suspicion that the private economy had become fundamentally stagnant. The Kennedy administration, however, was convinced, that given half a chance, investment (and the whole private economy) would display its latent strength. Events have proved this to be the case.

Buttressed first by the investment credit and new depreciation guidelines of 1962, and then by the Revenue Act of 1964, investment outstripped GNP growth in both 1964 and 1965. In fact, the growth of investment was strong enough in 1965 so that, for the first time in nearly a decade, actual investment equaled high employment private saving. In 1966, investment and private demand show no sign of slackening.

It is clear that the inherent strength and dynamism of the private economy had been mired in a rut through years of inadequate demand. Once expansionary policies unleashed private purchasing power, we saw that our economic vitality had not been eroded by affluence, by "big government," by the "managerial revolution," or by other familiar bogeys.

Expansionary fiscal policy does work

Deliberately expansionary fiscal policy has been a major propelling force for the economy in the last 5 years.

At the end of 1960, the Federal budget was essentially in balance (on the national income basis), while the economy was far out of balance and plagued by recession. Fiscal policy was clearly too restrictive. Over the past 5 years, Federal outlays have risen $32 billion, not quite matching in percentage terms the growth of GNP. Meanwhile, tax cuts have directly added more than $16 billion to the private income stream. The combination of expenditure increases and tax cuts substantially exceeded the normal high employment growth of revenues, thus providing a sizable net stimulus to private purchasing power.

The response of the economy has been dramatic. By increasing aftertax incomes of individuals, consumer expenditures and business sales have been directly lifted. In this way, and through the depreciation reform, the investment tax credit, and the reduction in corporate taxes, the profitability of private investment has been distinctly raised, contributing importantly to the strong expansion of business fixed investment we are now seeing. Statistical analysis shows that the direct and indirect effects of the 1964 tax cut alone were contributing about $30 billion to the level of GNP at the end of 1965 through higher consumer outlays and business investment. The strong rise of GNP has in turn generated sharply rising Federal revenues in spite of tax rate reductions. In spite of—indeed in part because of—the massive tax cuts, Federal revenues by the end of 1965 were, in fact, more than $30 billion higher than at the beginning of 1961.

5. Noninflationary expansion can benefit all groups

The course of the economy during the past 5 years demonstrates that economic expansion, accompanied by generally stable prices, can greatly benefit all groups in the society.

The advance of the economy—greater employment, higher productivity, larger volume of sales—has permitted large gains in real incomes for both labor and businesses. Both groups have benefited greatly, not at each other's expense, but by sharing the dividends of progress. We have had ample evidence in the past that attempts to gain excessively large wage increases do not in fact add to real wages, but rather raise prices. Similarly, price increases designed to widen profit margins have simply added to the costs of business, and swelled labor's demands and justification for bigger wage increases. This time, we have avoided either the wage-push or the profit-push engines of inflation. We have taken our gains in sound dollars and found that there was an abundance to go round.

Thus, in the 5 years between 1960 and 1965, all economic groups have made significant gains, even after adjustment for changes in prices. The average weekly spendable earnings of a manufacturing worker with three dependents rose by 13 percent, after adjustment for the increase in consumer prices. Because of inflation, his gain in the previous 5 years had been less than 4 percent. After adjustment for changes in prices, the average income of self-employed and professionals rose by 14 percent, and average net income per farm by nearly 34 percent. As always during a period of recovery from recession or slack, corporate profits showed the largest gains. From 1960 to 1965, profits before taxes increased by over 50 percent, aftertax profits by almost 67 percent, and corporate dividends by 41 percent. Adjusted for the rise in consumer prices, dividends have increased almost 35 percent.

Labor gained in this expansion without pushing up unit labor costs. Wage settlements generally remained close to the good rate of advance in productivity. Overall unit labor costs rose on the average by less than 1 percent a year and in manufacturing they showed essentially no trend. Business gained without relying on general price increases to widen profit margins. Between 1960 and 1964 the wholesale price index remained stable; it rose only during the last year, adding 2.0 percent, largely as a result of special circumstances. Consumer prices rose at an average of only 1.2 percent a year between 1960 and 1964 and by 1.7 percent in 1965. To some extent, this rise was offset by unmeasured improvements in product quality. The acceleration in prices last year was mainly caused not by a cost push in the industrial sector but by farm and food price rises reflecting production cycles in agriculture. The absence of inflationary pressures during the past 5 years made possible the pursuit of expansionary policies that have brought great benefits to all the groups participating in the production processes of the economy.

6. Economic expansion does not preclude a strengthened payments balance

In 1960 the United States had recorded its largest payments deficit in the postwar period on either measure of balance:

On the liquidity basis, $3.9 billion; and

On official settlements, $3.6 billion.

In the next 4 years, the liquidity deficit averaged $2½ billion and the official settlements deficit about $1¾ billion. In 1965 the deficit was reduced to about $1.3 billion on either measure.

Improvement came in both the private and Government sectors. Net sales abroad of goods and services rose from $4 billion in 1960 to $7 billion in 1965, reflecting our improving competitive position and the expanding world economy (although the slowdown in expansion abroad reduced our gain last year). Through strong and concerted efforts, the impact of Government transactions on the dollar outflow was greatly reduced. Net military costs abroad declined from $2.7 billion in 1960 to $2.0 billion in 1965, despite increased commitments overseas. The dollar outflow of Government grants has been reduced from $1.1 to $0.8 billion over this same timespan, also in the face of expanding commitments.

The administration recognized that the U.S. balance-of-payments deficit was not a symptom of the traditional disease of an overheated domestic economy. Instead of using the broad tools of tight money and tight fiscal policy, more selective measures were chosen to deal with the specific problem areas. The interest equalization tax, the voluntary credit restraint program, the emphasis on stable prices, and other parts of the payments program significantly helped to reduce the deficit. The problem is far from solved—indeed, we must make further progress this year. But 1965 demonstrated that it could be brought under control without sacrificing domestic expansion.

THE CHALLENGES AHEAD

1. The crucial test of price-cost stability

Price-cost stability is the big normal problem of high-level prosperity. An economy which uses its resources fully always faces the danger of inflation in the same sense that anyone basking on a sunny beach is in danger of sunburn. In both cases, the risks are welcome, and in both cases, there are prudent rules to help to avoid overdoing it.

It is essential that aggregate demand for goods and services stay within the bounds of our supply capabilities. In 1966, overall demand is not expected to strain productive capacity. Operating rates in manufacturing should show little change from where they are today, averaging 3 percent below preferred rates of businessmen. Labor supplies will be adequate to meet the overall needs of employers.

The balance of demand and supply is never identical in all areas. Overall balance may mean excess demand in some markets and surplus capacity in others. For example, in the past year, even with overall balance, supply problems have raised prices in such diverse areas as livestock and copper. The administration will continue to strive to alleviate shortages wherever they arise by diligent use of a wide range of policy instruments. It will continue to promote price-cost stability in every aspect of managing the Government's own affairs, such as pay, procurement, and resource policies.

Evidence of generally good balance among manufacturing industries is found in the patterns of operating rates and order backlogs. Operating rates in 1965 did not strain capacity. Moreover, investment is raising industrial capacity precisely where it is most needed. The availability of capacity is reflected in only moderate backlogs of unfilled orders in the face of substantial gains in sales and production. These indicators of pressures on capacity are far more favorable and encouraging today than they were when we ran into inflationary problems a decade ago.

While the movement toward full employment has produced labor shortages in some highly specialized occupations, the American labor market has generally demonstrated remarkable flexibility in adapting to new economic conditions. Managements have avoided skill shortages by redesigning jobs to accommodate a changed skill mix, upgrading experienced workers to more skilled classifications, intensifying on-the-job training, and stepping up investment to modernize facilities. The continually improving quality and mobility of the labor force have also contributed to our smooth progress and have been furthered by Government manpower training programs, more education, and better health.

In 1966, the unemployment rate will drop still lower under the impact of another large rise in production and the increase in the armed services. Even more demanding efforts will be required from labor and management to adjust to prosperity. But there are many favorable elements in the outlook. Productivity gains should continue at a good rate. Meanwhile, there is little to suggest a step-up in wage increases that would upset the general stability of unit labor costs. Indeed, in many basic industries the pattern of wages for 1966 has already been established in labor contracts previously negotiated. The extraordinary level of profits in 1965 gives clear evidence that business firms generally do not need price increases to maintain adequate returns on their investments. With the good balance of operating rates among industries, with new up-to-date capacity coming on line, and with keen competition from producers at home and abroad, we can prudently advance to higher rates of employment without sacrificing essential price stability.

Our success will depend upon responsible decisions in those areas where firms and unions have market power. The administration's guidepost set a standard for noninflationary price and wage movements that will provide an equitable and efficient share of the fruits of economic progress between labor and management. The wage guidepost calls for wage increases that remain in line with the economy's trend growth of productivity. "Trend productivity" describes the pace of productivity growth, on the average, in the absence of cyclical gains from taking up slack and of temporary setbacks from either underusing or overstraining capacity. While it cannot be measured precisely, careful studies point to a range for trend productivity between 3 and 3.3 percent. The Council is explicitly suggesting once again the use of a 3.2 percent figure for the wage guideposts.

The price guidepost allows for rising prices in industries where productivity gains cannot match the economywide average; but these must be counterbalanced by price reduction in areas of especially rapid productivity advance. The President's Report calls attention to a large number of products where the consumer has directly received the benefits of lower prices in recent years. It is essential that the importance of price reductions be increasingly recognized.

By working together, public and private decisionmakers have a great opportunity in 1966 to meet and beat the big normal problem of high-level prosperity—to demonstrate that price stability and full employment are compatible objectives in our dynamic and flexible economy.

2. The challenge of defense

This year, we face not only the normal problems of prosperity but some special ones as well. The economic impact of Vietnam presents an important new challenge to our improved but imperfect abilities to maintain stable and sustained prosperity. In the past, defense build-

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ups have often disrupted the American economy and have rarely been taken in stride.

To be sure, we have the recent favorable example of the $7 billion increase in defense outlays of 1961–62, associated with the Berlin crisis. However, it impinged on an economy that was barely emerging from recession and that had a wide margin of idle men and machines. But it would be just as misleading to compare present problems with the Korean crisis. The mobilization requirements then were of a totally different order of magnitude from anything now reasonably foreseen for Vietnam. In 10 months, from June 1950 to April 1951, the Armed Forces expanded by almost 1½ million men. This time, slightly more than 300,000 men are being added during fiscal 1966 and another 100,000 in fiscal 1967. Similarly, the increase of $23½ billion (annual rate) in defense outlays from the third quarter of 1950 to a year later simply dwarfs the $6 billion annual increase in today's much larger economy. In that 1-year interval, defense outlays rose from 4.8 percent to 11.3 percent of GNP. This year, defense outlays will reach 7.7 percent of GNP compared with the 7.4 percent ratio in the first half of 1965, the low point of recent years.

The current buildup should not produce the economic dislocations and disruptions—real or psychological—that marked the start of the Korean conflict. The present situation obviously does not call for the same type of emergency restraint that was necessary then. The tools for dealing with our foreseeable defense needs are fiscal and monetary policies, fortified by the competitive workings of the price system, by limited use of existing authority for priorities and allocations, and by responsible wage and price decisions in areas of market power.

In short, by standards of mobilization the current defense needs are modest. By standards of fiscal stimulus, however, they are substantial and significant. The $6 billion of added outlays this year will have an important broad influence on all industries and all areas of the Nation. But this stimulus has been appropriately offset within the fiscal program for 1966. Along with the incalculable human costs of armed conflict, defense needs are imposing the real economic costs reflected in the fiscal program: postponed tax reductions, more rapid tax payments, less rapid progress toward the Great Society. We are paying these costs to avoid the high toll of inflation. By making the proper adjustments we have good prospects for preserving a balanced noninflationary economy.

3. The new assignment of fiscal policy

Fiscal policy has demonstrated its ability to stimulate the economy when total spending lagged behind productive capacity. Now that demand and supply are in better balance, fiscal policy is called upon to contribute to smooth sustained expansion without adding further stimulus. This is a new assignment and a demanding one. But the principles to promote overall balance of supply and demand which have been successfully applied in the past are still there to guide us.

The enlarged defense requirements of Vietnam certainly complicate the task by enforcing a large increase in Government purchases of goods and services. The normal growth in Federal revenues generated by an advancing high-employment economy allows considerable room for increases in expenditures without making overall fiscal policy more expansionary. Our fiscal drag is welcome this year. But the margin it provides does not match the required addition to defense outlays along with the highest priority expenditures for Federal civilian programs.

The only way to prevent fresh new fiscal stimulus under these circumstances is to introduce restraint from the tax side. The appropriate restraining influence comes from the President's proposals to reschedule excise tax cuts and to put tax collections on a more current basis. With these measures, the fiscal program will not further stimulate the economy over the budget planning period of the coming year and a half. It approximately balances the stimulus of added expenditures and the restraint of increased taxes through both normal revenue growth and new legislation. The high-employment surplus in the national income accounts budget was virtually removed in the second half of 1965. Over the next year and a half, the fiscal program remains essentially at that position, tending to become somewhat more restrictive toward the end of that period. The President's program is a consistent and appropriate application of unwavering principles to a changed economic environment. We do not claim that this is a sure-fire formula for stable growth—but we know of no better strategy, and we believe this one should succeed.

4. The role of monetary policy

The new environment of the economy calls for the ingenious and diligent pursuit of monetary policies that neither choke off nor further stimulate the advance of the economy. An inadequate growth of credit could impede the expansion we want and can achieve. The external financing needs of business will be large in 1966. Banks are currently in a tight position, and hence highly dependent on additional reserves to meet the high-priority needs of their customers. On the other hand, too rapid a growth of credit could have inflationary consequences and work at cross purposes with fiscal policy. In particular, it could nullify the moderating effect on business spending intended by the acceleration in corporate tax payments.

Monetary policy—like fiscal policy—is obliged to stay flexibly attuned to the changing needs of the economy. As in the case of fiscal policy, monetary policy must find the right setting of the dials to help maintain an even keel of economic advance. It will not be easy to locate the happy median between the settings of "stimulative thrust" and of "reverse."

Both the Federal Reserve and the Administration have demonstrated their recognition of the importance of coordination between monetary and fiscal policies. Given the statutory division of responsibilities, the record of coordination has been remarkably good in the past 5 years. Yet it has not been perfect, as evidenced by the most recent increase of the discount rate in December. We all regret the blemish on the record, but should not lose sight of the overall pattern which this incident interrupted. We reiterate our view that nothing in the situation 2 months ago called for action before it was possible to reach coordinated decisions on fiscal as well as monetary policies for this year.

However, once the majority of the Federal Reserve adopted a firmer monetary policy, rather than choosing to link that decision to fiscal planning on taxes and expenditures, the budget decisions were fashioned in light of the moderating influence of monetary policy.

Our own judgment is that the combination of fiscal and monetary policies we now have is appropriate to the current situation and outlook for economic activity. It is conceivable that some other combination would be just as good or even better; nevertheless, it seems fruitless to speculate what that other combination might be.

The Administration and the Federal Reserve continue to consult on monetary policy, and we will certainly make every effort to improve coordination as well as the effectiveness of the individual policies. We are optimistic that the pattern of coordination which has been the rule through the past 5 years can be resumed and strengthened.

5. The need for flexibility

The policies outlined in the economic report are carefully designed to meet the economy's needs as they can be best diagnosed today. But policy must be ready to meet changing developments. The year 1966 is one of exceptional uncertainties. Unemployment rates under 4 percent will be a most welcome development and triumph for the Nation. But they have not been experienced in more than a decade, and they designate an unfamiliar territory which must be traversed with care. Further, forecasts of private demand can never be guaranteed. And defense outlays may need to be altered as we respond to the changing course of world events.

An alert and flexible stabilization policy can adapt to unfolding developments. It cannot compensate for every disturbance at the exactly right time and right amount. That is too much to ask and more than is needed. The flexibility of the private economy itself helps to cushion temporary fluctuations in the rate of growth of demand or mild shifts in its composition. The economy has weathered many squalls and stayed on course in recent years. For major contingencies, we have powerful policy instruments, and we have the will to use them. If world tensions should require a further addition to defense spending, or if private demand surprises us and rises so rapidly as to strain our productive capacity, the President has said that he will ask for such further tax measures as becomes necessary. And if the need should arise, I am sure that the Congress would respond promptly, just as it acted within 1 month to lower excise taxes last year.

Although it is hard to visualize private demand sagging spontaneously this year, flexibility must remain a two-sided strategy. In the event of a peaceful conclusion of hostilities in Vietnam, the welcome opportunity would arise to speed our progress with Great Society programs or to proceed with tax reductions that would enlarge private purchasing power. Easing of monetary policy would also become appropriate.

The possibility of prompt tax action—up or down—depends on reaching careful judgments on the type of tax actions that can best serve to spur or brake the economy in a time of urgency. The executive branch is undertaking studies to throw light on this issue; as the President suggested in his Economic Report, Congress might also find such background analyses rewarding.

Changing developments can present major challenges. Yet we are better prepared to meet these today than ever before. We shall maintain our vigilance and sharpen our tools. The American economy has achieved a wonderfully balanced and full prosperity. We shall do our very best to preserve and extend that record.

Chairman PATMAN. Thank you, sir.

Without objection, we will retain and use the 10-minute rule. Each member will be allowed 10 minutes on the first round of questions. We will continue the order we used before. Mr. Knowles will delegate someone to keep the time.

Mr. Ackley, you have stated—and I quote—

> However, once the majority of the Federal Reserve adopted a firmer monetary policy, rather than choosing to link that decision to fiscal planning on taxes and expenditures, the budget decisions were fashioned in the light of the moderating influence of monetary policy.

Are you saying there that you are fashioning your policies in accordance with the actions of the Federal Reserve? Is that what I am authorized to assume there?

In other words, are you following the Federal Reserve's monetary policy?

Mr. ACKLEY. We are accepting the Federal Reserve's decision as a fact of life, and as one element in the economic picture to which other decisions need to be adjusted.

Chairman PATMAN. Now, the increase in interest cost of the budget, I believe, is about $750 million. Was all that by reason of this decision of the Federal Reserve Board in December to raise the interest rates?

Mr. ACKLEY. Mr. Chairman, is the figure you are referring to the difference between the budgeted cost of interest in fiscal 1967 and that in fiscal 1966?

Chairman PATMAN. That is right; from the last year to the coming year.

Mr. ACKLEY. To fiscal 1967. It would be primarily due to higher interest rates, and secondarily due to some small increase in the size of the debt.

Chairman PATMAN. But caused by the Federal Reserve action in December 1965?

Mr. ACKLEY. I would certainly agree that the primary factor in interest rates is the monetary policy of the Federal Reserve System.

Chairman PATMAN. Yes. Now that rate increase, Mr. Ackley, has been heralded as a 4- to 4½-percent increase, which is only a 12½-percent increase. But you realize that the Fed also increased, at the same time, 90-day or more certificates of deposit, from 4½ to 5½ percent, which represented a 22.2-percent increase; and also, and in the same order, increases were made in the 4 percent 30–90 day certificates of deposits and time deposits to 5½ percent, thereby making an increase of 37½ percent.

Taking that into consideration, suppose General Motors had increased its prices on small cars, or low-priced cars, 12½ percent, on middle-priced cars, 22.2 percent, and on the higher priced cars, 37½ percent. Would that have been inflationary or not?

Mr. ACKLEY. I think price increases of that magnitude would surely have been inflationary, Mr. Chairman.

Chairman PATMAN. Would have been inflationary. Weren't you shocked at the amount of the interest rate increase, Mr. Ackley?

Mr. ACKLEY. Mr. Chairman, I think one has to remember that the ceiling rates on time deposits are ceilings, and not actual rates, and that the effort of the Board in that action was to raise the ceiling far enough in the hope that actual rates would not bunch up against it.

Chairman PATMAN. That's their argument, Mr. Ackley. That's what they claimed, of course, when they got this out. Then they got out a letter to the banks asking them not to use the increase, which I thought was not very timely, after giving them that right. If they didn't expect them to have to use it, why would they give them that 5½-percent ceiling?

The truth is, isn't it, Mr. Ackley, that there were a few banks that were hurting? They had about three-quarters of the $16½ billion in certificates of deposit that were coming due in December 1965, and January and February 1966. You realize that, don't you, Mr. Ackley?

Mr. ACKLEY. Yes, sir, Mr. Chairman.

Chairman PATMAN. And wasn't that the real reason for that sudden emergency and urgent increase in the first part of December 1965? These certificates of deposit?

Mr. ACKLEY. I think the Board was concerned about the ability of banks to roll over their certificates of deposit as they came due. I am not necessarily agreeing that the action they took was necessary to achieve that rollover, but indeed, that was one of the things that was concerning the Board.

Chairman PATMAN. That seemed to be the main reason for it, didn't it? The other could wait, but they didn't seem to think they could wait on that. Do you believe these certificates of deposit are legal, Mr. Ackley?

Has your legal department passed on that yet?

Mr. ACKLEY. Unfortunately, Mr. Chairman, the Council does not have a legal department.

Chairman PATMAN. You don't have a legal department at all?

Mr. ACKLEY. We are a very small staff, Mr. Chairman. We have a total of fewer than 20 economists.

Chairman PATMAN. But haven't you gotten the opinion of the Attorney General or anybody like that?

Mr. ACKLEY. I have not, personally.

Chairman PATMAN. You have no answer to make on whether or not they are legal or illegal? The Federal Reserve Board has never said that they were legal—neither have they said they were illegal.

But the Comptroller of the Currency is the only one that came out and allowed these banks to invest in certificates of deposit, and also promissory notes; but you have no statement to make as to their legality.

Mr. ACKLEY. I think you can find a better source for that question, Mr. Chairman.

Chairman PATMAN. Yes.

Now, Mr. Ackley, in your statement, under the heading "The Challenges Ahead," I was hoping that you would say something about financing the war. You know, in the beginning of 1941, 1942—about that time—in the Second World War, some of us went before the Ways and Means Committee of the House and tried to get the committee to adopt a program: first, to sell all the bonds that could be sold by the Government, for the purpose of financing the war, or the emergency. Sell to everyone who had money to buy the bonds.

But, when no more money could be obtained that way, and it was necessary to let the commercial banks create the money, or manufacture the money to buy the bonds, we proposed that the Federal Reserve instead be required to finance that part of it—the creation of money—and at a low rate of interest, and amortize the bonds over a 40-year period and pay them out that way.

Now, don't you think that consideration should be given to that now? Sell bonds as long as we can get money for them, but when money has to be created to sell the bonds, don't you think we should consider having the Federal Reserve create the money, rather than have inflationary money put out by the banks' creation?

Mr. ACKLEY. Mr. Chairman, in the first place, I would hope that we are not entering a period such as that of 1941–42, when we obviously had a massive increase in total demand. We met this in part through higher taxation, but only in part, so that we still had a large deficit to finance. I think the financing of the war was probably done fairly effectively.

I might personally have preferred somewhat larger tax increases, and less reliance on borrowing, but I really don't think the current situation is parallel to that one. At least we know——

Chairman PATMAN. All right, since you don't think it is parallel, we will not pursue that further, but I do want to remind you, Mr. Ackley, that during World War II, all throughout that war, the interest cost to the Government on short-term money was kept at a minimum. For each dollar the Government paid in interest then, we are required to pay $30 in interest now.

It has increased just that much.

Now, that is on short term, and on long term, it has increased more than 100 percent. So, I think in view of that fact, that we should certainly give very careful consideration to the suggestion that if money has got to be obtained by creation or manufacture—by the commercial banks—which is highly inflationary, as you know, and certainly more inflationary than the Federal Reserve banks' creation, that we should give consideration to not letting the commercial banks create and manufacture this money to buy those bonds, but rather to have a method of doing it through the Federal Reserve System.

Don't you think that is worthy of consideration, Mr. Ackley?

Mr. ACKLEY. Certainly, if we were to engage in an all-out war in which we had to use price controls and wage controls, I think we would have a very different circumstance to contemplate.

Chairman PATMAN. Well, of course, I don't think the price and wage controls enter into exactly this question, but that's your opinion.

That's for you to say.

The interest rates, though, are certainly very burdensome now. We are paying over $1 billion a month, and with this increase, it will be over a billion dollars a month for 12 months, caused by this increase of the Federal Reserve Board in the early part of December.

The point you are making here, if I understand it right, is that you did not favor the increase that was put on by the Federal Reserve Board, but since they have done it, you feel that it is within their power, and you are trying to live with it the very best you can.

Is that a fair summary of what you said there, Mr. Ackley?

Mr. ACKLEY. What I was trying to say, Mr. Chairman, was that we recognize the need in the year ahead for restraint, a combination of fiscal and monetary restraint. Whether the present exact mixture of fiscal and monetary restraint is the best we could have devised, it seems rather fruitless to speculate.

Rather, we accepted the restraint implied in the monetary policy, and adjusted our fiscal policy decisions accordingly.

Chairman PATMAN. Adjusted your fiscal policy decisions accordingly. That's what I was asking you.

I will make this suggestion, and then I will yield to my friend, the distinguished gentleman from New York, Mr. Javits.

You are putting out—I mean the Treasury is putting out—these 5 percent short-term bonds—that is, less than 5 years. As they have to be in order to be legal—and I notice they are trading some of those 5 percent bonds for about $5 billion worth of bonds held by the Federal Reserve open market portfolio.

Now, those bonds have been paid for once. I am not going to ask you any question, but I am going to ask you to consider this; you can put your answer in later: Does it look very sensible to you for the Federal Reserve to have $40 billion in Government bonds that have been paid for once with U.S. Government money, paid for once, and now then, to trade a part of those $40 billion in bonds for these new 5 percent bonds that are put out? That just doesn't make very good sense to me, and I want you gentlemen, and of course, you are the Council of Economic Advisers to advise on all these things, to bring us up an answer to that $40 billion.

You know, it doesn't look too good to have people continue to pay $1½ billion a year interest on bonds that have already been paid for once, seemingly, for the sole and only reason to let the Federal Reserve Board collect enough money, a billion and one-half, under some guise, to permit them to retain $200 million of it to pay their expenses without having to come to Congress for an appropriation.

That's the way it looks to me.

Now, I will yield to the gentleman from New York.

(The following material was supplied for the record by the Council of Economic Advisers:)

The Treasury and the Federal Reserve System keep separate accounts; and the Federal Reserve System, in accord with customary central banking practice, holds a large volume of Treasury securities as a part of the monetary base of this Nation. Given these practices, it is clear that the Federal Reserve will replace maturing Treasury securities with new ones. Indeed, as Chairman Patman points out, the Federal Reserve acquired some of the new notes issued in the last Treasury refunding. The same exchanges regularly take place in the case of Federal trust funds such as the social security trust fund, where similar separate accounts are maintained.

While this is a continuing practice, as Chairman Patman suggests, it should be noted that only a single payment is made on any particular Treasury security, when the Treasury redeems or exchanges that outstanding issue. Such redemption or exchange seems to be an intrinsic element in the current statutorily established arrangements involving the Treasury and the Federal Reserve. According to these, the Federal Reserve collects Treasury interest like any private holder but then returns the bulk of that interest to the Treasury, using the rest to cover its expenses. The Council is not prepared to judge whether the current arrangement provides, in all respects, the most effective accounting system or the most desirable means of financing the necessary expenses for operating the Federal Reserve; but we do judge that the opportunity of the Federal Reserve to redeem and/or exchange its Treasury securities is essential to the smooth operation of the present system.

Mr. ACKLEY. Could I, just before you do, Mr. Chairman, make one comment on your opening question to me, which I didn't quite have a chance to make?

Chairman PATMAN. Yes, sir, before yielding to Senator Javits.

Mr. ACKLEY. You referred to the increase in the discount rate, and the increase in the ceiling rate on certificates of deposit.

I would make the comment that, although the rise of one-half percent in the discount rate was translated fully into a rise in short-term interest rates, generally, including Treasury bill rates, the increase in longer term Government bond yields, corporate bond yields, and in mortgages and municipals has not been nearly of the same magnitude.

Chairman PATMAN. Well, the Government bond part—the long-term—they had already broken through the ceiling, long ago.

Senator Javits?

Senator JAVITS. Mr. Ackley, isn't it true that the administration should prepare fiscally and monetarily for war with the same determination that it is preparing militarily?

Mr. ACKLEY. I would certainly agree that, if war is a possibility, such preparation should be made.

Senator JAVITS. Well, we are in it now, aren't we?

Mr. ACKLEY. To the extent we are, indeed, yes.

Senator JAVITS. And the President has spoken about the determination with which we intend to move into it and prosecute it, correct?

Mr. ACKLEY. Yes, sir.

Senator JAVITS. Therefore, a speculation that suddenly the pressure may come off, et cetera, as an excuse for half measures is pretty idle, isn't it? It doesn't show very great determination, if in money we are going to proceed differently than what we proceed in men.

Mr. ACKLEY. Well, I am not sure I would agree with the characterization of half measures, Senator. Our view is that the total fiscal program is adequate to the expected circumstances of the economy. We can be wrong.

Senator JAVITS. In your judgment, does it leave you with enough residual room for maneuver so that you can protect the economy, as against the shock of a materially accelerated military effort?

Mr. ACKLEY. If there should be a material acceleration beyond the extent budgeted for and planned for, then I would agree with you that further moves on the fiscal monetary mix would almost surely be required.

Senator JAVITS. Does this plan for the economy presented to us by the President have within it the capability of the administration to move in the way you have just described?

Mr. ACKLEY. On tax matters, obviously, the administration can't move by itself. It requires the Congress to take action, and that is one reason, of course, why the President suggested that background studies might be appropriate, both in the executive branch and in the Congress.

I would point out that the ability of Congress to act rapidly on taxes has frequently been demonstrated—in the early stages of the Korean war when Congress enacted several tax bills very quickly, by its prompt action in the case of excise tax cuts last year, and by what I hope and expect will be very quick action on the President's tax proposals of this year.

Senator JAVITS. Now, does that imply, therefore, that this administration, unlike the Kennedy administration, is not seeking power to raise or lower taxes within given limits?

Mr. ACKLEY. That is correct.

Senator JAVITS. And that is the policy of the administration.

Now I think that, on this side, we are interested essentially in four things: (1) The problem of enforcing the wage-price guidelines; (2) the administration's budget concept, guns and butter, and the size of the deficit, and how it is contrived; (3) the tax policy which you have just referred to; and (4) the coordination with the Federal Reserve.

Now, first, on the guidelines, which interests us very greatly, would the administration favor, under existing circumstances, some clear legislative authority as to when and how to apply the wage-price guidelines? It could give you flexibility to adjust the wage-price guidelines periodically and could give the executive branch specific but limited authority to utilize its range of powers to defend the guidelines.

Mr. ACKLEY. Well, I am not entirely clear what that proposal might contemplate in all respects. Our view at the present time is that the present informal and voluntary guidepost approach is adequate for the kind of situation which we think we face.

Should the problem become substantially more serious, then it would be a different ball game, but at the moment we are not asking for congressional authority with respect to guideposts.

Senator JAVITS. Well, it is a fact, is it not, that various governmental powers have been utilized in aluminum and steel and in copper to spank people who didn't obey the guidelines?

Now, do you feel that that is the authority the President ought to have or exercise, or do you think he ought to have legislative authority before he uses other governmental powers to compel people to comply with the guidelines?

Mr. ACKLEY. Well, I am not sure I would agree with your characterization, Senator, that the policies of the Government have been used to spank people. I believe that the stockpile releases that have been made can be defended in terms of an appropriate use of surplus Federal materials, in a period of developing shortages in those materials.

It may be that some of the language that some of us may have used in describing some of these circumstances sometimes was stronger than it might have been. I have no particular apologies for what I have said about the steel or aluminum, copper, or transit worker, or any other case of guidepost violation. The guideposts were designed as standards for private behavior.

The President has repeatedly said that he would not hesitate to call public attention to violations of the guideposts, or what appeared to be violations of the guideposts. Since they are voluntary, the ultimate enforcer of them is the sense of responsibility of private individuals, and the weight of public opinion. I think that we have appropriately called attention to what appeared to us to be violations of the guideposts. In some cases those increases were withdrawn. In other cases they were not.

Senator JAVITS. Well, the administration then feels that it has the right, the authority, to exercise powers not legislatively granted for the purpose in order to enforce the guidelines.

Mr. ACKLEY. I think the administration has used whatever tools it has had available; used them legally, and responsibly. I believe it is entirely appropriate for the Government to use whatever policies and whatever it is doing in the market in support of its national price stability objectives. Since it does have a large stake as the Nation's largest single buyer I find nothing inappropriate in the actions that have been taken.

Senator JAVITS. Does the administration prefer the present situation to clear legislative authority to establish and defend the guidelines?

Mr. ACKLEY. I think at the present time the administration would not recommend legislative authority to establish guidelines.

Senator JAVITS. Now, what about the manipulation of guidelines? A good many labor leaders have complained that the guidelines right now ought to be 3.6 percent, if you applied the previous standard, and you have got them at 3.2 percent by changing the standard.

How do you defend that?

Mr. ACKLEY. Senator, the standard for the wage guidepost since its first statement, was that the advance in wage rates and fringe benefits should not exceed the trend of productivity in the economy.

That has been repeatedly stated in this form, and at no time until the 1966 report has the Council recommended a specific figure for this purpose.

It is true that in the 1964 and 1965 reports, there was a table included which showed a column called "trend productivity" measured by a 5-year moving average. Those 5-year moving averages in 1964 and 1965 both turned out to be 3.2 percent.

I think it would be entirely inappropriate, however, to say that we had changed the rules by departing from a 5-year moving average in 1966.

I would suggest that we look at chart 10 in our report, which in the second bank shows the annual change in output per man-hour over the postwar period.

(Chart referred to appears herein.)

This is the change in output per man-hour in the total private economy. You will see it is an erratic series, that the gain in productivity each year is not the same.

It fluctuates. It fluctuates in part because of accidental factors, but it also fluctuates systematically in times of recession and rapid recovery.

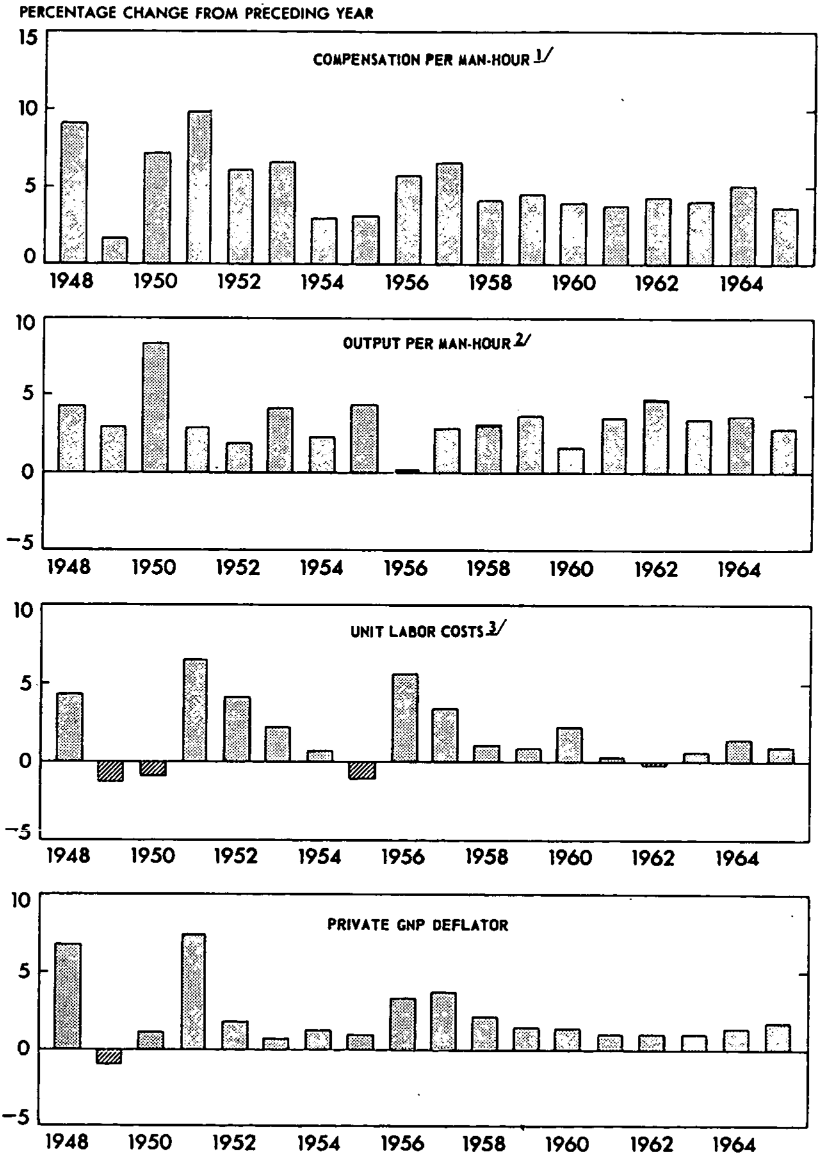
It so happens that the average of that series over the whole postwar period turns out to be 3.3 percent. The average for the latter half of the period is slightly lower than that.

The 5-year moving average in 1964 included both a low gain of productivity in the year 1960 and an exceptionally high one in 1962. The same was true of the 5-year moving average up to 1965. Again, it included that low productivity gain of the recession year 1960, and the exceptionally large one in 1962. But if one looks now at the last 5 years, it seems clear to me that it would be quite a misinterpretation of the guidepost principle to say that, because the year 1960 disappears from that 5-year average, the trend of productivity has advanced.

Senator JAVITS. There is a change, though. You are not applying the same base now that you did last year.

Chart 10

Changes in Compensation, Prices, and Productivity in the Private Economy



1/ TOTAL COMPENSATION DIVIDED BY ALL PERSONS MAN-HOURS WORKED.
2/ PRIVATE GNP DIVIDED BY ALL PERSONS MAN-HOURS WORKED.
3/ COMPENSATION PER MAN-HOUR DIVIDED BY OUTPUT PER MAN-HOUR.
SOURCES: DEPARTMENT OF LABOR, DEPARTMENT OF COMMERCE, AND COUNCIL OF ECONOMIC ADVISERS

Mr. ACKLEY. In every case, the statement of the guidepost was that the advance in wage rates should not exceed the trend growth of productivity. In the last two reports, a 5-year moving average was a fairly simple and not inaccurate representation of the trend of the productivity.

It would be quite an inaccurate representation of the trend if we were to use that formula this year.

Senator JAVITS. So you are not using it?

Mr. ACKLEY. We are not using that as a measure of the trend of productivity.

Senator JAVITS. Now, Mr. Ackley, my time is up, but I would like to state in conclusion that I do not wish to be misinterpreted as objecting to the guidelines. On the contrary, I think that if we are going to gird for war, we should gird for war in the area of price—prices, wages, and taxes—and that the civilian should sacrifice as much as the man who is drafted or who enlists, but I do think that it is very important to get to the bottom of just how this is done, and why, and why the administration considers it adequate in the monetary and financial field in the relation which in my view it bears to the sacrifices we are asking of our people in the military field.

Thank you, Mr. Chairman.

(The material which follows consists of additional questions by Senator Javits and the subsequent answers of the Council of Economic Advisers:)

REPLIES OF THE COUNCIL OF ECONOMIC ADVISERS TO QUESTIONS SUBMITTED BY THE HONORABLE JACOB K. JAVITS

Question 1. How did the Council apply the wage-price guidelines when they were first announced, and how did you succeed in industry or labor unions accepting or adhering to the guidelines?

Answer. The guideposts were first formulated in the 1962 annual report of the Council of Economic Advisers. They were designed to provide standards for evaluating price and wage decisions in those situations where either unions or managements or both have substantial degree of market power and, as a result, considerable discretion in the pursuit of wage and price policies.

The guideposts have never been formally or officially accepted by any labor or business organization. But as a consequence of several factors—the experience of midfifties, the continuous educational effort on the part of the Council and other administration agencies, the leadership of the President in promoting price-cost stability—there has been a much better recognition than ever before of the importance of noninflationary wage and price decisions to permit the pursuit of full employment and full prosperity.

Question 2. On the basis of what authority did the administration utilize the aluminum stockpiles or defense or highway construction purchases to enforce the guidelines?

Answer. The guideposts are not enforced; nor are they enforceable. They are intended to serve as specific standards by which private decisionmakers might determine whether their price and wage behavior takes adequate account of the public interest. At the same time, they provide standards by which the public, and representatives of the public, might judge the consequences of price and wage actions for maintained cost-price stability. These judgments may point to the desirability of Government action or public announcements in some instances.

As of last November, the Government possessed almost 1.5 million tons of surplus aluminum in its stockpiles. The Government had been trying to sell this surplus aluminum since last summer, but had been unable to reach a satisfactory agreement with the major producing companies. Meanwhile the rising demand for aluminum, aggravated by burgeoning military requirements, was pushing production up against capacity in the aluminum industry. Under these conditions it made no economic sense for the Government to withhold the large aluminum surplus from the market. Thus, acting under sound legal advice, the Government prepared to relieve the shortage by the direct sale of this aluminum. Thereafter, the producing companies agreed to a long-term arrangement for its disposal through them.

We presume that the reference in the question to defense and highway purchases relates to the announced intention of the Government at the time of the price increase in structural steel to purchase its requirements from those companies with the lowest prices. We should not believe that anyone interested in promoting Government efficiency would counsel otherwise. Indeed, the Government is not only authorized but, in fact, charged with the responsibility to buy from the source most advantageous to the Government, price and other factors considered (cf. title 10, sec. 2305, and title 41, sec. 253 of the United States Code).

Question 3. Would you supply for the record of these hearings the dates and circumstances under which the wage-price guidelines were invoked by the administration, and whether or not it succeeded in enforcing the guidelines since 1962?

Answer: As noted above, the guideposts have never been and could not be "enforced" by any agency of the Federal Government. As the answer to question 1 indicates, the guideposts have been formulated as standards for judging wage and price behavior rather than as standards for enforcement. However, the record of price and wage behavior since 1962 suggests that actual wage and price changes have been, by and large, not very different from those that would be based on the guideposts. This behavior has been a result of private decisions made in recognition of the public interest and not of any enforcement.

The President has made many public appeals to both labor and management to observe the guideposts, and so have other members of the administration. Also, in some situations, the administration took action that contributed to a wider adherence to the standards of the guideposts. There have been literally hundreds of occasions in which the implications of guideposts, both in general and for specific cases, have been discussed in informal conversation between administration officials and either businessmen or labor leaders, often with the result that wage or price changes were held within or closer to the guidepost standards than would otherwise have been the case.

We might mention a few of the most recent instances in which guidepost policy action received widespread public attention. In September 1965 the Government helped the parties in the steel industry to reach a labor agreement that was within the guideposts. The CEA also indicated, in January 1966, that an increase in steel prices announced by the Bethlehem Steel Co. was not justified under the guideposts. This price increase was eventually modified.

In October 1965, the Council of Economic Advisers prepared a guideposts analysis of price increases made by producers of primary aluminum. These price increases were later canceled.

The President also persuaded the Congress last fall to enact a pay increase for civil service employees which was within the guideposts.

On other occasions, the President or members of the administration have publicly reported and regretted the fact that particular wage or price decisions appeared to violate the guideposts.

Question 4. How do you reconcile the administration's actions in the copper, aluminum, and steel price cases with the President's declaration in his 1966 Economic Report that "the Federal Government does not have authority to impose ceilings on wages and prices"?

Answer. The actions cited are readily reconciled with the absence of authority to impose price and wage ceilings, since they did not involve an imposition of, or attempt to impose, such ceilings in any way, shape, or form.

Question 5. Would you explain why the guideposts are applicable more to industries characterized by large firms and strong unions than to others?

Answer. In a hypothetical perfectly competitive environment, there would be no need for guideposts. In the absence of generally excessive or deficient total demand the price level would be stable, and competition among workers would tend to prevent wages from rising faster than productivity. Guideposts would be superfluous.

In point of fact, however, in many industries, unions or management or both possess considerable discretionary power to set wages and prices. There have been clear instances in the past when that power was used to raise prices and costs, even in the presence of unused manpower or capacity in the particular field. This use of market power can undermine the foundation of noninflationary prosperity, under conditions when aggregate demand is just sufficient to employ most available resources.

It was to counter this threat to noninflationary prosperity that the administration formulated the price and wage guideposts.

This rationale for the guideposts indicates that they would be applicable only to situations in which significant discretion exists in setting prices and wages. These industries tend to be "characterized by large firms and strong unions."

Question 6. What is your answer to labor leaders who reportedly object strenuously to the Council's decision to change its methods of computing the guideposts?

Answer. The Council has been consistent in stating the wage guidepost: the average increase in compensation per man-hour should not exceed the trend increase in output per man-hour for the entire private sector.

Because of cyclical and other shortrun factors, increases in output per man-hour vary considerably from year to year. During years of economic contraction, plant capacity and overhead labor are less efficiently utilized, resulting in relatively small—or even negative—productivity increases. Conversely, during periods of recovery, productivity gains tend to be unusually large. A guidepost based upon actual annual productivity increases would therefore be volatile, erratic, and inequitable. In any case, the erratic factors in productivity growth make it virtually impossible to predict annual productivity gains with accuracy. On the other hand, the trend rate of productivity growth—that rate which technological advance, the constantly improving quality of the labor force, and the growing capital stock can sustain—is reasonably stable and can be estimated within a fairly narrow range of error.

The exact value of trend productivity is difficult to ascertain. In order to isolate the underlying trend, the Council has attempted to adjust for shortrun factors using a number of sophisticated statistical techniques. While these techniques do not all yield identical results, all of the figures fall within the range of 3.0 to 3.3 percent, with 3.2 percent emerging as the most likely value. While there is room for honest disagreement among economists within this range, we know of no serious student of productivity who would endorse a figure as high as 3.6 percent. The National Industrial Conference Board, Inc., in its recent study of the "Economic Potentials of the United States in the Next Decade," used a trend productivity estimate of 3.2 percent. The National Planning Association in its national economic projections to 1975–76 adopted a figure of 3.0 percent. After accumulating a substantial body of evidence on the trend rate of growth of productivity, the Council chose 3.2 percent as the best estimate of trend productivity and, hence, the most appropriate figure for the 1966 guidepost.

It is true that in the 1964 and 1965 reports there was a table showing a column called "trend productivity" measured by a 5-year moving average. In those 2 years, the 5-year average turned out to be 3.2 percent, a figure which was consistent with what most economists consider to be the underlying producitivity trend for the postwar period. The 5-year average in those 2 years was consistent with trend productivity because it encompassed years of both recovery and recession. This year, however, the bad producitivity year, 1960, is dropped, leaving only recovery years with oversized productivity gains in the average. Thus, while the 5-year average was a reasonably accurate and simple representation of a trend in 1964 and 1965 when it spanned a business cycle, it would be a gross misrepresentation of the trend in 1966, when the average covers only years of recovery.

By the same token, in 1961 after slow growth and recurrent recession, a 5-year moving average of productivity would have yielded only 2.2 percent as the average annual growth. This would have been an erroneous measure of trend productivity; and so would the 3.6-percent figure which a 5-year moving average would yield for 1966. This is an error which we simply cannot afford in a period when the economy's capacity to maintain both full employment and cost-price stability is being put to a severe test.

Question 7. Business leaders have been reported as saying that the Government has not applied the guideposts evenhandedly. What is your answer to them and would you document your answer for the record? (A case in point is the New York transit strike.)

Answer. It is not surprising that some businessmen may feel that the administration's actions to achieve cost and price stability have favored labor; nor is it surprising to find union leaders who believe that the policies and guideposts for noninflationary behavior are much tougher on wage increases than on price rises.

In fact, the guideposts apply equally to both wages and prices, and actions have been evenhanded. Following are a few of the actions in the area of wages:

The administration helped in the negotiation of a steel contract that met the guidepost standards. It supported a Federal Employees Salary Act that was consistent with the guideposts. It achieved adherence to the guideposts in the wage changes of maritime employees. Perhaps most important is the fact that the administration has consistently impressed upon labor leaders a clear recognition of their share of the responsibility for helping to maintain noninflationary prosperity.

In the case of the New York transit negotiations, both sides were clearly informed of the administration's concern for a responsible settlement prior to the signing of the contract.

There have been some wage changes that are inconsistent with the guideposts just as there have been some price decisions that do not meet the standards of noninflationary behavior. But there has been no favoritism of either side in the policies designed to maintain stability of costs and prices.

Question 8. What would be the effect on the economy in terms of employment, production, price levels, etc., if the wage-price guidelines were done away with entirely and instead you were required to rely solely on fiscal and monetary policy?

Answer. The historical record of the past decade testifies to the bitter consequences that could ensue if the wage-price guideposts and the principles underlying them "were done away with entirely." In 1956–57 we experienced an inflation that undermined prosperity as a result of irresponsible wage and price decisions. In the late 1950's we managed to maintain price stability by stunting the growth of the economy and tolerating recurrent recessions. The Council is not prepared to recommend either course—an unsustainable prosperity marked by inflation, or price stability with stagnation. We consider noninflationary prosperity supported by responsible wage-price decisions far preferable to either of these alternatives; that is why we have advanced the guideposts.

Question 9. Would you favor clear legislative authority to apply the wage-price guidelines, which would allow for the periodic recalculation of the guidelines and would specifically give the executive branch authority to defend these guidelines?

Answer. The guideposts still represent a rather new development and approach to the problems of cost-price stability. Our experience with them has been actually quite limited. The current informal arrangement provides for flexibility in the light of additional experience. At this time we feel it is too early to "institutionalize" the guidepost by creating special legislation pertaining to them.

Question 10. What would be your position if the Joint Economic Committee developed a set of rules, in cooperation with the Council of Economic Advisers, which would guide the executive branch in applying the guidelines? We could make a staff study, then hold hearings, and finally recommend to Congress a set of rules on the guidelines which would be binding on the administration until you request a change in these rules. If committee hearings support your case, we would so recommend and the rules could be changed.

Answer. JEC studies pertaining to the complex issues of cost-price stability would undoubtedly make important contributions to our thinking on this important subject. But, as indicated in our answer to question 9, our experience with the guideposts is much too limited to make it advisable at the present time to incorporate them in specific legislation.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Thank you, Mr. Chairman. Mr. Ackley, I agree with the Council that in the situation in which we find ourselves of being much closer to full employment and use of resources than we have been for years, the observance of soundly defined and fairly arrived at guideposts in prices and wages is very important.

I prepared legislation—and I know you have gone over it thoroughly—designed to make the guideposts procedure fairer, and to enable the better focusing of public opinion on price and wage behavior in violation of the guideposts. In essence, that legislation does two things:

It says that each year, when you gentlemen and the President bring up your guideposts, that the Joint Economic Committee would have the power to review the guideposts, and if it objects, try to put through the congressional procedures a change in them, after consultation with the Council of Economic Advisers.

Second, once the guideposts are adopted, the Council of Economic Advisers would be mandated to flag the Joint Economic Committee, whenever there was imminent price or wage behavior which threatened national economic stability, and then the Joint Economic Committee would hold hearings on the matter, and make findings, as to whether, in fact, there was a violation of the guideposts and make such recommendations to the parties, labor or management, as the Joint Economic Committee deemed advisable. Are you for that, or against it?

Mr. ACKLEY. Well, as I have indicated, Mr. Reuss, in my reply to Senator Javits, at the present time, the administration is not recommending legislation in this direction, I think your proposal——

Representative REUSS. Are you opposing it?

Mr. ACKLEY. I suppose, if we are not recommending it, we in some sense are opposing it.

Representative REUSS. Why?

Mr. ACKLEY. That question does not really arise at this time, I guess.

Representative REUSS. Well, it does, because you have been asked to report on it, and the committee is calling you on it.

Mr. ACKLEY. Our feeling is that the present voluntary and informal procedures are adequate for the circumstances we face. I think a number of questions can be raised about your proposal, which under present circumstances are relevant, but might become less relevant if the situation were to change materially. With respect to the guideposts, it would seem to me that we are really still feeling our way on these procedures. It may be a little too early to institutionalize them, before we have experimented with them, tried them, and seen what effects they may have.

Representative REUSS. But you are asking management and labor to abide by them?

Mr. ACKLEY. We are hoping that they will; yes.

Representative REUSS. If we can't understand them, how can management and labor be expected to understand them?

Mr. ACKLEY. Well, I think management and labor are sufficiently able to understand at least the spirit of them to participate voluntarily, if they choose to do so. The congressional blessing of the guideposts would, I think, give them greater moral sanction. It would indicate that, not merely the administration, but the Congress, too, was interested in this concept, and in responsible behavior by private parties.

Representative REUSS. Then you are for that half of my bill?

Mr. ACKLEY. I would not say that at the present time I would advocate it. I wonder, Mr. Reuss, what would happen if you held hearings at this time on the guideposts? I think you would find that many spokesmen for organized labor and management would be unalterably opposed. Suppose Congress were unable, in the face of this opposition, to agree on the language of a guidepost statement?

Would this advance the cause of responsible price behavior?

Representative REUSS. Congress would have to agree. If it disagreed with the Council of Economic Advisers' formulation, it would then have to, by law, change that, which means it would have to agree on some change.

Let me give you a practical example of how this might work. Senator Javits has raised the question of the 3.2-to-3.6 business, and apparently what happened was that when you came along to 1966 and projected the last 5 years of productivity increases, you then found that with 1960 dropped out, this was too high, the 3.6 it yielded was too high, and 3.2 seemed to you, in your sincere judgments, a more rational figure from the standpoint of the national interest. Isn't that about what happened?

Mr. ACKLEY. That is right. Not only a more rational figure, but a better indication of what the trend of productivity really is.

Representative REUSS. Right. Now isn't it a fact that if that is so, in a year like, say, 1965, or an earlier year, the deadening impact of putting in the low productivity year of 1960 plus some other mediocre productivity increase years, probably resulted in a lower wage guidepost than would have been the case had you, in those years, taken into account the fact that due to presidential policy, our country was moving rapidly toward fuller employment and larger growth, and hence, with this increased use of resources, greater productivity?

What I am getting at is: Wasn't labor maybe gypped a little bit in those earlier years—or at least, if they had stuck with the guideposts wouldn't they have been gypped? And wouldn't congressional hearings in those years on the guideposts and on the wisdom of using a 5-year moving average, as opposed to other methods of guessing at the future, have been valuable?

And may they not be again valuable in the future?

Mr. ACKLEY. I think hearings before this committee are always valuable in producing light.

Representative REUSS. Of course, but I meant, on this specific Reuss proposal, that we review the guideposts.

Mr. ACKLEY. I don't think, incidentally, that labor has been gypped by the guideposts. In the first 2 years that they were published, there was no specific numerical representation given to the guideposts. In the 1962 Economic Report, there was a table which summarized a number of calculations about productivity in the economy.

I believe that some of our journalistic friends, seized one number out of that table in the 1962 Report—a 3-percent figure—and it was frequently described in the press that 3 percent was "the guidepost." The Council had never so endorsed it, and indeed, had never specifically, as I said, in our Reports of 1964 or 1965, endorsed a 5-year moving average.

Representative REUSS. It was in there, though, and I must say I read it as a member of the public, and I thought you were using the 5-year moving average, and, in fact, if you had used another standard, it might have been that in those years of rapid productivity increase, you might have had a slightly higher wage guidepost than the 3.2 that you ended up with.

You might have had 3.3 or 3.4 in those years, without inflationary impact, because productivity increases in actuality were above that figure.

Mr. ACKLEY. Of course, the concept of the guideposts from the beginning was that the appropriate wage advance in a particular year should not fluctuate with the year-to-year change in productivity. In 1960, if we had had guideposts, we would not have proposed that the wage increase should have been 1 or 2 percent, which is all the productivity gain was.

Representative REUSS. But that is what you are doing in 1966, and I don't say you are wrong. You are taking a look at 1966, and saying, well, because we are much closer to capacity now, it just would not be appropriate to use a 5-year-moving average which includes all pretty good years, when you were moving upward, and I don't object to this. What I do object to is a situation where Congress, and particularly the Joint Economic Committee, remains in the dark about this, where there is not a full opportunity to debate these matters in an institutional way.

Let me turn to another aspect of the guideposts. Whether or not labor did get gypped a little, or would have gotten gypped if they had stayed within the guideposts in the last 3 or 4 years, it is a fact, is it not, that we want to do everything possible to maintain a noninflationary situation today, which will be, if it comes true, one of the nicest things we could do to labor in this country?

If we could protect their existing wages by seeing that they are not diluted by rising prices, this is one way to make it up to labor for whatever inadvertent gypping there may have been.

Would you agree?

Mr. ACKLEY. Indeed.

Representative REUSS. Now I notice in the guideposts that you say this year, as you have said before, that prices should fall in those industries where the increase of productivity exceeds the national trend. Now the administration has been very vigorous upon occasion in taking action where price increases above the guideposts have been sought in key industries, but I have never heard of their doing very much about this aspect of the guideposts; namely, prices should be reduced where the increase of productivity exceeds the national trend. Yet it is equally important to the maintenance of a stable cost of living index, particularly in a situation where, as last year, the whole thing went up 2 percent. I, therefore, ask you if you would tell us briefly now, and then file at length with the committee a list of those industries where the increase of productivity exceeds the national trend, with such helpful data as there may be on what companies in those industries are particularly eligible to be noble at the present time, and such recommendations as you may have on what they can be doing about (*a*) keeping our cost of living stable, and (*b*), indicating to labor that if labor accepts the new 3.2 drop of the 5-year moving average suggestions, that by and large, it will be in the national interest.

Would you be able to do that?

Mr. ACKLEY. We will certainly try to pull together such material as we can, Mr. Reuss. We have indicated a number of such industries, where productivity advances have exceeded the national average. and in many of which prices have been trending down.

Representative REUSS. I think you mentioned the ones in which prices were going down. That is great. You should give them a medal. But what about the ones where they should have been going down, but are not?

Mr. ACKLEY. Well, we will see whether we have any information which would have a bearing on that. And we will convey it to you.

(The following material was subsequently supplied for the record by the Council of Economic Advisers:)

Table 3 shows industries for which the available data indicate a growth rate of productivity which is above the trend rate for the entire private economy. For each of the industries, the average annual rates of change of the relevant wholesale price index for three recent periods are tabulated.

In the interpretation of this table, several points should be kept in mind:

1. The list is determined in large part by data availability and is therefore far from being exhaustive, or even comprehensive. It is important to recognize that these particular industries are not the only ones of rapid productivity gains. On the other hand, the list is probably a good enough sample to present a reasonably good picture of the price behavior of those industries with above average productivity trends. It might be noted, in this connection, that comprehensive studies of industry productivity trends are exceedingly important to the effectiveness of the price guidepost. The Division of Productivity Measurement of the Bureau of Labor Statistics is expanding the coverage of its studies as rapidly as permitted by the size and resources of its staff. But, at least in the near future, serious gaps will remain in the data on industry productivity.

2. Productivity measurement presents conceptual and statistical problems and is affected by the period of time covered. The figures shown cannot be taken as precise to the last tenth of 1 percent by any means. Moreover, productivity data do not reflect changes in unit material costs or other nonlabor cost elements which might appropriately be reflected in prices under some circumstances.

3. The following table suggests that the majority of high productivity growth industries have been lowering prices gradually over the past 5 years. Since 1960, prices have declined in 12 of the 17 industries listed. The results are less encouraging for the past year when only 5 of the 17 industries lowered prices. Moreover, most of the price decreases have been quite small, while the excess of the industry productivity growth above economywide productivity trends is large in a number of instances.

TABLE 3.—*Industries with above-average rates of productivity growth*

[In percent]

Industry	Average productivity growth rate [1]	Average price change [2]		
		1957–65	1960–65	1964–65
GROUP A				
Nonmanufacturing:				
Coal mining	[3] 7.5	−0.5	−0.5	−0.4
Copper mining	[3] 4.1	2.0	1.7	9.6
Gas utilities	6.9	2.8	1.2	1.8
Electric utilities		.0	−.2	−.3
Iron mining	[3] 9.2	−1.6	−1.4	−.1
Manufacturing:				
Cement, hydraulic	5.3	.4	−.5	.2
Malt liquors	5.5	.2	.1	.2
Manmade fibers	4.2	−.8	−.5	−.8
Paper, paperboard, and pulp mills	4.9	.1	−.4	.9
Petroleum refining	6.6	−1.3	−.4	3.5
Primary aluminum	7.8	−.5	−1.2	3.3
Tires and inner tubes	6.4	−1.5	−.7	1.1
Tobacco products	5.5	1.1	.9	.3
GROUP B				
Plastic materials	11.6	−1.9	−1.7	−.7
Motor vehicles	5.0	.4	−.1	.2
Dairy products	4.0	1.2	.7	.6
Railroads	5.9	−1.2	−2.0	(4)

[1] Average productivity growth rate relates to changes from 1957 to 1963 for all industries in group A and railroads in group B. They are based on BLS indexes of output per man-hour. (See Indexes of Output per Man-hour, Selected Industries: 1939 and 1947–63.) Growth rates for other industries in group B relate to changes from 1959 to 1964 and are based on Federal Reserve indexes of industrial production and BLS man-hour data.
[2] Based on BLS wholesale price indexes for all industries except railroads; in the latter, average freight rates, computed by Interstate Commerce Commission, were used.
[3] Based on output per production man-hour.
[4] Not available.

Sources: Department of Labor, Board of Governors of the Federal Reserve System, Interstate Commerce Commission, and Council of Economic Advisers.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Mr. Chairman, thank you.

I find that I am going to have to spend most of my time making a statement, in order to lay the basis for questions.

Chairman PATMAN. Mr. Curtis, would you yield just a moment, please? I can see now that it looks as if we will have to ask you gentlemen to come back this afternoon. Will that be satisfactory?

Mr. ACKLEY. We are prepared to.

Chairman PATMAN. We will adjourn here at 12 noon, and resume at 2 o'clock this afternoon, if that is satisfactory.

Thank you, Mr. Curtis.

Representative CURTIS. There are 200 pages of narrative in the Economic Report, with some tables, and three-quarters of an hour here of your statement, which almost restates what is in the report, but so much of this material is what I would regard as rewriting history, and advancing theories as if they were doctrines, that we have to clear this up a bit.

Second, I find it difficult as a member of the loyal opposition to move in on some of these major questions. We requested that the Council of Economic Advisers appear in early December when the issue was before us in regard to the Federal Reserve. Had you appeared, and had we conducted orderly hearings, a lot of this material would be out of the way.

Also, the minority requested hearings on the stockpile question and the guidelines, and this committee has failed to hold those hearings.

Again, if we had zeroed in on this, a great deal of this material would be before us in a more condensed form. It is almost beginning to be that the minority party is the only voice speaking up for the powers and rights of the Congress.

I was very interested in your comment in answer to Mr. Reuss that possibly if labor and management were to come in before this committee, to express their views on the wage-price guidelines, that the administration might be hampered in proceeding in this fashion. In other words, if the people begin to speak up, maybe the administration's policies could not be carried out.

Now I hope that the implications of that are not quite as profound as I may be making them. This is not a dictatorship, and I hope we don't reach that point. Although, I must say from the manner in which the administration has successfully avoided presenting economic matters to the Congress, as well as military matters, it is beginning to look this way.

Now one point I would like to emphasize—and it should be emphasized, in my judgment, right in the very beginning of the Economic Report—is that we now have a wartime economy. And I would actually pick the date. It began in September 1965, when the expenditure levels went from a $97 billion average on up to where we apparently will spend about $106 billion this fiscal year.

Now I am emphasizing this, because for over 10 years—with the previous Council of Economic Advisers, and now including this one—I tried to distinguish between war- and peace-time economies. Many of your models are based on years of 1952 and 1953, not the least of which was your so-called growth gap, with no recognition of the fact that that was a war economy, and you were relating it to peacetime. I think we can definitely say this: That we can no longer again talk about the longest sustained peacetime growth, because this is not peacetime.

Now, I do find a statement in the Economic Report—two statements which I think deserve emphasis—and are the basis of what I at least identify as our problems right now.

On page 20 of the report:

> Perhaps our most serious economic challenge in 1966 will be to preserve the essential stability of costs and prices which has contributed so significantly to our balanced progress.

Now my criticism, though, is that having stated that, very little really is done that would zero in on it, and this is where our line of interrogation should go.

On page 151 of the report there is a very basic and significant statement. Referring to our balance of payments—

> Nevertheless, if a deficit continues too long or becomes too large the strength of the country's currency can be impaired. There is, in fact, an absolute limit of any country's ability to continue in deficit; eventually, it must run out of reserves as well as borrowing capacity.

I think my judgment would be that we have reached that point. We have been in the serious situation that this describes, for some time, and I find no effort or no recommendations that attack the disease itself. All of it is palliative, and really relating to the symptoms.

Now, if I may refer to some specifics, I find that the 3.4 percent increase in the Wholesale Price Index from December 1964 to December 1965, is not contained in here. In fact, statements are made as if that were not a serious situation. The 2.2 percent increase of the consumer price index from December 1964 to December 1965, is not in here. In fact, I think you use a figure of 1.7, or 1.8, which, I would say, certainly hides the seriousness of this particular symptom.

There is mention of the $1.7 billion loss of gold in 1965, but after mentioning it, there is no alarm, no concern; apparently, everything is great. You have solved the balance-of-payments problem, according to this.

There is no mention at all of the decline of the trade surplus by $1.9 billion in 1965. Yet, it was increasing exports that was given as the administration's theory of how they were going to get at the basic problem of the balance of payments.

Now, going to some of the rewritten history, I notice the misstatement of the tax theory of those who actually were successful in getting their theory adopted, which was not the administration's stated theory.

On page 173 of the report, I find this rewriting of history—

> Significantly, in 1954, the bipartisan character of expansionary fiscal policies was established for the first time, as the Republican administration of President Eisenhower adopted measures that had previously been linked to the New Deal and Keynesian economics.

I well remember, as a member of the Ways and Means Committee, Chairman Dan Reed introducing H.R. 1 which became the tax reduction bill of 1954; and his statements were that he was following the tax theory of Secretary Mellon, which had been proven, he thought, where they cut taxes at times of a deficit, the theory was based on the assumption that the tax rate was so high it was eroding the tax base, and that if we lowered the rate, we would actually increase the take through enlarging the base.

This was the theory that the Republicans took in the Joint Economic Committee, as well as in the Ways and Means Committee in regard to the 1964 tax cut, which they favored. This was zeroed in on in the motion to recommit in the House, where the Republicans said if expenditures were held to $97 billion level in fiscal 1964, and $98 billion in fiscal 1965, the tax cut could be beneficial.

I, personally, had felt $95 billion for both years was more realistic, but in order to establish the principle, I went along with my Republican friends on the Ways and Means Committee. Now the President in his budget recognizes this fact. He said:

> When I urged the Congress to enact the Revenue Act in 1964, I stated that the growth in economic activity yielded by the tax reduction, in combination with economy and efficiency in Government expenditures would lead to a balanced budget.

I note that the Economic Advisers in their report do not mention whatsoever restrained expenditures. Quite the contrary, the theory Dr. Heller presented to this committee was that if we restrained the increase in Federal expenditures, we would be defeating the very objective of the theory, which was to increase aggregate demand.

Now the facts of the matter remain that—and I am reading now from the January 1966 Economic Indicators—fiscal 1964 expenditures, $97.7 billion; fiscal 1965 expenditures, $96.5.

So the theory that our tax rates were an impediment to economic growth, and should be lowered to broaden the base, but that this should be done in context of expenditure restraint, I think was amply proven out.

And this theory continued to be applied. As we read the monthly Indicators' expenditure figures of June and July of 1965, the first 2 months of fiscal 1966, we find a continued expenditure level of around $97.3 billion. The break occurred in September 1965, when instead of a slight seasonal decline that we expect in September, the rate jumped to $9.5 billion in September, thus going up to about $114 billion annual expenditure level.

Here is where your "new economics" have come now into play for the first time. Not before. And it is this area that I think we have to direct our attention to. The President should have notified the Congress, when he saw these expenditure levels jumping in this fashion. This is exactly one of the indicators that Mr. Martin, Chairman of the Federal Reserve Board, saw, and tried to call attention to. Here we are, on February 1, 1966, 4 months later, with our first opportunity of debating and conducting a dialog on this very essential shift in fundamental fiscal policy.

I see my time is up on that preliminary statement. I will have to come back and conclude the statement before I can even get to questioning.

Thank you.

Chairman PATMAN. Senator Sparkman?

Senator SPARKMAN. Mr. Ackley, in your discussion of inflation you referred to the spendable earnings of the manufacturing worker rising by 13 percent, after adjustment for the increase in consumer prices. Then you said; "Because of inflation, his gain in the previous 5 years has been less than 4 percent."

Have we had inflation over the past 5 years? Of any serious amount?

Mr. ACKLEY. This reference is to the period between 1955 and 1960, Senator Sparkman. In the period between 1960 and 1965, the most recent 5 years, the gain in real spendable income was 13 percent. In the previous 5 years, between 1955 and 1960, it had been less than 4 percent.

Senator SPARKMAN. I am sorry, I thought you were talking about the 5 years previous to the present year.

Mr. ACKLEY. Actually, in that earlier 5-year period, the gain in money wages was about the same, but the advance in consumer prices was substantially greater, and the net real gain after adjustment for price increases was much lower.

Senator SPARKMAN. Do you feel that inflation is a threat at the present time?

Mr. ACKLEY. Yes; I think so.

Senator SPARKMAN. Of course, it is always a threat.

Mr. ACKLEY. It is always a threat, and it is particularly a threat at a time when the economy is operating at as close to full use of its resources as it is today.

Senator SPARKMAN. Between 1960 and 1964, the wholesale price index remained stable. It rose only during the last year, increasing by 2 percent, largely, you say, as a result of special circumstances. Could you explain briefly what those special circumstances were?

Mr. ACKLEY. Well, of the rise in the wholesale price index from 1964 to 1965, based on the annual average figures, slightly over half was due to rises in the prices of farm products and foods.

These were concentrated in a relatively small area of farm products and foods, particularly in the area of livestock and meat prices, although there were others, also.

These appear to have been due, primarily, to reductions in livestock production, as part of the cycle which we observe in production of animals.

Undoubtedly, the reduced production in 1965 was associated with the relatively lower prices for livestock in the previous year. The farm sector, then, accounted for more than half of the increase in wholesale prices over that year.

Of the balance, a lot was concentrated in the nonferrous metals area, where world market conditions were very tight. In some of the the nonferrous metals—copper, particularly—strikes and interruptions to supply in such areas as Zambia, the Congo, and Chile, had created a world shortage.

But that 2-percent increase between 1964 and 1965 in wholesale prices, was rather spotty. It was not a general increase across the board.

In many of the basic industrial areas there was no price change, and there were, as the President's report points out, a number of price reductions over that period. So that the special circumstances refer to the farm area and particularly to livestock production cycles, and these internationally traded raw materials.

Senator SPARKMAN. Mr. Ackley, yesterday, the president of the American Banker's Association made a speech in New York to the credit conference of the American Banker's Association. It is reported in a newspaper story under the heading "ABA Head Warns Against Rate War."

He discussed the recent Federal Reserve action, raising the discount rate and the permitted ceiling on certain time deposits and certificates of deposit. He pointed out how bad it would be to have a rate war between small banks and big banks, and between banks and savings and loan associations, and other lending agencies. It seems to me he made some very appropriate remarks.

In discussing these certificates of deposit, he pointed out, among other things, that the minimum amounts accepted are often \$1,000, and in some cases, as low as \$25. I believe we had similar testimony in the hearings with the Federal Reserve Board. Now, aren't the small banks bound to suffer, in connection with the handling of these certificates of deposits?

Mr. ACKLEY. Senator, you are getting me into an area in which I don't consider myself an expert. I believe it is true that the smaller banks have not found themselves compelled to pay these very high rates for certificates of deposits, generally speaking.

Whether this is an advantage or a disadvantage, I don't know. Presumably, they seem to be able to acquire adequate funds to meet the needs of their customers without paying these very high rates that some of the large New York City banks have recently been paying.

To this extent, the cost of money to them is lower than it would otherwise be.

Senator SPARKMAN. The gentlemen from the Federal Reserve answered the question somewhat the same way. I believe they stated that the recent action had not affected ordinary small savings, and that the smaller banks would run on their savings, but when certificates of deposit get down to as low as $25, or even $1,000, it seems to me it is pretty quickly an invasion into the field of ordinary savings.

Mr. ACKLEY. I think there is a problem with these rates spreading into the area of small savings; the rates were intended to attract very large amounts of corporate funds.

I gather that the Federal Reserve has not felt it was possible to make a distinction here, although I think a great deal can be said for a distinction, if they could find some legal basis for establishing it.

Senator SPARKMAN. I am thinking, also, of the effect, not only on small banks, but on savings and loan associations, by reason of the change in interest rates, and on home mortgages. Won't they be seriously affected?

Mr. ACKLEY. Well, certainly the rise in mortgage interest rates which we are beginning to see is going further to hamper the recovery of residential construction, which has been going no place for several years.

Senator SPARKMAN. It has been lagging.

Mr. ACKLEY. Yes.

Senator SPARKMAN. It probably might not be entirely relevant here, but it seems to me that an important aspect of the current economy, is the present lag in making small business loans, especially the business loans program of the Small Business Administration. Have you studied that any?

Mr. ACKLEY. I am sorry. I am not sure that I know very much about it. I wonder if perhaps Mr. Okun could speak on that; if he knows what has been happening there.

Mr. OKUN. I don't know that I would describe the situation as a lag in their program.

Senator SPARKMAN. Well, starting last October, I believe, they quit taking applications for business loans. In other words, it was not only a lag, but a complete stoppage.

Mr. OKUN. Well, let me put it this way: they used up their funds more rapidly in response to stronger demands for business loans.

(The following material was supplied for the record by the Council of Economic Advisers:)

SBA established a moratorium on new loan applications under its regular direct loan program in early October. SBA continues to approve and make loans on applications previously received. Furthermore, applications are still being accepted under the loan guarantee program, as well as for economic opportunity and disaster loans.

The business loan activities of SBA are a growing program. Current estimates call for total loan commitments to small business under SBA's direct and guaranteed loan programs to amount to $355 million in fiscal year 1966 and $428 million in fiscal year 1967, compared with $340 million in fiscal 1965.

Senator SPARKMAN. Well, Congress was still in session. There could have been a supplemental request, couldn't there, that would have taken care of that?

Mr. OKUN. I am sure that could have been possible.

Senator SPARKMAN. Anyhow, my time is up, but I think it is something that certainly deserves a lot of thought in connection with the study of the economy of the country.

Chairman PATMAN. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Ackley, the administration has called for the voluntary exercise of disciplines and restraints in the private sector. For example, labor is to hew to the 3.2 guideline, and business is to forego inflationary price increases.

Do you believe the administration has set a proper example of self-discipline in this new budget?

Mr. ACKLEY. Well, the budget certainly does involve a very small net increase in civilian programs. I believe that, apart from special Vietnam costs, the administrative budget has been held to a $600 million increase. I am sure that the advance in some of the educational and health and poverty programs has been held back below what would have been possible and desirable in the absence of the large increase in spending for Vietnam.

I think the sacrifice involved in postponing tax reduction and in accelerating tax payment is a real sacrifice to those who have to participate in it.

Senator JORDAN. Now, when you mentioned a figure of $600 million, are you taking into account the supplemental budget requests?

Mr. ACKLEY. Yes; this is the difference between the estimated budget for fiscal 1967 and for fiscal 1966, including regular and supplemental appropriations.

Senator JORDAN. Mr. Ackley, what percent of the estimated receipts calculated in the new budget, are of a single shot or a nonrecurring nature?

Mr. ACKLEY. A substantial quantity are of that character. The acceleration of tax payments obviously can only be done once, and when payments are current, then that is no longer a source of additional financing.

Senator JORDAN. Yes. Do you recall how much is calculated to be received by reason of the acceleration of withholding on individual income?

Mr. ACKLEY. I think Mr. Okun has those figures right at his fingertips. I could call on him to give them to you.

Mr. OKUN. As I recall, Senator, the acceleration in corporate taxes for fiscal 1967 will add $3.2 billion to budget receipts, and the acceleration for individual income taxes will add $400 million.

Senator JORDAN. What other items are there of a nonrecurring nature? For example, the profit on silver coinage—how much do you estimate that this will add to the receipts? It certainly is a nonrecurring type of item.

Mr. OKUN. There is likely to be a continuing increased level of seigniorage as a result of the shift in coinage. It is not entirely nonrecurring. I would agree that the figure for fiscal 1967 is likely to be higher than what we can count on for the years ahead, by perhaps a half a billion dollars or thereabouts.

Senator JORDAN. You think that is the only difference there might be between getting the transition made now as against a continuing coinage of nonsilver coins?

Mr. OKUN. That is hard to estimate. Undoubtedly, there is an extra amount of seigniorage associated with the transition.

Senator JORDAN. To what extent has the sale of capital assets been a part of the estimated receipts?

Mr. OKUN. We do have a program for asset sales which has been going on, and which has been growing. It reflects a longrun desire of the administration to encourage private participation in lending programs.

It is expanding to $3.3 billion for this fiscal year, from about a billion and a half in the last one, and will move up to $4.7 billion for the next fiscal year.

At the same time, I think one has to take into account that this is not in any sense a measure of the change in Federal financial assets that we are expecting in fiscal 1967. Indeed, at the same time that the Federal Government will be selling this $4.7 billion of assets, it will be adding to its assets more than $3 billion of new loans and new financial acquisitions. Moreover, if you take a somewhat broader view of Federal financial assets, to include land purchases and foreign currency, you will find that in fiscal 1967 the net total is just about zero. We are not reducing the holdings of Federal assets of this sort.

Indeed, I think this gives us a better picture of what the budget is really doing. For some years now, the administrative budget has included a substantial total of transactions which are not directly payments into the income stream, but rather financial transactions whereby the Federal Government trades one type of asset for another. For fiscal 1967, we expect to eliminate this wedge in the administrative budget, and bring it closer to the national income accounts budget, which most economists feel is a more accurate measure of the economic impact of Federal fiscal programs.

Senator JORDAN. In your opinion, then, the acquisitions have pretty well offset the dispositions?

Mr. OKUN. That's a good summary.

Senator JORDAN. In the absence of a continuation of these nonrecurring items, how do you anticipate you will find revenues in the year that lies ahead? What do you look to for that?

Mr. ACKLEY. I think our revenue needs for the fiscal 1968 will have to be faced when we are a little closer to fiscal 1968. Certainly, if the pace of the Vietnam war continues or accelerates, we would obviously have to look elsewhere for other sources of financing.

I think the choice of these nonrecurring items as a substantial part of the increase in revenues was a deliberate one, in recognition of the uncertainties with respect to the duration and extent of the emergency which required them.

Senator JORDAN. The administration has already indicated its intention to increase taxes, should the occasion arise. As a matter of of fact, they start out this year by increasing taxes on telephones and auto purchases. Could you tell us why these two excise taxes were selected over others?

Mr. ACKLEY. Of those excise taxes which were reduced as of January 1, these accounted for the major part. They were also taxes which were not eliminated, but were reduced, and, therefore, there was no necessity to reestablish administrative machinery, either on the part of the Government or of the private taxpayers involved.

It was felt that delaying tax reduction was an easier and better thing to do from the standpoint of the consumer and the businesses involved, rather than seeking out new sources of tax revenue.

Senator JORDAN. Well, why not the luxury items, instead of telephones, for instance?

Mr. ACKLEY. Well, among the luxury item taxes that expired on January 1, were nightclub and cabaret and other types of recreation taxes.

The administrative difficulties with these taxes, whose yield is relatively small individually, suggested that it would be simpler for all parties concerned if we picked out the two that really accounted for the bulk of the tax reduction and maintained them at the previously existing levels.

Senator JORDAN. Now, Mr. Ackley, you used a figure that I find hard to reconcile with the information that comes to me, when you say the average net income per farm has increased nearly 34 percent.

This is a meaningless figure unless we know to what extent the size of the farm has been increased. Do you have those figures?

Mr. ACKLEY. I am sure we have them. I am not sure that I could put my hand on them quickly.

Senator JORDAN. Would you provide them for the record? I think 34 percent is completely meaningless, unless you take into account the tremendous trend toward increase in the size of farms.

Mr. ACKLEY. As we point out in our Report, Senator, although there has been some increase in the average size of farms, family farms have not declined as a percentage of the total, but in fact, have remained a stable percentage of total farm ownership.

(The following information was later supplied for the record by the Council of Economic Advisers:)

After adjustment for price changes, average net income per farm in 1965 was nearly 34 percent higher than the 1960 level. As Senator Jordan suggested, average farm size also rose during the 1960–65 period. The increase from 298 acres to 342 acres amounted to 15 percent or considerably less than the rise in net income per farm.

Senator JORDAN. Thank you. My time is up.

Chairman PATMAN. Mrs. Griffiths?

Mrs. GRIFFITHS. Thank you, Mr. Chairman.

I would like to congratulate you on writing into your Annual Report of the Council of Economic Advisers the economic costs of discrimination. As important, at least, as is the spiritual effect of discrimination, in my judgment the economic effect, also, plays a great factor.

And I would like to ask you: If the economic and social policies could be specifically designed to lower Negro unemployment to the current unemployment level of whites, the resulting gain, you say, in GNP would be $5 billion; I ask you, which whites—male, female, or both?

Mr. ACKLEY. This is simply if we reduced the average unemployment for Negroes to the average unemployment level of whites.

Mrs. GRIFFITHS. It is not the average unemployment level of Negro men to the average unemployment of white men, and the average unemployment of Negro women to the average unemployment of white women?

Mr. ACKLEY. I think the calculation was made on the overall averages. I am not sure that it would make a great deal of difference if it were done separately for males and females.

Mrs. GRIFFITHS. I think it would make quite a lot of difference. You have less than 2 percent unemployed among white married men. It is much greater among white women. If you will examine your table 19—do I read this correctly—where a woman, a white woman, is the head of a family, 16 percent of such families are in poverty?

They comprise 16 percent of the 100?

Mr. ACKLEY. Yes.

(Table 19, referred to, follows:)

TABLE 19.—*Incidence of poverty and distribution of poor households, 1964*

Type of household [1]	Incidence of poverty (percent) [2]	Percentage distribution of poor households
All households	19.8	100.0
Farm households	30.0	9.1
Nonfarm households:		
Head 65 years of age and over	38.0	34.7
Head under 65 years of age:		
White:		
Male head	8.1	23.7
Female head	31.3	16.0
Nonwhite:		
Male head	28.2	8.9
Female head	60.2	7.6

[1] Households are defined here as the total of families and unrelated individuals.
[2] Incidence of poverty is measured by the percent that poor households are of the total number of households in the category.

NOTE.—Poverty is defined by the Social Security Administration poverty-income standard; it takes into account family size, composition, and place of residence.

Sources: Department of Commerce, Department of Health, Education, and Welfare, and Council of Economic Advisers.

Mrs. GRIFFITHS. Which is approximately the same number of families affected as would be affected by both nonwhite male and female.

Is that right, or not?

Mr. ACKLEY. Yes, you are quite right. Sixteen percent of the poor families are white families headed by females, and another slightly over 16 percent are nonwhite.

Mrs. GRIFFITHS. Now, I would like to ask, then, if women were given the same opportunities as white males, which I assume that you are now pushing for, for all Negroes, what would be the gain in GNP?

Mr. ACKLEY. We could try to calculate that.

Mrs. GRIFFITHS. Thank you, I would be glad to know.

Now, I would like to ask you further. When you calculate that, I would like to know what percentage of that applies when women's wages are lifted equally with men, and not where they are just given jobs.

And may I point out, I have seen recent contracts negotiated by labor unions where they have categories for male employees, female employees, with an hourly rate differential from 17 cents an hour to $2.50 a day.

So, I would assume that it is going to make a tremendous difference.

Mr. ACKLEY. That would seem to be in violation of the legislation which the Congress passed last year.

Mrs. GRIFFITHS. Yes. It is the national policy of this country not to discriminate, isn't it?

Mr. ACKLEY. That's my understanding.

Mrs. GRIFFITHS. Therefore, I think that this is a proper addition to this Economic Report, to show the difference. I do not think that you can make a quick calculation on what happens to Negroes, because unless you break it down into Negro women and white women, you aren't going to come up with the correct answer.

Mr. ACKLEY. Well, we can certainly try the calculation, broken down separately, and see how much difference it makes.

(The material which follows was supplied for the record by the Council of Economic Advisers:)

In the annual report,[1] we indicated that "if economic and social policies could be specifically designed to lower Negro unemployment to the current level of whites, the resulting gain in GNP would be $5 billion." As stated at the hearings, this calculation was based on the average unemployment levels for whites and nonwhites and did not separate the totals by the male and female components. We have investigated the effect of disaggregating, as suggested by Mrs. Griffiths, and find that the result is essentially unchanged.

A similar calculation indicates that if the female unemployment level (for all races) were lowered to equal that of males, the resulting gain in GNP would be $6.5 billion.

It should be recognized that this calculation is difficult to interpret because of the different attachment to the labor force of females as compared with males and the different occupational mix found among female workers. For example, in 1965, 39 percent of all females were employed in the clerical and sales occupations as compared with 13 percent for males. On the other hand, 24 percent of the female workers were in the household and other service worker occupations as compared with only 7 percent of male workers. To some extent such figures reflect both differences in the level of training and in the regularity of labor force participation.

It is not possible to estimate how these calculations would be affected by equalizing wages for the same work performed by males and females. While the legislation enacted last year clearly outlaws such discrimination, it undoubtedly has not been eliminated. The national policy, however, is to end such inequities as quickly as possible.

The elimination of wage discrimination between males and females doing identical work is desirable on grounds of equity as between workers. Most likely the major economic effect of such action would be to improve the distribution of income as between male and female workers, however, rather than to increase total real GNP. On the other hand, real GNP could be increased by the elimination of discrimination which denies women access to certain jobs and forces them to carry on less productive pursuits. We are not aware of any information which would permit the qualification of this potential benefit to the Nation.

Mrs. GRIFFITHS. Thank you.

Chairman PATMAN. I wonder if we should continue a while longer, or should we recess now until 2 o'clock?

Mr. CURTIS. Why don't we complete the first round?

Chairman PATMAN. Well, Mr. Widnall is next; Mr. Widnall and then Senator Proxmire.

Mr. REUSS. Mr. Chairman, I must go. Could I make a quick unanimous consent?

Chairman PATMAN. Certainly.

Mr. REUSS. The chairman has raised what seemed to me an interesting legal point on these certificates of deposit and promissory notes, and the witness said the Council doesn't have a general counsel. Accordingly, I ask unanimous consent that the staff be instructed to obtain from the Attorney General an opinion as to the legality of certificates of deposit and promissory notes.

Chairman PATMAN. The unanimous consent is that the committee obtain from the representative agencies—I assume the Department of Justice, the Comptroller of the Currency, the Federal Reserve, and

[1] The Annual Report of the Council of Economic Advisers, January 1966. P. 110.

the FDIC—their opinions on the legality of the certificates of deposit as now used.

Mr. REUSS. And promissory notes.

Chairman PATMAN. Or recently used, and promissory notes.

Mr. REUSS. I take it there is no objection to this request. I said the staff; let's make it the chairman, if that's agreeable to the chairman, who will address these questions.

Chairman PATMAN. Is there any objection?

The Chair hears none; it will be done.

(A copy of the letter immediately following was sent to the agencies previously mentioned. Their responses were subsequently received and are printed herein.)

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
February 1, 1966.

DEAR MR. ———: In the course of today's testimony before the Joint Economic Committee, a question arose as to the legality of the issuance by commercial banks of negotiable certificates of deposit and promissory notes. Mr. Gardner Ackley, Chairman of the President's Council of Economic Advisers, testified before the committee that he did not have available to him any opinion of counsel as to whether or not it is legal for banks to issue negotiable certificates of deposit and promissory notes in exchange for short-term funds.

In the circumstances, I have been directed by the committee, with unanimous consent, to request that you supply this committee at your earliest possible convenience with your considered legal opinion as to whether it is legal for commercial banks to issue the aforementioned negotiable certificates of deposit and to treat the sums so received as time deposits. Likewise, your considered legal opinion is requested as to whether or not promissory notes may legally be issued by commercial banks.

Sincerely yours,

WRIGHT PATMAN, *Chairman.*

(Responses follow:)

THE ADMINISTRATOR OF NATIONAL BANKS,
Washington, February 2, 1966.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Longworth House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: You have requested in your letter of February 1, 1966, that this Office supply the Joint Economic Committee with a legal opinion as to the propriety of commercial banks issuing negotiable certificates of deposit, their treatment of the funds received thereby as time deposits, and the issuance of promissory notes.

Section 24, title 12 of the United States Code (par. seventh) empowers national banks to engage in the business of banking including specifically the receipt of deposits. National banks for over 100 years have exercised this authority by receiving deposits and issuing evidences of such receipt in the form of transferable and negotiable certificates. Indeed, even in these times this is the only form of evidence of time deposits issued by national banks and other commercial banks in certain areas of this country. To our knowledge the authority for national banks to issue such instruments has never been seriously contested.

Similarly there is no question that sums received by the bank for a time certain and not withdrawable at the demand of the depositor are time deposits. The fact that the certificates of deposit are negotiable does not change the character of the time deposit contract with the bank.

With respect to the issuance of promissory notes, we again refer to section 24, title 12 of the United States Code (par. seventh) and also to Congress recognition of the power of national banks to incur indebtedness in 12 U.S.C. 82. Since the inception of the national banking system it has been recognized as a "necessary incident" to the business of banking that banks have the authority to borrow money. See, for example: *Aldrich* v. *Chemical National Bank,* 176 U.S. 618, 20 S. Ct. 498, 44 L. Ed. 611 (1900); *National Bank of Commerce* v. *National Bank,* Fed. Cas. No. 18, 310 (Mo. 1878); *Charlotte First National Bank* v. *National Exchange Bank,* 92 U.S. 122, 23 L. Ed. 679 (1875); *Western National Bank* v. *Armstrong,* 152 U.S. 346, 14 S. Ct. 572, 38 L. Ed. 470 (1894).

In the case last cited, Mr. Justice Shiras, speaking for the court, set forth the derivation of a national bank's right to incur indebtedness and issue notes evidencing such indebtedness as follows:

"The power to borrow money or to give notes is not expressly given by the act. The business of the bank is to lend, not to borrow, money; to discount the notes of others, not to get its own notes discounted. Still, as was said by this court, in the case of *First National Bank of Charlotte* v. *National Exchange Bank of Baltimore* (92 U.S. 127 [23:681]), 'authority is given in the act to transact such a banking business as is specified, and all incidental powers necessary to carry it on are granted. These powers are such as are required to meet all the legitimate demands of the authorized business, and to enable a bank to conduct its affairs, within the scope of its charter, safely and prudently. This necessarily implies the right of a bank to incur liabilities in the regular course of its business as well as to become the creditor of others.'"

One of the primary purposes of the National Currency Act which created the national banking system was to provide for the issuance of circulating bank notes issued by such banks. Indeed, the historic basis for the borrowing power of American banks may be found in the practices of the English banks prior to the origination of the national banking system.

"The very first banking in England was pure borrowing. It consisted in receiving money in exchange for which promissory notes were given payable to bearer on demand, and so essentially was this banking as then understood, that the monopoly given to the Bank of England was secured by prohibiting any partnership of more than six persons 'to borrow, owe, or take up any sum or sums of money on their bills or notes payable at demand.'"

Auten v. *U.S. National Bank* (174 U.S. 125, 142).

In conclusion then, it is unquestionably within the power of national banks to issue promissory notes as evidences of their borrowing, to issue negotiable certificates of deposits and to treat the sums received therefor as time deposits.

Sincerely,

James J. Saxon,
Comptroller of the Currency.

Board of Governors of the Federal Reserve System,
Washington, February 9, 1966.

Hon. Wright Patman,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

Dear Mr. Chairman: This is in response to your letter of February 1, requesting a "considered legal opinion" on two questions:

(1) "Whether it is legal for commercial banks to issue * * * negotiable certificates of deposit and to treat the sums so received as time deposits";

(2) "Whether or not promissory notes may legally be issued by commercial banks."

No law or regulation administered by the Federal Reserve System forbids commercial banks to issue negotiable certificates of deposit or promissory notes or to treat funds received for certificates of deposit as time deposits. In general, the powers of commercial banks are derived from the laws that provide for their organization, regulation, and supervision. The statutory provisions governing the powers of national banks are in the National Bank Act and other Federal laws principally administered by the Comptroller of the Currency. In the case of State banks, powers are derived chiefly from the banking laws and regulations of the respective States, which are applied and enforced by the State supervisory authorities. We understand that your inquiry has been addressed also to the Comptroller of the Currency, and you may deem it advisable to request the opinions of State banking authorities. I am enclosing a "Compilation of State Statutes Respecting Limitations on Amounts Banks Can Borrow," which may be of some assistance in your study of this matter, although neither the compilation nor the summary included therein should be regarded as authoritative.

Section 5202 of the Revised Statutes (12 U.S.C. 82) appears to recognize the authority of national banks to borrow, and it is believed that the National Bank Act has been interpreted, throughout its history, as permitting national banks to issue promissory notes. Judicial decisions relating to the powers of national banks to borrow are collected in note 205 to section 24 of title 12 of the United States Code Annotated.

Section 24 of the Federal Reserve Act (12 U.S.C. 371), as originally enacted in 1913, provided that national banks "may continue hereafter as heretofore to receive time deposits and to pay interest on the same." The McFadden Act of 1927 (44 Stat. 1232) amended this provision to read substantially as it does at the present time:

"Any such association may continue hereafter as heretofore to receive time and savings deposits and to pay interest on the same, but the rate of interest which such association may pay upon such time deposits or upon savings or other deposits shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such association is located."

The foregoing enactments appear to reflect a legislative intent to confirm the authority of national banks to accept "time deposits" as well as "savings deposits." In recent decades, at least, the certificate of deposit has been the principal instrument issued by commercial banks by which receipt of time deposits has been evidenced. The Banking Act of 1933 (48 Stat. 182) added to section 19 of the Federal Reserve Act a provision that is now (in amended form) the 13th paragraph thereof. That enactment directed the Board "from time to time [to] limit by regulation the rate of interest which may be paid by member banks on time deposits, and [the Board] may prescribe different rates for such payment on time and savings deposits" according to enumerated criteria. Although subsequent legislation has amended the provision in some respects, it has continued to reflect congressional recognition that receipt of time deposits is a usual, and presumably legitimate, activity of commercial banks. The first paragraph of section 19 of the Federal Reserve Act (12 U.S.C. 461) authorizes the Board of Governors to define the term "time deposits" and a number of related terms.

Pursuant to the statutory direction mentioned in the preceding paragraph, regulation Q of the Board of Governors (12 CFR 217) regulates the payment of interest on time and savings deposits by banks that are members of the Federal Reserve System. Section 217.1(b) defines the term "time deposits" to mean "time certificates of deposit" and "time deposits, open account." Section 217.1(c) provides that a "time certificate of deposit" may be either negotiable or nonnegotiable.

Although regulation Q does not constitute a source of banking powers for member banks, it evidences the Board's belief that many member banks, if not all, possess legal authority to issue certificates of deposit in negotiable form.

Certificates of deposit actually have been issued in substantial amounts by both National and State banks for many years. It is not known to what extent certificates of deposit were issued in negotiable form prior to the 1960's. As you are aware, in the last few years the use of negotiable certificates of deposit, issued principally in large denominations by metropolitan banks, has increased greatly.

The question whether commercial banks may legally issue promissory notes can be approached from several directions. A promissory note may be negotiable or nonnegotiable, may be payable on demand or have a maturity of a few days or 30 years, and may arise from individual negotiation or be part of a large issue of identical instruments in the nature of investment securities. In recent years, a number of banks have issued long-term "capital notes," subordinated to deposits but senior to equity capital, for the purpose of strengthening the "capital cushion" that protects deposits as well as obtaining additional funds to lend or invest. In contrast to notes of that type, and coming into common use even more recently, are promissory notes in large denominations, with maturities of a few days or weeks, issued by banks mainly to corporate customers that have idle funds on which they wish to receive a return until needed for other purposes.

During 1965, a number of banks began to issue short-term promissory notes in circumstances that, in the Board's judgment, resulted in avoidance of laws and regulations governing payment of interest on deposits and maintenance of reserves against deposits, particularly our regulations Q (12 CFR 217) and D (12 CFR 204).

For this reason, on January 26, 1966, the Board published a Notice of Proposed Rulemaking that would affect the status of short-term promissory notes under regulations D and Q (31 Federal Register 1010). The proposed amendment to those regulations, a copy of which is enclosed, would define the term "deposit" to include promissory notes to the extent indicated therein. If the amendment is adopted, such promissory notes payable on demand or with an original maturity of less than 30 days would constitute "demand deposits" as defined in section 217.1(a) of regulation Q. Since the 12th paragraph of section 19 of the Federal Reserve Act (12 U.S.C. 371a) and section 217.2(a) of regulation Q forbid member banks "directly or indirectly, by any device whatsoever, [to] pay any interest on any deposit which is payable on demand," it would be unlawful for a member bank thereafter to issue interest-bearing promissory notes, covered by the definition, that were payable within less than 30 days. Such promissory notes with maturities of 30 days or more would be subject to the maximum rate of interest applicable to time deposits under the supplement to regulation Q, which is 5½ percent per annum at the present time.

Sincerely yours,

WM. McC. MARTIN, Jr.

Enclosures.[1]

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, February 11, 1966.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Your letter of February 1, 1966, requests our opinion as to whether it is legal for commercial banks to issue negotiable certificates of deposit and promissory notes in exchange for short-term funds.

Since the legality of such practices in the first instance would depend on the provisions of the National Banking Act, in the case of national banks, and of the banking laws of the various States, in the case of State-chartered commercial banks, the officials charged with the direct responsibility of interpreting those laws can best advise you. There is nothing in the Federal Deposit Insurance Act which either authorizes or prohibits the issuance of negotiable certificates of deposit or short-term promissory notes by insured banks.

However, certain provisions of the act and the rules and regulations of this Corporation assume the legality of certificates of deposit issued by an insured bank in the usual course of business. Thus, section 3(1)(1) of the act includes in the definition of a deposit the "unpaid balance of money * * * received or held by a bank in the usual course of business and * * * which is evidenced by its certificate of deposit." Pursuant to that section, all such certificates of deposit, both negotiable and nonnegotiable, issued by insured banks are considered by the Corporation as deposits for insurance purposes.

Part 329 of our rules and regulations, relating to the payment of deposits and interest thereon by insured nonmember banks, specifically provides (sec. 329.1) that a time certificate of deposit is one form of time deposit and defines it as a "deposit evidenced by a negotiable or nonnegotiable instrument" which is payable as stated in the regulation. Similarly, part 330 of the rules and regulations, pertaining to recognition of deposit ownership not on bank records, provides inter alia (sec. 330.1) that the owner of a negotiable certificate of deposit, to whom such certificate was negotiated before the bank closed, will be recognized for purposes of a deposit insurance claim to the same extent as if his name appeared on the bank's records.

If we can be of any further assistance to your committee, please let me know.

Sincerely yours,

(Signed) K. A. RANDALL,
Chairman.

DEPARTMENT OF JUSTICE,
OFFICE OF LEGAL COUNSEL,
Washington, D.C., February 10, 1966.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. House of Representatives, Washington, D.C.

DEAR CONGRESSMAN PATMAN: The Attorney General has asked me to acknowledge your request of February 1, 1966, for an opinion with regard to the issuance of certificates of deposit and promissory notes by commercial banks.

As you know, this Department is limited by law to furnishing opinions to the President and officials of the executive branch. However, we shall be glad to look into the questions you have raised and provide whatever background and information we can for the use of the Joint Economic Committee.

Sincerely,

NORBERT A. SCHLEI,
Assistant Attorney General.

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[1] Document submitted by Federal Reserve Board entitled "Compilation of State Statutes Respecting Limitations on Amounts Banks Can Borrow—October 1964," appears in pt. 2, hearings: Recent Federal Reserve Action and Economic Policy Coordination, Joint Economic Committee, U.S. Congress.

MARCH 1, 1966.

Mr. NORBERT A. SCHLEI,
Assistant Attorney General, Office of Legal Counsel,
U.S. Department of Justice, Washington, D.C.

DEAR MR. SCHLEI: Thank you for your letter of February 10 in reply to my letter to the Attorney General requesting that the Joint Economic Committee be supplied with your considered legal opinion as to whether it is legal for commercial banks to issue negotiable certificates of deposit and to treat the sums so received as time deposits; also whether promissory notes may legally be issued by commercial banks.

As we are anxious to go to press with the committee's hearings on the 1966 Economic Report of the President, it would be appreciated if you could get replies to us by the end of this week.

Sincerely yours,

WRIGHT PATMAN, *Chairman.*

DEPARTMENT OF JUSTICE,
OFFICE OF LEGAL COUNSEL,
Washington, D.C., March 3, 1966.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. House of Representatives, Washington, D.C.

DEAR CONGRESSMAN PATMAN: This is with further reference to your letter of February 1, 1966, requesting an opinion with regard to the issuance of certificates of deposit and promissory notes by commercial banks.

As I stated in my acknowledgment of your letter on February 10, 1966, we are not in a position to provide you with an opinion. However I trust that you will find the following information useful.

We have carefully examined the Federal fanking statutes and we have read the the replies of the Comptroller of the Currency, the Chairman of the Board of Governors of the Federal Reserve System and the Chairman of the Federal Deposit Insurance Corporation to your requests for their views on the same questions you have asked us.

Our review of the banking statutes has revealed nothing to prohibit a commercial bank from issuing negotiable certificates of deposit or from treating the sums against which they are issued as time deposits. Similarly, we have found no statutory barrier to a bank's acquisition of funds against its issuance of a short-term promissory note. In all, our study has revealed nothing of significance to add to the three letters you have already received.

Sincerely,

NORBERT A. SCHLEI,
Assistant Attorney General.

Mrs. GRIFFITHS. I wanted to ask one more question.

What is the inflationary effect of wiping out discrimination, if any?

Mr. ACKLEY. Well, if you mean by wiping out discrimination allowing people to be paid——

Mrs. GRIFFITHS. Both types. Giving, allowing them to be paid in accordance with the Federal regulations, the statutory enactment, equally.

Secondly, not denying them employment or increases or raises because of race, creed, religion, or sex.

Mr. ACKLEY. I think there are offsetting factors, Mrs. Griffiths. To the extent that our discriminatory practices deny us the use of available trained and productive womenpower, or——

Mrs. GRIFFITHS. Or Negro?

Mr. ACKLEY. Or Negro workers; then clearly, we are denying ourselves some productivity that would increase our output. To the extent, of course, that people merely continue to do the same things, and are paid more, I suppose it does raise labor costs.

It may be a desirable increase in labor costs, but it could be an increase in labor costs, which would not be offset necessarily by higher productivity, if the workers continued to do the same thing.

Mrs. GRIFFITHS. Well, then, would you support it?

Mr. ACKLEY. If we regard that as a social policy that we want to achieve, then, of course, we can afford it.

Chairman PATMAN. Mr. Widnall?

Mr. WIDNALL. Thank you, Mr. Chairman.

Dr. Ackley, in your statement, you said, "The response of the economy has been dramatic. By increasing after tax incomes of individuals, consumer expenditures and business sales have been directly lifted. In this way, through depreciation reform, investment tax credit, reduction of corporate taxes, the profitability of private investment has been distinctly raised, contributing importantly to the strong expansion of business investment we are now seeing."

Now isn't it true that one reason for the current expansion has been the large increase in debt—particularly consumer debt? Last year, the percentage of disposable personal income required to meet installment debt was 14.2 percent. The highest level ever. For installment and mortgage debt together, the figure was 17.8 percent, also a historical high.

If there were a recession what would be the implications of these large commitments to repay the debt?

Mr. ACKLEY. Certainly, in case of a recession, which we all hope we can avoid, in spite of Senator Javits' prediction this morning, the burden of debt becomes far more serious. A person who loses his job, but who has contractual payments to meet, is obviously in difficulty.

Mr. WIDNALL. Well, hasn't this alarmed the economic advisers of the administration, the fact that the consumer debt has been rising so markedly?

Mr. ACKLEY. Repayments on consumer debt have risen slightly as a fraction of disposable income.

We have a rather extensive discussion of this in chapter 1 of our annual report. The best evidence we have been able to accumulate suggests that the increase in this overall ratio is not due primarily to individual families incurring more debt relative to their incomes, but rather to an increasing number of families who are reaching the income brackets and the life cycle brackets where families typically use consumer credit.

The evidence from surveys of consumers does not indicate that individual families of a given type are now much more heavily in debt, but primarily that there are more families of the type that typically borrows. The poorest families don't and ordinarily aren't able to use consumer credit.

Now that more families have moved into the income brackets where they are able to obtain credit, and that there are more younger families who are establishing households, we have the higher percentage overall, without necessarily an increase in the average debt burden on families of any given type.

That seems to be primarily what has happened.

Mr. WIDNALL. Well, in other words, it almost looks as though wage increases mean you have the power to increase your debt, and you have got a sword of Damocles hanging over your head that is a little bit larger than the one you had before.

I know that many have said to me after they have gotten a wage increase, "It seems to me we owe more; we are in worse trouble than we were before we had the wage increase," and actually, it is just because they have found the ability to borrow more and get extended credit, and I think that a lot of what has been going on in the last year or two has been increased credit, increased consumer debt, as a result of some wage increases.

Now, isn't that important in this sector?

Mr. ACKLEY. I am sure individual families now as always have overextended themselves. I think when we look at the total picture, however, we are somewhat reassured by the fact that families in the aggregate have increased their financial assets far more than they have increased their indebtedness.

Again, these are not necessarily the same families, but taking the consumer segment as a whole, we don't see a distinctly unhealthy situation because of the growth of consumer credit.

Mr. WIDNALL. Following up what Senator Jordan said, the budget shows only a small net increase in domestic expenditures for 1967. However, increases have been offset by $4.7 billion in sales of financial assets.

Since these sales do not restrict or restrain domestic demand to the same degree as real spending cuts would, isn't your budget much more expansionary than it appears from the increase in spending alone?

Mr. ACKLEY. Well, in the first place, Mr. Widnall, the increase in the sale of financial assets is not $4.7 billion. We have budgeted $3.3 billion for the current fiscal year. Thus, the increase in sale of financial assets is not the full $4.7 billion, but rather $1.4 billion.

Mr. CURTIS. What is that? Different fiscal year? It says $4.7 billion.

Mr. ACKLEY. Yes, $4.7 billion is the scheduled budgeted sale of financial assets in fiscal 1967. In fiscal 1966, it is $3.3 billion.

Mr. CURTIS. Oh, I see, yes, a total of 8, then?

Mr. ACKLEY. Over the 2 years, yes.

Mr. CURTIS. That's what I mean.

Mr. ACKLEY. At the same time, as Mr. Okun pointed out a little while ago, the financial assets which the Government is acquiring are also increasing to about the same extent.

Representative WIDNALL. Isn't it true that in order to accomplish this, you are proposing some Federal subsidies in interest or discount? Sale of assets?

Mr. ACKLEY. Well, the sale of assets does certainly transfer these debts into private hands, which we have always felt was within bounds a desirable objective of Federal policy.

Representative WIDNALL. Well, I am thinking now about the participation certificates, and others that you are proposing to sell through FNMA, and provide a new market, actually, for long-term debt assets held by various departments of the Government, which could become a market that is in serious conflict with the normal markets of the United States for credit sources.

Don't you think that this competition that is going to be provided through the Government proposal can have a serious effect on the other markets?

Mr. ACKLEY. Certainly it cannot be done without some impact on the total credit market.

On the other hand, private saving is also rising very substantially, and some of those savings will flow into these particular instruments, instead of flowing into an equivalent quantity of Federal debt.

Representative WIDNALL. I understand the savings went down percentagewise.

Mr. ACKLEY. Savings?

Representative CURTIS. Went down percentagewise?

Mr. ACKLEY. Are we talking about personal saving as a percentage of disposable income?

Representative CURTIS. They declined.

Mr. ACKLEY. Between 1964 and 1965, there was some small decline, percentagewise. The total of private saving, and the savings of households, has of course increased tremendously.

Representative WIDNALL. Mr. Okun said that there would be no real net change through sales of these assets, because you would be acquiring new assets. I notice the new assets he said we would acquire, though, were more of a frozen asset category than liquid assets, which we would be using up in selling these Government assets. You talk about other currencies we are going to acquire. These are frozen as to use in most instances, and in many instances, we have got to—we have got so many hundreds of millions of them that we can't use, how can they be considered any kind of a comparable asset?

Mr. ACKLEY. To the extent they involved foreign currencies acquired through Public Law 480, and so on, you are absolutely correct. I think that is a relatively small part of the total, however. Most of the assets are those acquired through purchase of mortgages, and through various lending programs such as Small Business Administration, Export-Import Bank, and so on.

Representative WIDNALL. The Council of Economic Advisers admits that inclusion of fringe benefits would raise total wage adjustments in the first 9 months of 1965 by 0.75 percent. Added to the 3.3 percent average yearly wage adjustment in major contracts during this period, this would put total increase in employee compensation over 4 percent, way above the guideposts. Even for contracts covering a period longer than a year, the adjustment would put the figure at close to 3.5 percent.

Yet the Council continues to maintain that wage increases were within the guideposts last year. What is your comment on this?

Mr. ACKLEY. We cannot contend that wage increases, either in all cases or on the average, were completely within the guideposts. Our estimate of the increase in hourly compensation in the total private economy in 1965 is a figure of 3.7 percent. Compared with an increase in productivity in the total private economy of 2.8 percent, this means an increase in unit labor costs of almost 1 percent, in 1965—which is appreciable, and obviously, a subject of concern.

Representative WIDNALL. The Labor Department indicated that negotiated pay increases, not including fringe benefits, were 4.2 percent in the final quarter of 1965, compared to 3.2 percent in 1964, and 3.1 percent in 1963.

Averaged out over the life of the contract, however, the increases would be 3.3 percent, according to the Bureau of Labor Statistics. Industry economists have said that with fringes included, settlements in 1965 would be between 3.5 and 4 percent even on the Labor Department's average basis, still far above the guidelines.

Don't you consider these increases inflationary?

Mr. ACKLEY. Yes, indeed. I think wage increases above the guideposts are inflationary. The guideposts are a standard for noninflationary wage increases; to the extent they are exceeded, it is inflationary, as registered in this nearly 1 percent increase in average unit labor costs.

Representative WIDNALL. I would like to make this comment on three messages by the President. I think that the Economic Report was more honest that the state of the Union message and the budget message to the Congress.

It recognized, for the first time, I believe, the inflationary measures that are inherent in the economy today; and actually—I think in a sort of cute way—got around to wage and price controls without action by the Congress. As we have noted, there has been a change from guidelines to guideposts, and guidelines indicate a flexible position, guideposts are more inflexible, as I see it.

Representative CURTIS. Very good.

Mr. ACKLEY. Mr. Widnall please let me correct you on one thing. The wage price guideposts have been guideposts from the very beginning.

Representative WIDNALL. Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Mr. Ackley, I agree with you that we have had a wonderfully balanced and full prosperity. There is a tendency in these question periods to emphasize the negative rather than the positive.

Also, I think that your statement to us this morning in laying to rest some of the myths was very helpful. I don't agree, and I am sure that no member would agree fully, on all points, but I think that we have made great progress, and the speech of President Kennedy, made at Yale in 1962, was directed at this same kind of thing. I think that by following up in 1966 and showing the progress that has been made by economic developments, you have served a real purpose this morning.

I would like to ask you about your Annual Report of the Council of Economic Advisers, pages 41–42, where the GNP potential seems to be based on a 4-percent unemployment level. Since we have reached that, I wonder if the high employment surplus is still based on that figure; 4.1 percent was the last figure I recall, and as I understand it, it is expected to be less than 4 percent in the coming year.

Mr. ACKLEY. We could, of course, recalculate the high employment surplus on some other percentage of unemployment. We have not done so. We have continued to calculate it on the basis of 4 percent.

Senator PROXMIRE. Why not? Everything in your report, and also the statement that you made this morning, and what we have heard from Secretary Wirtz and others, seems to suggest that we can get the 3½ percent without inflation. Why not give serious consideration to a somewhat lower level?

Mr. ACKLEY. We have deliberately refrained from setting a new target for unemployment now that we have approximately achieved the old interim target, Senator, primarily because we are not sure enough what kinds of problems we will meet as we move down to 3½ percent. If, as we hope and expect, a 3¾-percent average unemployment rate for 1966 is possible, with relative stability of prices, then I think it might then become appropriate to aim for 3½ percent or even possibly 3 percent.

Senator PROXMIRE. This is a "supercautious" policy. In other words, you don't consider a target until after you have hit it, gone through it, and devastated it, and then you consider it may be a target.

It would seem to me in view of the fact that there was a great question—and I remember, Chairman Martin and others questioned—whether we would get down to anything like 4 percent, or even 5 percent, without inflation. We had inflation, but, of course, it has been very moderate. We have gotten down to 4 percent now and as I say, you have very well documented arguments that we can reduce unemployment further, if we follow wise policies, without inflation.

I would simply recommend that you give real consideration to 3½ percent.

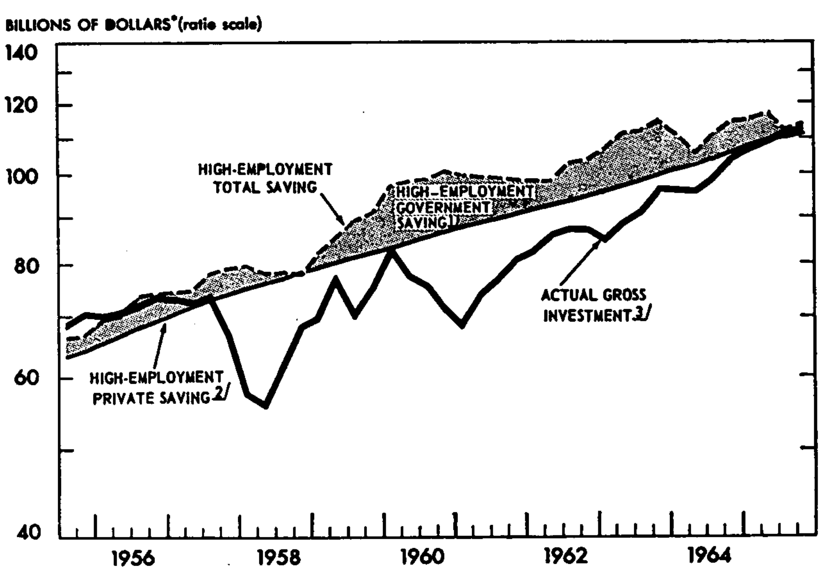
Mr. ACKLEY. We certainly will.

Senator PROXMIRE. Now this concept of a full employment surplus or a high-employment drag, or whatever you want to call it, is so new to us that it is very difficult for me, and I am sure for other Members of Congress, to grasp, but it seems to me that on the basis of your chart (see below), that from 1958 to 1965, there was a definite full employment surplus or high-employment drag on the economy, that the effect of the Federal budget was deflationary—clearly more so than the budget now before us.

(The following chart is taken from the Annual Report of the Council of Economic Advisers, 1966:)

Chart 4

Investment and High-Employment Saving



* SEASONALLY ADJUSTED ANNUAL RATES.
1/ FEDERAL HIGH-EMPLOYMENT SURPLUS PLUS STATE AND LOCAL ACTUAL SURPLUS.
2/ 15¼ PERCENT OF TREND GNP IN CURRENT PRICES.
3/ GROSS PRIVATE DOMESTIC INVESTMENT PLUS NET FOREIGN INVESTMENT.
SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

It seems to me that we had a drag during this period when we wanted expansion. We now seem to have a neutral fiscal policy. The President set a $500 million surplus in the cash budget and a $500 million deficit in the national income accounts budgets, pretty much of a neutral policy in a period during which inflationary pressures are expected to be somewhat greater.

Is this a correct conclusion on my part, or not?

Mr. ACKLEY. Yes; I think essentially correct. On the national income accounts basis, the full employment surplus which was largely eliminated in the latter half of 1965 would stay at roughly that same level throughout 1966 and become a small positive figure in the first half of 1967.

Senator PROXMIRE. So in a sense—and I have not seen this discussed very much in the financial columns—in a sense, the fact is that this budget is the least dragging, the least negative, the least discouraging of expansion that we have had in the last—well, in the last 6 or 7 years?

Mr. ACKLEY. I think we have to distinguish two things. One is the *level* of the full employment surplus or deficit, and the second is the *change* in it. Reduction in the full employment surplus is highly stimulating. Holding a constant full employment surplus is certainly less so. I would not deny that a low full employment surplus is more stimulative in some sense than a higher one.

Senator PROXMIRE. I see. You would be more expansionary if you recommended tax cuts or recommended higher expenditures, and so forth?

Mr. ACKLEY. Indeed.

Senator PROXMIRE. Instead, you are recommending pretty much of a hold the line?

Mr. ACKLEY. And I would point out that the corporate acceleration does not enter in the national income accounts budget. To the extent that it has a drag effect—and we are sure it has some—it is over and above the effect of the full employment surplus.

Senator PROXMIRE. Isn't your expectation of growth in 1966, the coming year, somewhat optimistic in view of the fact that you say you expect it to be about the same in the coming year as it was last year, yet last year we were able to reduce unemployment sharply? This coming year, in view of the progress we have made, and the fact that we have about 1.8 percent of our married men, only, out of work, which is practically none, you know, practically down to the between-jobs group, does not it seem a little optimistic to expect that we would have the same kind of progress in the coming year?

Don't you have to assume that you are going to have the same degree of unemployment improvement if you have the same growth in 1966 that you had in 1965? What I am saying is this: That one big element in our growth was the reduction of unemployment, and can we expect that same element this time?

Mr. ACKLEY. We expect a reduction of the unemployment rate, perhaps somewhat less rapid than the reduction in the past 12 months. The expected growth in real GNP in constant prices is about a half percent lower in 1966 than in 1965. The growth is about the same dollar amount, but it starts from a higher base. It is about 5 percent instead of about 5½ percent, roughly.

Senator PROXMIRE. Now that is a slight modification of it.

Mr. ACKLEY. It would contribute to another large reduction in unemployment.

Senator PROXMIRE. Yes. Of course I won't get to this in this series of questions, but one of the problems I have that other members of the committee don't seem to have is that I don't think that there is, or is likely to be, very much stimulus from the Vietnam war in our economy, and I think your analysis of that has been very good. Without that economic stimulus—if you recognize reality instead of the emotional feeling that we get about what is a tragic situation—it would seem that we don't have the kind of economic drive, force, and stimulation, that many people assume.

Let me ask you about a very disturbing column that appeared in Sunday's paper. Hobart Rowen wrote the following in the Washington Post, and I quote:

> The unanswered question at the moment is whether or not the President's total program will actually impose the degree of restraint that is necessary.
>
> One need not look beyond their decision to hold the wage guidepost to 3.2 percent when the arithmetic as used before would have called for 3.6 percent—for a measure of official concern about potential inflation.
>
> On grounds of equity and good sense, it would have been easier to defend a 3.4-percent guidepost, or even a range—since the determination of productivity to which the guidepost formula had been linked is certainly not an exact science.
>
> The arbitrary decision that it would be useful to hold wage increases down this year is political and not economic.

Would you comment on that?

Mr. ACKLEY. I would be happy to, Senator.

I disagree with my good friend Mr. Rowen in this case. Our judgment that a 3.2-percent guidepost was appropriate was based on our analysis of actual and expected productivity trends. I know of no serious student of economics who has proposed that the trend growth of productivity at the present time is in excess of 3.3 percent. Certainly not 3.6, not even 3.4 percent. I think we are adhering to the spirit of the guideposts as it has been clearly expressed since the first enunciation of it.

Senator PROXMIRE. When you say that, are you talking about the labor economists, too? Have you had a chance to study their findings?

Mr. ACKLEY. We have met on several occasions with the labor economists.

Senator PROXMIRE. They don't make—they don't maintain that—after all, these are competent men, and they have an ax to grind, but they are competent and honest. Don't they show a greater increase in productivity than 3.3 or 4?

Mr. ACKLEY. I believe that the labor economists with whom we have discussed this several times argue on other grounds—rather, for example, that the wage guidepost ought to be adjusted for the increase in the cost of living, or simply that it was somehow inequitable for us to change a calculation which had been interpreted as a 5-year moving average.

Senator PROXMIRE. I just have time for one short question before my time is up. I would like to ask about the poor showing in the last 2 years on residential construction. In your report, you talk about overbuilding in 1961 and 1963, and mention family formations in relationship to the construction, but not show any real documentation to support this.

Can you give us any further explanation of the reason for this very poor showing in this one segment of the economy, in view of the fact that it has been a dynamic, growing economy, and can you give us any comparison in depth of what the relationship between family formations and residential construction has been in the past years?

Mr. ACKLEY. We have included the figures on family formation.

Senator PROXMIRE. You have them for 1 year, as I recall. Do you have them for past years, too?

Mr. ACKLEY. Yes, they are certainly available for past years. There is always an excess of new housing construction over family formation, which is presumably accounted for in part by demolitions and abandonments. The relationship between new construction and new family formation in the past year has been about the same as in previous years.

We could prepare a little analysis of that, if you would wish.

Senator PROXMIRE. I would appreciate it very much. My time is up, Mr. Chairman.

(The following material was subsequently supplied for the record by the Council of Economic Advisers:)

As table 4 shows, there is no invariant, year-by-year relationship between the growth in the number of households and the number of housing starts. The rate of growth of income and its distribution, the cost of home construction, the terms and availability of mortgage credit, and the amount, quality, and location of housing already available at any time also play important roles in determining the volume of residential construction activity. However, statistical analyses indicate that persistence of larger than normal housing starts relative to household formation tends to become reflected in higher vacancies which, in turn, depress building activity.

Until the 1954–55 housing boom, it appears that a backlog of demand had existed in the housing market as a result of the Second World War and the limitations on mortgage lending and residential construction during the Korean hostilities. The 1954–55 housing boom probably filled much of this backlog of demand. From 1955 through 1959, sharp swings in homebuilding activity appear to have reflected irregularities in the rate of growth of income,, changes in prices, and changes in the mortgage market. On average during this period, however, the rate of household formation was slightly higher than in the preceding 5 years while the excess of new housing starts relative to annual net growth in households narrowed to an average of about 520,000 per year. This margin widened during the 1961–63 upswing in residential construction activity. Indeed, if the 1961 data are adjusted to allow for the change in reporting base (see footnote to table 4) the average gap between the number of housing starts and the number of additional households amounted to about 600,000 per year for the entire 1960–64 half decade.

A sizable gap between the number of housing starts and the additional number of households is regularly accounted for by demolitions, abandonments, seasonal housing, and normal vacancies due to population mobility. Unfortunately, current data are not available on the number of demolitions and abandonments and there is reason to believe that they may have increased in recent years owing to highway construction, urban renewal, and upgrading of housing. Nevertheless, a higher housing vacancy rate did reemerge in 1963–64. As table 5 shows, the strong increase in building activity in the West (particularly multifamily units) resulted in persistently high rental vacancies in that area. The decline in residential construction activity in 1964 and 1965 was also concentrated in the West.

Factors contributing to the demand for new homes in the 1961–63 period, particularly rising family income and readily available mortgage credit, continued to be favorable during 1964 and most of 1965. Incomes have continued to rise strongly while mortgage interest rates remained level until last September. Although construction costs rose somewhat more rapidly in 1964 and 1965 than in the preceding 3 years, this rise was no greater than in 1955–56 or 1958–59. Thus it appears that higher vacancy rates were a key factor in the recent lagging performance of the homebuilding sector.

TABLE 4.—*Annual change in number of households and annual number of nonfarm housing starts, 1950–65*

[In thousands]

Period	Change in number of households [1]	Number of public and private nonfarm housing starts [2]	Number of private farm and nonfarm housing starts [2]
Annual average:			
1950 to 1954	847	1,587	
1955 to 1958	878	1,400	
1960 to 1964	[3] 928	1,451	1,439
1950	1,102	1,952	
1951	848	1,491	
1952	830	1,504	
1953	559	1,438	
1954	895	1,551	
1955	997	1,646	
1956	758	1,349	
1957	859	1,224	
1958	900	1,382	
1959	(4)	1,531	1,517
1960	681	1,274	1,252
1961	[3] 1,361	1,337	1,313
1962	537	1,469	1,463
1963	807	1,614	1,609
1964	1,255	1,564	1,557
1965	[5] 900	[6] 1,518	1,503

[1] Change in number of households from March or April of year shown to number in March or April of following year. Annual data are derived from a sample survey and therefore they and the annual changes are subject to sampling errors.

[2] Number of housing starts, private or public plus private, including farm are not available prior to 1959. Since 1959, the number of farm starts has fluctuated between 20,000 and 30,000 per year. The downtrend in the number of farm households and upgrading of farm dwellings were undoubtedly offsetting factors influencing the number of farm housing starts in the preceding decade. In any case, it is unlikely that they accounted for a significant part of the fluctuation in the difference between net household growth and the number of housing starts.

[3] As published in Census Current Population Reports, Series P–20, No. 130. Adjusting for change in estimating procedure to incorporate 1960 Census data (see Census report cited above, p. 2), the data are as follows: 861,000 for 1961 and 828,000 for 1960–64 average.

[4] Not available because of change of definition of household between 1959 and 1960 surveys.

[5] Based on projections for 1965 and 1966, series A. See Current Population Reports, Series P–20, No. 123.

[6] Preliminary.

Sources: Department of Commerce and Council of Economic Advisers.

TABLE 5.—*Rental vacancy rates* [1]

[In percent]

	1960	1961	1962	1963	1964	1965
United States	7.6	7.7	7.4	7.5	7.5	7.7
Northeast	4.1	4.0	4.7	4.8	5.0	5.1
South	8.8	9.4	8.8	8.8	7.9	8.4
North Central	7.6	8.6	8.4	7.8	6.8	6.6
West	11.4	9.5	8.3	9.1	11.2	11.7

[1] Rates are for the 4th quarter of each year in order to be comparable with the latest available data.

Source: Department of Commerce.

Chairman PATMAN. In accordance with the unanimous-consent agreement, we will stand in recess until 2 o'clock this afternoon here in this room.

(Whereupon, at 12:30 p.m. the committee recessed, to reconvene at 2 p.m. the same day.)

AFTERNOON SESSION

Chairman PATMAN. The committee will please come to order.

Mr. Ellsworth?

Representative ELLSWORTH. Thank you, Mr. Chairman.

Mr. Ackley and gentlemen, I am sorry I wasn't able to stay the whole time this morning, but I did read your statement and have read and studied your annual report. I have just one or two very brief questions.

First of all, I am very concerned about this question of the cost of the war in Vietnam and the effect that it might have on the economy. For example, without going into detail, I know that over the last several years those people who make estimates about the extent of our involvement in Vietnam have consistently underestimated what the involvement was going to be in the next 6 months or the next 12 months.

Yesterday the bombing started again in the north. This morning in the Wall Street Journal there is an article on the front page that says:

> There are several options open to the President—a modest increase in U.S. troop strength in the south to make present tactics more effective, a sizable expansion of the combat efforts in the south, along with a sharp rise in U.S. forces, and an extension of the ground war into Laos, a major escalation in bombing of North Vietnam, or even an air-sea offensive against Red Chinese military potential—

All of those involving larger commitments of the national effort and presumably more cost.

Now, would you explain to the committee the extent to which you were able to take some of these possibilities into account in the preparation of your report, and also would you comment in a general way on what you think the Congress and the President would be able to do, should the national effort require a substantial or a major increase in our effort in the Vietnam war?

TESTIMONY OF GARDNER ACKLEY, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; ACCOMPANIED BY ARTHUR M. OKUN—Resumed

Mr. ACKLEY. I would have to plead guilty of being one of those who was either ill-informed or a poor guesser about the trend of Vietnam expenditures. I think last summer, before decisions were actually reached, a number of us did not realize the extent to which the plans that were then tentatively being made might involve substantial increases in defense expenditures.

I am obviously no expert on what lies behind the numbers that are in the President's budget in this area. My understanding is that those estimates are based on the present military planning. It is possible, however, that contingencies could arise which would require substantially increased expenditures. If that were the case, the President has stated very clearly that he would come to the Congress not only for further appropriations, but also for appropriate action on the revenue side. I would expect, particularly if the Congress had an opportunity to consider in advance the kind of tax changes that would be appropriate under those circumstances, that the Congress would be able to move rather quickly in enacting appropriate increases in taxes.

Representative ELLSWORTH. I would hope they would. In other words, what you are saying is that the President and the administration, despite everything that is in this Economic Report and despite the limited nature of their proposals so far, might have to come before Congress if this Vietnam thing expands substantially and ask for an entirely different framework in which to preserve stability in the domestic economy; is that correct?

Mr. ACKLEY. I think that is conceivable. Of course, the opposite is also possible, that the hostilities might end, in which case changes of the opposite sort would be called for.

Clearly, budgetary planning had to be based on some set of assumptions. It was based on military assumptions which apparently were determined by the Joint Chiefs of Staff and the National Security Council as being an appropriate plan for the kind of developments that were foreseen.

Representative ELLSWORTH. I am sure that is true and I am sure that is very well put. But when this report was prepared, and the budget, nobody really knew, did they, at that time whether the bombing pause would be interrupted and bombing of the north resumed or not?

Mr. ACKLEY. I think that is probably correct, although I believe that the military planning contemplated defense forces that would be adequate for a continuation of hostilities at substantially above the level of this past year.

Representative ELLSWORTH. Of course our concern, among other things, is with the inflationary effect of a very substantial increase in Vietnam activity. For example, adjacent to my community is a very large ammunition production facility at DeSoto, Kans., and they are going into production at a great rate. They are going to hire maybe 2,000, maybe 3,000, maybe 4,000 people. It has already had a tremendous impact on local businesses and industries all around in our area on wages that small businessmen and others are having to pay to retain their help, and even at that they are losing their help; so it seems to me that there is a very great danger on an overall basis that an underestimate may again have been made with respect to the extent of the Federal spending that is going to be required in connection with Vietnam, and that we may have to do more than we think, more than your report indicates, in order to control inflation, and I can tell you that people out in the countryside are really worried about inflation. Housewives and white-collar workers and the retirees are very concerned that the Congress and the President and the whole Federal structure do everything that they possibly can, that they make full use of the broadest possible fiscal and monetary weapons they have to control inflation. That is our main worry.

Mr. ACKLEY. I think that is a concern which we all share, and I am sure the President's determination is as great as ours that we take the appropriate fiscal measures that will avoid inflation.

Representative ELLSWORTH. Thank you very much.

Thank you, Mr. Chairman.

Chairman PATMAN. Senator Miller, would you like to interrogate the witnesses now?

Senator MILLER. Thank you very much, Mr. Chairman.

Mr. Ackley, do you have any idea how many workers are covered by escalation clauses for increases automatically according to changes in the Consumer Retail Price Index?

Mr. ACKLEY. I am afraid I have forgotten the precise number. It is many fewer than was the case a few years ago. As I recall, it is in the neighborhood of 1 to 2 million, but I could be wrong about that. We will check the figure and put it in the record.

Senator MILLER. I have information that a recent Labor Department study of 306 major collective bargaining agreements shows that all but 12 provide for possible wage adjustments in 1966 and the number of workers scheduled to receive deferred wage increases is the greatest since 1957.

About 35 percent will get increases of between 10 and 11 cents an hour, compared to 1965 when the largest number, 32 percent, was at 7 to 8 cents an hour.

In addition, 48 percent of all workers who receive deferred increases next year will also have their wages adjusted based on changes in the Consumer Price Index, but I don't have the number of people that that 48 percent represents.

You would estimate it at 2 million, would you?

Mr. ACKLEY. That is very rough, and my memory is poor for numbers. A relatively small fraction of the total labor force has provision for cost-of-living adjustment.

Senator MILLER. What are the major industries in which this number is concentrated?

Mr. ACKLEY. One certainly is the aerospace industry where this kind of arrangement is typical.

(The following was supplied for the record by the Council of Economic Advisers:)

About 2 million workers covered by major collective bargaining agreements have automatic cost-of-living adjustment clauses. It is also estimated that about 200,000 unorganized workers—in establishments where union workers have escalator clauses—are also covered. The major industries with such automatic cost-of-living adjustment clauses are automobiles, aerospace, meatpacking, and trucking.

Senator MILLER. To what extent do the price indexes understate the degree of inflation that is taking place? I think this is an important question because sometimes we have people who suggest that the retail price indexes have an upward bias, implying that they overstate inflation.

The Council admits that in a period of weak demand list prices are discounted—are lower—freight absorbed, and other terms of the transactions changed. The Wall Street Journal on October 18 noted that price boosts have gone far beyond those announced to the public, including changes in discounts, charges for delivery, minimum acceptable order sizes, special services, repair of purchased equipment, and so on.

Would you agree that we had hidden inflation of this kind as well as that reflected in the price index?

Mr. ACKLEY. I am sure our price indexes are imperfect in both directions, Senator. I am sure that, on the one hand, they do not allow for all of the increases and improvements in quality of goods and services. I am equally sure that they don't catch all of the discounts and special allowances that are made when markets are weak, nor the restoration of those discounts when markets tighten.

On the other hand, our price indexes do catch a considerable amount of this type of price variation. For example, in the past year the price indexes both at wholesale and retail show a substantial increase in the prices of petroleum products. Yet the producers of those products say that nothing has happened, except that special allowances and discounts which were formerly in effect have been removed.

In that area at least, the price indexes do catch the subtle changes. But their effectiveness certainly varies widely from one part of the economy to another. Indeed, the Council has always felt that substantial improvements could be made and should be made in our price indexes.

A report by the Stigler committee a few years ago suggested the nature of some of these possible improvements and we would hope that the Department of Labor may be able to investigate some of these possibilities.

Senator MILLER. I am familiar with the Stigler committee report, but I am concerned not so much with improvements in the price index as it is presently constituted as with things that are outside of the price index. For example, in my State when somebody talks about an increase in the cost of living of 2 percent last year and he sees in the same article in the newspaper that farm real estate has increased 10 percent, he wonders how there can be such a difference.

Granted that farm real estate is not, per se, included in the Retail Price Index, it certainly indicates an inflation, and I am wondering what other areas besides the Retail Price Index should be given attention when we are talking about the amount of inflation that we are having in this country.

In other words, I don't believe, whether you have an upward bias or a downward bias, that the Retail Price Index, granted that it extends only to wage earners and their families, is giving the country a clear picture of how much inflation we have.

It certainly doesn't do it with real estate.

Mr. ACKLEY. I certainly agree that real estate is not included in any of the price indexes. There are, of course, various kinds of biases in our indexes. Certainly the GNP deflator has some rather strong upward bias in it because of the way it treats the Government sector.

Senator MILLER. Would you explain that?

Mr. ACKLEY. Yes. The deflator for the Government sector for the GNP account assumes that any increase in Government wages and salaries is a pure cost increase. In other words, it makes no allowance for improvements in the productivity of the Government workers. It prices the input rather than the output.

This tends to be true in some of the service industries as well and in construction. I agree that we have no measure of the extent of this upward bias and that there may be compensating downward biases. I think we do need to improve our indexes as much as we can.

Senator MILLER. Of course, to offset that, you might use the postal service as an indication. There are some people who recognize that the increase in postal workers' salaries is included in that implicit price deflator, but there would be quite a few people, I think, who might question whether this has resulted in improved postal service.

I grant that it is pretty hard to measure this.

Another question. The Council admits that Government actions have an important effect on industrial prices. For example, the rise in payroll taxes that took effect this year increased employer costs by nearly seven tenths of 1 percent.

Won't the administration's proposals to increase the minimum wage and broaden its coverage as well as to change the unemployment compensation system have a marked upward effect on costs and ultimately on prices?

Mr. ACKLEY. I should suppose that the effect of any increase in the minimum wage would depend on how large an increase was involved. I assume there are productivity increases even for workers who receive the minimum and that an increase in the minimum wage consistent with the general average gain in productivity in the economy would probably have minimal effect on labor costs.

Certainly increased payroll taxes for unemployment insurance might have, at least in the first instance, an effect on labor costs as well.

Senator MILLER. Suppose you have a situation where there is no increase in productivity. Then this would definitely have an upward increase effect, wouldn't it?

Mr. ACKLEY. Indeed it would. On the other hand, there are many industries where the productivity gains are greater than the average, so that it would be more than offset.

Senator MILLER. Would it be your judgment, then, that the minimum wage increase with the offsets would not result in an increase in costs?

Mr. ACKLEY. I think it would depend entirely on what proposal might be made.

Senator MILLER. Let's take the administration's proposal.

Mr. ACKLEY. It has not made one, Senator.

Senator MILLER. As I understand it, the administration has proposed at least $1.50 an hour—just has proposed.

Mr. ACKLEY. I'm sorry. I don't believe that it has officially proposed anything.

Senator MILLER. Well, suppose it is $1.50 an hour.

Mr. ACKLEY. Effective immediately?

Senator MILLER. Well, let's say effective July 1.

Mr. ACKLEY. In a wage change that occurs only sporadically, I think one has to go back to the time that the existing wage was originally established to get any valid comparison. If you take the period since the $1.25 minimum wage was established, a $1.50 minimum wage would represent an increase over that entire period of something more than 3.2 percent a year. I don't know exactly how much more.

(The following statement was supplied for the record by the Council of Economic Advisers:)

The $1.25 minimum wage took effect in September 1963. If the minimum were raised to $1.50 this September, the annual rate of increase over the 3-year period would be 6¼ percent.

Senator MILLER. When you give me that answer, are you thinking in terms of the minimum wage base, or are you also encompassing the bumping effect?

Mr. ACKLEY. There certainly is a bumping effect and I think we have to take account of that.

Senator MILLER. Have you any figures on what would happen from a bumping effect standpoint from an increase of $1.25 to $1.50?

Mr. ACKLEY. I believe that Secretary Wirtz submitted to Congress, either yesterday or today, a report on the minimum wage, which I have not seen. Since he will be appearing before your committee in a few days, I think it would be appropriate to ask him about the effect of the minimum wage on labor costs.

Senator MILLER. You would get this from the Labor Department? You would not work this up with your own economists?

Mr. ACKLEY. Certainly. That is our only source of data.

Senator MILLER. Thank you. My time is up.

Chairman PATMAN. We have gone around one time, so we will start again. I will take my 10 minutes, if it is all right.

First, Mr. Ackley, on these CD's. We don't have our charts here today. We had them in December when we had the Federal Reserve Board before us on that rate increase, but the facts are that the CD's commenced really about 1960 at the end of the year. I mean, the negotiable certificates of deposits issued in large amounts by the big banks.

In 1960 at the end of the year it didn't amount to too much, but went on up to the end of 1965 to $16.5 billion rather quickly, commencing mostly, I think, in 1962.

Now, do you have any records to show, as these large certificates of deposits were sold by the banks, that there were fewer bidders for short-term securities? In other words, most of these, we were told, were purchased by corporations that had idle funds and by using those idle funds in this new market, this certificate of deposit market, that took them out of the bidder class for short-term Government securities. Is that correct or not?

Mr. ACKLEY. I should assume in many cases corporations which now invest in CD's formerly invested in Treasury bills.

Chairman PATMAN. And then Treasury bills were down to about 2.35 and along there, to the best of my recollection—no; 2.37 in 1961—but about that time they commenced selling these CD's at a much higher rate of interest, of course, and naturally the corporations were no longer interested in short-term securities and, therefore, they did not continue to be bidders for short-term securities. That is why—in your table C–48—that from 1961 to December 1965 the rate went up nearly 2 percent.

It would appear that the banks by enticing these holders of these large cash balances of corporations to invest in CD's at, say, 5 or 4¾ percent, necessarily took them out of the market for the short term; don't you think that had tremendous effect on causing the short-term rate to go up to where it is now, even above the long-term rate?

Mr. ACKLEY. Mr. Chairman, that certainly may have been one factor. There are a lot of factors that affect the liquidity needs of corporations.

Chairman PATMAN. Let's just stay with this one.

Mr. ACKLEY. I should suppose it would make some contribution.

Chairman PATMAN. The truth is, they were bidding on these short-term securities and the rate was kept low, but when they were induced to get out of that short-term market and go into the large bank certificates of deposit, that necessarily forced the interest rate up and at that time both the Federal Reserve and the Treasury were trying to arbitrarily cause short-term rates to go up, were they not?

Mr. ACKLEY. Yes; I was going to mention that as another factor.

Chairman PATMAN. They were cooperating, in fact, I think, against the public interest, and I told them so. I don't think it was right, but they did. They forced the rate up. I will not go into it further now because I have something else here.

I mentioned to you the $40 billion in the Federal Reserve banks that have been paid for once that are now held by the New York Federal Reserve Bank, that the people are still paying a billion and a half dollars a year in interest on; paying it to the Open Market Committee of the Federal Reserve System, and I don't think it is right for people to have to pay their debts twice.

That is the reason I bring this up. Recently I sent to an active list of monetary economists belonging to the American Economic Association—about 500 of them—certain questions on this and 86 of them replied. I mean, they replied fully.

They have very interesting answers, all of them. Whether they agree with me or not is immaterial, but they have very interesting answers. About 30 percent of those who replied, however, did agree that we should not any longer pay interest on those obligations that were paid for once.

In these questions that were asked, one was: How large a portfolio should the Federal Reserve System hold in relation to the money supply, the gross national product, or aggregate liquid assets? That is No. 1.

No. 2. If the portfolio grows too large, what should be done with the excess? How should the interest be handled?

No. 3. Should the Federal Reserve expand its operations to dealing in private and municipal debt instruments?

No. 4. Should standards be laid down relative to the maturity composition of the Federal Reserve portfolio of Government bonds?

Now, those questions were answered and we have compiled them, for publication. The replies of all these 86 economists are in this volume. We will have a page proof tomorrow morning to give to you, and I wish you would have this examined. If you feel that it is something you should comment on and would give us your opinion, it would be appreciated.

If you feel that it is outside of your jurisdiction, of course, we won't insist on just trying to compel you to do it. We wouldn't go that far, but if you want to do it voluntarily, we would appreciate very much your giving us your opinion on those questions that were submitted and were answered by those 86 economists, if you please.

(The comments which follow were supplied for the record by the Council of Economic Advisers:)

Congressman Patman's survey of financial economists has provided a valuable opportunity for airing professional views on questions that have arisen regarding the size of the Federal Reserve System's portfolio, the disposition of interest income, and nature and maturity of the securities (or other assets) in which the Federal Reserve System conducts its open market operations. The survey elicited the opinions of many leading experts.

Its results indicate several notable broad areas of consensus. There was general agreement that the Federal Reserve must hold some minimum portfolio in order to have appropriate flexibility in conducting open market operations. The current portfolio was generally thought to be well above this minimum; but the excess was typically not regarded, in itself, as a matter of great importance or a source of problems requiring correction. The survey results also include a number of ideas deserving serious further consideration, in particular those regarding use or control of the System's interest earnings and possible advantages (or disadvantages) of extending the types of assets in which the System can deal.

Chairman PATMAN. You stated this morning that the guidelines were intended to be "standards for private behavior," which I think is very good. Do you think that there should be guidelines for interest rates the same as for other things, Mr. Ackley?

Mr. ACKLEY. Well, I certainly think, Mr. Chairman, that monetary policy should not be capricious. It should be aimed at national objectives. I would think, however, that the guidelines for Federal Reserve policy would not be analogous to those for private wage and price decisions.

Chairman PATMAN. Don't you think it is pretty bad behavior for them to have a 37.5-percent increase on interest rates at one stroke, like on December 6, with the guidelines at 3.6 percent.

Mr. ACKLEY. I think all of us regret the necessity for interest rates to increase at any time. I believe, however, that one has to consider the impact of monetary policy on the economy. In my view, monetary policy is an instrument both of stimulation at times and of restraint at other times, and ought to be free for appropriate use.

Chairman PATMAN. Don't you think it is reasonable to say in the early part of December there was no reason for increasing these interest rates, the rediscount rate, or the interest rates on CD's, and time deposits, except to bail out those few banks—handful of banks—that had this approximately $12 to $15 billion of certificates of deposit that they wanted to roll over or extend, and the only way that they could be assured of getting them rolled over or extended was to get the Federal Reserve to allow them up to a 5.5-percent interest rate?

Don't you think that was the main motive behind that?

Mr. ACKLEY. I believe that Chairman Martin testified before your committee in December, Mr. Chairman, that that was one of their primary concerns, that although there might have been arguments about the economics of their action, he was confident that he understood the money market aspects of it, and that this was an important consideration in their decision.

Chairman PATMAN. They couldn't see inflation then, I am told. At least, their testimony indicates that they couldn't see any inflation in the foreseeable future, but they certainly did create an inflationary condition there.

I think, if we have inflation, it can be put right on the Federal Reserve Board's doorstep, because they caused it. They caused it with this order of December 6, 1965—automatically and arbitrarily increasing interest rates by 37.5 percent.

I think it was terrible and any inflation we have, I think, goes right back to there. Concerning the ways to fight inflation, it has been my experience and observation over the years—over a long period of time—that there are plenty of ways to stop inflation, many good ways that you can absolutely stop inflation, but there is no known or proven way to stop a recession or depression.

Is that a correct statement or not?

Mr. ACKLEY. I am not sure I would accept it as correct, Mr. Chairman. I believe that the tools of monetary and fiscal policies can be used equally effectively in fighting inflation and in fighting recession and depression.

Chairman PATMAN. Well, you can't push a string. You can permit people to have money without interest or a negative rate of interest. That doesn't cause them to use it. You know, Mr. Hoover tried that. It absolutely failed. So that is the reason I say that you can't push a string.

You can't push money on to people by lowering the rate of interest, but there are plenty of ways that you can stop inflation.

The best way, I think, is to siphon off the excess purchasing power by taxation. I mean, if inflation really gets rough. I wouldn't do it just for a little expansion or anything like that, but siphon it off and pay it on the national debt and then while you are reducing the national debt, you are saving the people the service charges on the debt, which of course now are considerable, $12 billion a year plus $750 million, and I think that is one of the best ways.

But from my own experience and observation, I am convinced that there are plenty of good ways to stop inflation, whether it is just a little inflation or a big inflation. But there is no yet proven way of stopping a recession or a depression.

Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman. I will try and pick up where I left off of setting up the context of the question I hope to get around to.

I left off pointing out that I felt that the Economic Report misstated the history of tax reduction as applied in 1964, 1954, 1948, as well as 1927; that the theory was that our tax rates were so high that they were impeding the growth of the base and we had to get the rates down.

In contrast to that was the theory that the administration spokesmen advanced, that we had to increase aggregate demand. The test of which theory was applied involves taking a look at the expenditures level because the first theory required expenditure restraint, the second did not.

The "new economics" theory contemplated continuing the rate of increase of Federal expenditures. The point is that the actual theory applied was the classical one that the tax rates were too high and had to be lowered to broaden the base.

I want to relate this again to the excise tax cut of 1965. Far from this being a sudden removal of these taxes, as the Economic Report indicates, as a result of a message on the part of President Johnson, this had been something that Republicans, and others outside the Congress, had advocated for some time, and was needed even ahead of the reform in corporate and individual income tax rates. To some degree this was the case because we had imposed certain of those excises deliberately to cut down on the economic usage in transportation and communications for wartime periods, some of them for World War II and some for Korea.

Furthermore, the Ways and Means Committee held some rather extensive hearings in July 1964 where scholars came before us to discuss aspects of the Federal excise system. I felt those hearings clearly revealed that these taxes were seriously impeding economic growth. Note that the theory is based upon removing the impediments to economic growth, not upon the theory that the Council of Economic Advisers advances in its report to try to stimulate demand by increasing aggregate purchasing powers. It may have that incidental effect, but the theory behind it was to remove impediments to growth.

Now, to understand these contrasting tax theories, I think we have to relate them in context to very high rates in corporate and individual income taxes that were established in the 1930's. What we have been doing is cutting down from very high rates of the past.

A very comparable area is tariffs. We started out with very high rates of the Smoot-Hawley tariff, which is still the basic tariff law, and all of these reciprocal trade acts of the 1930's and 1940's and 1950's, which I have been in favor of, have been reducing these rates. We have about run out of trading material, as I point out, because we now have gotten to the point where we have these rates down. If anyone questions this basic economic theory that you can narrow the base by increasing the rate, I point out that this is the entire theory of a protective tariff. I submit that this was the theory the administration advanced in urging the imposition of the interest equalization tax, to impose a tax, on our investment going abroad, with the object in mind of deterring it, not to gain revenues.

In order to discuss fiscal policy today, I think there must be a recognition of these two different economic theories.

I find that the Economic Report contains this statement which I point out is another example of treating a theory as if it were doctrine instead of advancing it as a theory and defending it. Quoting from the report, you say:

> But there can be no question—

This is doctrine, you see—

> that growth has been spurred by two highly visible developments:
>
> First, and more important, the governments of most countries have assumed an active support to promote expansion and growth, guided by a new understanding of how government policy affects economic activity.

That is a perfectly respectable theory for those who believe that you should use fiscal policy, that is, tax policy, and monetary policy to promote growth. This is in contrast to the neutralist theory, where you try to keep monetary policy in conformance with economic growth, and where in tax policy you also try to keep neutral so as not to impede economic growth. This is not just a matter of semantics. The point I make is that these are not doctrines upon which there is agreement; they are only theories; they are the points at issue.

Going back now again to this basic context, here is what worries me the most:

In our society, it seems to me, we have moved forward on a theory of separating economic power from political power. I happen to think that this separation of powers, to which we don't often direct public attention, is probably the very key to our remarkable economic and political development. The neutralist theory that I have advanced in both fiscal policy and monetary policy adheres to maintaining this separation.

As to the other theory, the one advanced is this citation that I just read, is "Governments have assumed an active responsibility." That active responsibility to which I think the Council of Economic Advisers refers is using monetary policy affirmatively and using fiscal policy, taxation, and debt management, in affirmative ways.

The area where I think government should act affirmatively is in expenditure policy. Here is where I hope that we can direct some attention and establish a more forthright dialog. I want to get away from this immediate problem that we have in fiscal matters. The Ways and Means Committee has now been requested to have a "tax-cut" cut.

Mr. ACKLEY. We call it a negative tax cut.

Representative CURTIS. A negative tax cut. I want to go back—and I am dealing with history now, immediate history—to the 1965 excise tax cut.

I have been arguing for it for years for the reasons I have advanced. Yet, when the administration proposed it, I said I could not go along unless I was reassured that the administration would hold to the $99.7 billion expenditure level that it had projected in the budget for fiscal 1966 in its January 1965 budget message. Finally, at my request, the President of the United States sent a letter to the Ways and Means Committee around the end of May or early in June, in which he restated this. The Secretary of the Treasury also restated it. I put the Presidential letter in the Congressional Record, by the way.

I asked, "Do you intend to hold expenditures down in spite of the Vietnam war buildup, in spite of the $700 million additional new obligational authority requested from the Congress in February?" and the answer was "yes."

This is in committee hearings, in debate on the floor of the House, and it was on that premise that I felt we could move forward with the excise tax cut. But that premise is no longer true. The September 1965 expenditure figures changed it. I certainly think that it is necessary to do something in the tax field, but again we had this same colloquy come out in the request to increase the debt ceiling in June 1965. There is nothing in your report about the debt ceiling at all.

The President requested a $329 billion ceiling. This was predicated on the $99.7 billion expenditure level for 1966.

I suggested that it ought to be $327 billion predicated on a $97.7 billion level, and we compromised on $328 billion which was on a $98.7 billion level; this was enacted.

The theory was that the expenditure policy would be held to $98.7 billion for fiscal 1966. The administration said that it would be able to adhere to it as late as June 1965.

This is significant in light of the expenditure statistics that I have previously read. These studies show in the first 2 months of fiscal 1966 you were abiding by these expenditure levels. There is about a $97.3 billion annual level for those 2 months, and then in September this fundamental change in expenditure policy occurred, and this is what has put us in our present fiscal situation.

Now, there is a third way, I would argue, that we could handle the fiscal policy. I should mention the first two: One, increased taxes, the other to increase the debt or a mix. This becomes a serious question, I think, for Ways and Means and for this committee. We have to figure out how much should be imposed further on the debt management area and how much in the area of tax policy. However, the third way—and the one I am primarily interested in—is expenditure policy. I happen to think we have flooded the motor in the expenditure area in several important areas.

One is foreign aid. Very clearly I think that we are actually hurting rather than helping. If we got down to a proper mixture of around about $1 or $2 billion a year, we would be doing a much better job. Certainly the redundancy that exists in the area of the poverty program indicates a flooding of the motor, which is impeding our movement toward eliminating this serious situation in our society.

I could mention other examples, in agriculture and so on. Here is where I would like to see the discussion develop. I happen to think we can have both guns and butter, but we can't have both guns and butter under the kind of expenditure structure that the administration has presented to us. If it goes on with these ill-considered expenditure policies, with the difficult aggregate total, we are going to be in a serious situation both in the area of foreign economic problems as well as domestic.

With that preliminary statement, Mr. Chairman, I find my time has run out, but I will, on my next turn, ask some questions, which I am anxious to do.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Mr. Ackley, earlier today both Senator Javits and Mr. Curtis raised the question of the impact of the Vietnam war on prices and on the economy, and I would like to ask you about it, too. In your judgment, does the almost insignificant increase in defense expenditures in proportion to GNP in fiscal 1967 as compared to fiscal 1965 and 1966—that is, 7.6 percent up to 7.7 percent—accurately relate the full inflation impact of the Vietnam war is we followed present plans, that is, if the proposal that we expend about 7.7 percent in 1967 on defense is followed through?

Mr. ACKLEY. I think, Senator, that the impact can only be seen in the context of the total economy and what else is going on. The additional $6 billion of expenditures for Vietnam in calendar 1966——

Mr. OKUN. It is 7.6 percent for each fiscal year. It is 7.7 for the calendar year.

Senator PROXMIRE. Fiscal year; yes.

Mr. ACKLEY. This $6 billion is imposed on an economy in which private demands are also going strong and growing rapidly. The strongest element, of course, in the last couple of years has been the increase in private investment expenditures. We are approaching the full use of our capacity and, thus, if we spend more on one thing, we have to spend less on something else.

Fortunately, our total capacity is growing all the time, so that we are able to absorb a larger total expenditure, but the growth of expenditures over the past year and the year ahead will be such as to bring us even closer to the full utilization of our capacity. Therefore, it risks the possibility of an excess demand which might produce inflationary pressures.

We think the fiscal program, along with monetary restraint, is adequate to prevent general excessive demands.

Senator PROXMIRE. Nevertheless, we are in a position in 1967 to have more available for the civilian sector of the economy than ever before by far?

Mr. ACKLEY. Oh, a great deal more. I think we have estimated an extra $40 billion of private and public civilian expenditures in 1966.

Senator PROXMIRE. There just isn't any comparison—if you are talking about a war situation—in the situation now and the situation in 1950 and 1952 during the Korean war where, as I understand, we went from 5 percent of the GNP devoted to defense in 1950 to 12 percent in 1952, which is, of course, an enormous difference.

Mr. Ackley. Yes; the comparison is of that order.

Senator Proxmire. Isn't it also true that, even with the Vietnam conflict, big as it is and demanding as it is, we are spending less, substantially less, of our gross national product on defense in 1967 than we did in 1960, and in 1959 and in 1958?

Mr. Ackley. Certainly less than we did in 1962. I am not sure about the earlier comparison.

(The following material was supplied for the record by the Council of Economic Advisers:)

As table 6 shows, Senator Proxmire is correct that defense spending as a fraction of GNP for 1965 and 1966 is substantially less than it was in 1958–60. Indeed, the proportions for 1965 and 1966 are below those for any year since 1951.

Table 6.—*Defense impact in relation to GNP, calendar years 1950–66*

Calendar year	Federal purchases of goods and services for national defense	
	Billions of dollars	Percent of GNP
1950	14.1	5.0
1951	33.6	10.2
1952	45.9	13.3
1953	48.7	13.4
1954	41.2	11.3
1955	38.6	9.7
1956	40.3	9.6
1957	44.2	10.0
1958	45.9	10.3
1959	46.0	9.5
1960	44.9	8.9
1961	47.8	9.2
1962	51.6	9.2
1963	50.8	8.6
1964	49.9	7.9
1965	49.9	7.4
1966 [1]	55.7	7.7

[1] Projected.

Sources: Council of Economic Advisers, Bureau of the Budget, and Department of Commerce.

Senator Proxmire. As I understand it, Secretary McNamara testified on this earlier and it was my understanding—I could not be precisely accurate—we spent around 8.5 to 9 percent during that period and that we are spending less in relation to our GNP than we were during that period.

Mr. Ackley. I am not sure that the magnitude is quite 10 percent versus 7.7, but the difference is considerable.

Senator Proxmire. At any rate, so it seems that while we may have the inflationary problems, the inflation area problems are those that have to do very largely with the peacetime economy, an economy which is approaching—approaching but not achieving yet—a preferred level of capacity operation.

You say it is around 89, 90 percent?

Mr. Ackley. Yes, sir.

Senator Proxmire. A little bit below, not much, but a little bit below on the average, the preferred capacity in an economy also in which we have found recently that the so-called unskilled people and the people whose skills are very moderate can be trained and can enter into a market which demands higher skills?

Mr. ACKLEY. Yes, indeed. You have stated very well the favorable factors in our outlook.

Senator PROXMIRE. Well, what are the unfavorable factors, in your judgment, that should make us most concerned about inflation other than the special cases which you seem to imply are one-shot affairs: food and some of the mining products, and so forth?

What are the other aspects of this economy that should concern us inflationwise?

Mr. ACKLEY. I would agree, first, that overall industrial capacity is probably not our major bottleneck. Our high rates of investment mean that we are adding to plant capacity about as fast as we are adding to demand for industrial products. It seems more likely to me that the dangers may lie, and I don't want to exaggerate them, on the side of labor supply.

As we push the unemployment rate below 4 percent, increasingly there will be areas and industries and skills in which shortages of labor will appear. These could have at least two possible kinds of inflationary effects.

One, they could prevent the expansion of production and create shortages relative to rising demands; and, second, I suppose they would strengthen the ability of unions to demand and get wage increases in excess of productivity gains so that they might push up costs.

Senator PROXMIRE. Here is exactly why the wage-price guidelines are so important and if the wage-price guidelines are observed by industry—and, as I take it, the coming year the pattern has been pretty well established, hasn't it, in the major industries?

Mr. ACKLEY. Certainly in the major large industries that is true. But a large portion of our industrial labor force is not organized.

In most of the service trades, for example, retailing, many smaller manufacturing firms, we don't have the situation of a large powerful union bargaining against a large powerful employer.

I would guess that we will see in the year ahead larger wage increases among unorganized workers and in the service trades than in the highly unionized, strong industrial segments.

Senator PROXMIRE. And almost all of this increase in demand and this pressure on prices is coming, in your judgment, from a civilian economy?

Mr. ACKLEY. From a combination of a very strong civilian economy and the additional defense expenditures, which have been placed on top of it.

Senator PROXMIRE. Your experience suggests that at least in coming years it is unlikely we are going to sustain the present level of business investment which has been a very dynamic aspect of this. On the basis of past experience that has been something that has been somewhat cyclical.

We have had an extraordinarily big increase in this area recently and it obviously has been stimulated by the depreciation guideline decision, investment credit, tax cuts.

In your judgment, without further governmental stimulus of this kind, is it likely that this sector of the economy that is so dynamic and that has such a clear effect on expansion is likely to continue at the same rate?

Mr. ACKLEY. I think I could be confident that we would not continue indefinitely having plant and equipment expenditures increasing roughly twice as fast as gross national product in percentage terms. This would imply an ever-increasing share of gross national product going into plant and equipment investment.

The present share is something around 10.5 percent. I am not ready to say that this is not a sustainable share of gross national product. But I would suggest that it can't rise indefinitely and that, therefore, that implies that growth of private investment will not always be as strong a stimulating force as it has been in the last 2 years.

Senator PROXMIRE. Let me take you into another area. I am delighted to see that you have devoted a full chapter, and a very excellent chapter, to the agricultural sector of our economy. It is very helpful. It is very strong, I think, on analysis. I think it is a little weak on prescription, but all these analyses as far as agricultural economies seem to be that.

The one part of your analysis that I differ with very sharply though is where you say, and I quote:

> A substantial number of farmers who have successfully adopted and who produce the bulk of our food and fiber are realizing incomes nearly equal to what their resources could earn off the farm.

You make a similar statement, a little more specific, I believe, when you say, farmers in the $10,000 and over sector are realizing returns nearly comparable with what their resources could earn in nonfarm occupations.

I have tried to get the most accurate statistics I could from the Department of Agriculture. Everything they have indicates the opposite of that. I am not just talking about the so-called marginal farmers, but the farmers with big farms that gross $100,000 a year and more have pitifully inadequate returns. This is true in almost any commodity you can name on the basis of what the Department of Agriculture has furnished us.

I put into the record about a year ago a whole series of the reports of what farmers are making in terms of return on their investment and in terms of hourly income, and it is all just pitifully low. While there has been some increase in the last few months, it is certainly grossly inadequate to achieve what you seem to be claiming here.

What is your documentation for what I think is quite a startling statement?

Mr. ACKLEY. The Department of Agriculture has been making further studies and, I believe, has underway now some fairly elaborate studies which it hopes to publish before the end of the fiscal year. These studies attempt to investigate the returns to farmers of various-sized farms classified by their annual sales.

I believe these figures will show something like this: For the larger commercial farms whose gross sales are $10,000 or above, the return is roughly equal to a 5-percent return on the value of their capital plus a wage rate for the labor of the farmer and his family, equal to the average hourly rate of pay in manufacturing. These returns are measured after all expenses for hired labor and purchased materials.

Senator PROXMIRE. If you were a betting man and I were a betting man, I would bet that it won't come within a "country mile" of that. It just can't come close. Maybe it will, but I would be astonished.

Mr. ACKLEY. The figures I have seem to indicate that it does.

(The preceding discussion has elicited the following material which was supplied for the record by the Council of Economic Advisers:)

The Council's report states on page 133:

"Many of the farmers in this sector (the sector comprised of farms with annual gross sales in excess of $10,000) are realizing returns nearly comparable with what their resources could earn in nonfarm occupations."

Pursuant to section 705 of the Food and Agriculture Act of 1965, the Department of Agriculture is now studying the parity income position of farmers. The preliminary results of this study corroborate the statement in the Council's report. The final results of the study will be presented to the Congress not later than June 30, 1966.

Parity returns to commercial family farmers are defined as those required to make the current rate of return to the labor and capital employed by such farmers in farm production equal to the current rate of return to comparable labor and capital employed in the nonfarm economy. Family farms are those with families as risk-taking managers and using less than 1.5 man-years of hired labor.

It is assumed that the parity return on the labor of the farm operator and family workers is $2.62 per hour, the reported 1965 money wage of production workers in manufacturing. The parity return on farmers' equity capital is assumed to be 5 percent, the approximate farm mortgage interest rate on all mortgage loans presently outstanding. Farmers' equity assets are measured in 1965 values.

The preliminary empirical results, using these assumptions and estimates of farm costs and returns for 1965, indicate that realized net farm income that year for the group of farms with gross annual sales of $10,000 or more is near the parity income level. Realized net farm incomes of farms grossing $20,000 or more exceed the parity level, on average, while the average income of farms grossing $10,000 to $19,999 falls somewhat short of that level. In 1965 an estimated 461,000 farms had gross annual sales of $20,000 or more; an estimated 584,000 farms grossed between $10,000 and $20,000.

These results must be interpreted carefully. The income figures relate to economic class aggregates. Not all farms grossing $20,000 or more are earning parity returns. On the other hand, some farms in the $10,000 to $19,999 class may be earning parity incomes.

Different assumptions regarding parity rates of return on capital and labor would of course produce different results. An assumed parity return on equity capital of more than 5 percent would reduce the number of farmers realizing this new defined parity income. Similarly, an assumed wage rate of less than $2.62 would lower the parity income standard and thereby increase the number of farmers realizing that level of earnings.

Moreover, if farm equity assets were valued at acquisition cost, or at earlier price levels than of 1965, the rates of return would correspondingly increase.

Senator PROXMIRE. Just think of this fact: You say $10,000 gross. I think probably half of these farms would fall between $10,000 and $25,000 gross.

Now, a farmer who grosses $15,000 or $20,000, on the basis of everything I have heard and seen and experienced, not only in Wisconsin but around the country, is going to be lucky if he nets $3,000 or $4,000.

In Wisconsin he works 70, 80 hours a week, according to the Department of Agriculture statistics. His wife works a substantial amount of time. His children work. Your report shows that he averages a $50,000 investment. An 8- or 10-percent return and an earned wage after all his costs of $2 per hour is just mathematically impossible.

I see my time is up on this round, but I do want to commend you on the fact that you have shown a real interest, an excellent analysis of this, and I think the rest of your analysis regarding poverty agriculture is most helpful.

It is so important that an authoritative agency such as yours, which is listened to by the public and which doesn't have a particular ax to grind for the farmer takes this objective and competent view of our agricultural problems and I thank you for it.

Mr. Ackley. Thank you, Senator.

Chairman Patman. Mr. Ackley, I think it is my time now and I won't take all the 10 minutes, I hope.

If further measures are needed to combat inflation, don't you think an increase in taxes would be more equitable and more effective than further increases in interest rates?

Mr. Ackley. I think I would hesitate to speculate very definitely on what kind of mixture of further restraint might be called for if additional restraint should indeed become necessary. I think it would depend partly on the circumstances—whether the strains were developing primarily in the capital goods sector that might be affected more by higher interest rates, or whether they were in the consumer sector where tax increases would be most effective.

I believe we would have to face that problem when and if the time came. I hope that we won't have to face it.

Chairman Patman. I want to make an observation now on these price and wage controls. A lot of people throw statements around and make suggestions.

I have gone through that on the floor of the House and in committees and I know something about what we are up against. I don't think it is possible to have price and wage controls in this country unless sentiment is practically unanimous for them. One time we had an awful war going on here—World War II. We were spending $250 million a day on the battlefield, just shooting it away, causing a potential inflation and everything else, and people were getting big wages, and bank accounts were swelling. They had all kinds of money, and they couldn't buy durable goods.

Although we were in a war and we didn't know exactly how it was coming out—it was a tough war, a bad war—yet people were reluctant to comply with just simple price control regulations. We had a terrific black market, as many of you remember, and before we go into price and wage controls, I think we ought to make sure that we have public sentiment supporting us in it. Otherwise, we can't win, and that is a question I think that involves more than most anything else in our private economy, the domestic economy, and the national economy.

You know, during World War II we had 8 million prices and wages to deal with, and let it be said in behalf of the Congress that we brought those bills on the floor of the House under an open rule where any kind of an amendment would apply to any of those 8 million prices; the Congress was anti-inflationary and I think the Members of Congress can be depended upon more to fight inflation effectively than any other group, particularly the monetary group. I believe that.

I notice that in December it was indicated that in this meeting down at Johnson City, Tex., there was a lack of coordination by the Federal Reserve. You know, the Employment Act of 1946 stated that these national policies shall be determined in coordination with other agencies of the Government. It is undisputed that the Federal Reserve did not coordinate their activities with the other agencies of Government affected thereby.

It is true that they discussed things with you—at least the Chairman did. The other six members seemed to be in the dark. They didn't even know what was going on. That is another weakness in our coordination. I think these other six members of the Board are entitled to the same information that the Chairman gets, at least somewhere along the line.

Anyway, they didn't coordinate even with the Federal Home Loan Bank Board involving the savings and loans, a $115 billion a year savings and loan business in this country, which is a pretty good size. They were not even consulted; so there is no coordination.

Have efforts been made since that December 6 meeting to have better coordination, Mr. Ackley, than you had in the past?

Mr. ACKLEY. As I indicated in our opening statement this morning, I think there was a failure of coordination in December. We think the record up until then had been really very good. We certainly hope that it will continue to be. If your question addresses itself to the matter of whether new organizational arrangements have been established, I think I would have to answer "No." At least, so far there has been no new organizational arrangement for coordination between the administration and the Federal Reserve.

Chairman PATMAN. May I invite your attention, my dear sir, to the Employment Act of 1946, which is written in very plain language and I think it would be appropriate if you gentlemen would suggest to the President of the United States that he implement that act just a little bit better. It has never been implemented by any President.

It was signed, of course, under Mr. Truman 20 years ago, incidentally, 20 years ago this month, and it, of course, has worked under Mr. Eisenhower and under Mr. Kennedy and under Mr. Johnson, but better implementation, I believe, is needed. The President of the United States himself must select a coordinating committee; namely, the Federal Reserve, the Comptroller of the Currency, the Federal Home Loan Bank Board, the Council of Economic Advisers, the Secretary of the Treasury, and everyone that he believes should be in that coordinating group and establish it under himself.

I think that is the implementation that is needed, and then the Federal Reserve would be right in there and they would be obligated to coordinate their efforts and actions along with other agencies of the Government that the act of 1946 requires them to coordinate their activities with.

It has never been implemented and I wish you would give consideration to that, my dear sir.

In the Annual Report of the Council of Economic Advisers, you state:

> Clearly, fiscal and monetary policies must be closely coordinated, and effective coordination has prevailed in the past 5 years. * * * Consultations between the Federal Reserve and the administration continue, helping to assure that monetary and fiscal policy together will provide appropriately for sustained and balanced expansion.

Between these two sentences there is a statement:

> The administration regretted that the discount rate increase last December interrupted that pattern.

Are we to conclude from this that the December incident was a single fall from virtue, and that effective coordination preceded and has succeeded that incident?

I will not press you for a reply on that, because I know you can't speak for the President on it and you never claimed to speak for him, but may I suggest that there is something stated in the Annual Economic Report of the President right along that line.

You know, the courts of the country have held many times that just one bite is not sufficient to hold that a dog is a vicious dog. Now, were you saying in there that, "You had your bite, Mr. Martin. We can't call you vicious now because the courts held even a dog is not considered a vicious dog with just one bite, but we are going to watch you in the future and we have a little admonition here for you."

I will read the statement—President Johnson's statement—from his Economic Report. He says:

> I will also look to the Federal Reserve System to provide assistance in promoting the objectives we all share: * * * meet the credit needs of a vigorous and growing economy, while * * * preventing excessive credit flows that could carry the pace of expansion beyond prudent speed limits.

I just wonder if that is an admonition, or warning, or a mandate. Anyway, that is open to interpretation. But I have a feeling that the Federal Reserve is more on the spot right now than they have ever been.

Mr. Curtis?

Representative CURTIS. When Mr. Martin testified in December, he referred to a "Quadriad" that met with regularity, consisting of himself, the Chairman of the Council of Economic Advisers, the Director of the Budget, and the Secretary of the Treasury. I think he said a weekly meeting. Is that correct?

Mr. ACKLEY. No. We meet formally approximately once a month with the President.

Representative CURTIS. With the President. And that has been continuing?

Mr. ACKLEY. Yes. There has not been one since the meeting on December 6. There probably will be one this month.

Representative CURTIS. Let me get to some of the questions that I have in mind.

No. 1, what kind of a debt ceiling do you think you are going to request this year?

Mr. ACKLEY. Mr. Curtis, I am awfully sorry that I can't answer that question.

Representative CURTIS. This is a very important question, of course, because it goes to the very heart of the balance that the Ways and Means Committee, at any rate, might recommend on how much of this deficit should be financed through taxes and how much through debt.

Mr. ACKLEY. The cash budget is very close to balance. I would assume that a very large increase in debt ceiling would not be required.

Representative CURTIS. I thought it was actually—around this time—at $6.4 billion on one and a $6.9 billion on the other. Am I not correct for fiscal 1966?

Mr. ACKLEY. I was referring to fiscal 1967.

Representative CURTIS. I am talking about this fiscal year, because the debt ceiling has to do with this fiscal year. That is what I am talking about, what is right in front of us. If you haven't figured this, I guess you haven't gone through the exercise of trying to figure out what the impact on debt management will be from this kind of added load, because it is $6.9 billion, I think, actually on a cash basis?

Mr. ACKLEY. Yes; that's right.

Representative CURTIS. Incidentally, as far as I am concerned, you can dispense with the total figures of the 1967 estimates. They are composed of so many questionable ingredients that I hardly regard that as a realistic budget. I think we can zero in on the 1966, so the question is: How much are you going to ask us to rely on debt management policy, and how much on increased taxes, and do you think this is a proper balance?

Let me go to another question.

Mr. ACKLEY. I might say in that connection that I am sure Secretary Fowler, when he appears before you on Thursday, may be able to say more about the debt limit.

Representative CURTIS. I regret that Secretary Fowler appeared before the budget was available to us and before the Economic Report was available. I tried to ask him these question, and I got nowhere there. Yet these have economic implications.

I guess the question has been answered. You didn't consult with him in regard to the economic implications of this mix or what the mix should be. That, to me, is a startling conclusion.

Am I correct in saying that you didn't consult with him on the implications of how much the mix should be between tax and debt management?

Mr. ACKLEY. Oh, not at all, Mr. Curtis. I was merely saying that I wasn't informed on the precise amount of the increase in the debt that was expected to be outstanding. I notice the budget figures which Mr. Okun has found for me suggest that the public debt at the end of fiscal 1967 that is subject to limitation is estimated in the budget at $321.5 billion, as compared with $319.8 billion at the end of 1966.

The following material was supplied for the record by the Council of Economic Advisers:

The relative magnitudes of debt and tax financing of Federal expenditures were carefully considered in judging the desired fiscal impact of the budget. The budget projects the size of the public debt as of the end of fiscal years 1966 and 1967.

As is customary, the budget does not contain specific requests for legislative action on the debt limit. Required action with respect to the debt limit depends not only on the total change in the debt over the course of the fiscal year but also on the timing of expenditures and receipts within the year. As the President indicated in the budget message, some action will be necessary on the debt limit this year. This action should allow adequately for seasonal fluctuations in the size of the debt and for needed flexibility in debt management. As the pattern of expenditures and receipts becomes clearer, an appropriate request will be made.

Representative CURTIS. But the point is, you have a flexibility factor in there.

Mr. ACKLEY. As compared with $317.6 billion at the end of fiscal 1965.

Representative CURTIS. But you have a flexible factor that is in there for debt management, which I hope is not encroached upon simply to avoid the very tough fact that your expenditures, if they were increased beyond the estimates——

Mr. ACKLEY. Yes, indeed.

Representative CURTIS. Let me ask another question.

Is the President going to request an increase in the interest ceiling on long-term bonds to 4½ percent? As I see in your chart here, it looks like you are selling these bonds at discount or they are being sold at a discount?

How about this? Are you going to do anything about that?

Mr. ACKLEY. I don't think it has been determined as to whether the administration will request any change in the interest ceiling.

Representative CURTIS. Don't you think this is a very important consideration?

Mr. ACKLEY. It is, indeed.

Representative CURTIS. In the area of debt management?

Mr. ACKLEY. It is, indeed, but it is one in which no administration position has yet been reached. At this time, the administration is not requesting any change.

Representative CURTIS. This is the thing that disturbs me. I have made the remarks that the report says inflation is our big problem, and I agree with it. I think inflation is already here. But then when it comes to examining into some of the alternatives of what you do about it, I find that the crucial questions, like the ones I am asking about the debt ceiling, the interest ceiling, have not been under consideration, at least not so that we can discuss them.

Let me point out one thing. Incidentally, I made an error. I said "2.2" for CPI increase from December 1964 to December 1965.

Mr. ACKLEY. 2.2 percentage points. I think it is 2.0 percent.

Representative CURTIS. I was referring to a chart and I was simply correcting my record. If you relate that to roughly the $550 billion purchasing power, there is $12 billions gone out of purchasing power. The interest on the Federal debt, I notice, is another $12 billion, so we have a problem here of $24 billion resulting in this area of combination debt management and inflation, a very important economic factor. The Federal Government income estimates for fiscal 1967 assume further inflation. I tried to find out from the Secretary of the Treasury just how much. It is closer to 3 percent, I would say, than 2 percent. I think he is probably right in that, but that is a poor way to figure on getting revenue. If you regard inflation as the thing you are trying to dampen, to actually estimate a deficit budget of $1.8 billion by counting on around $3 billion or more from simply inflating the dollar is a poor policy.

You wouldn't regard that as good fiscal policy, would you?

Mr. ACKLEY. No, Mr. Curtis. Certainly inflation is one of the easiest ways to balance the budget, but we do not wish to balance it that way. Actually our estimates for gross national product do not imply a 3-percent price increase, but a continuation of the less than 2-percent increase in the GNP deflator that we experienced last year.

Representative CURTIS. Oh, no. Your implicit GNP deflator is above 2 percent.

Mr. ACKLEY. I believe that last year it increased 1.8 and we estimated essentially the same increase for this year.

Representative CURTIS. In the light of the last 4 months when Federal expenditures went up—in the last 4 months of this calendar year—you have seen the jump both in Consumer Price Index and the Wholesale Price Index, which up until this calendar year has been pretty stationary. I think if those are your estimates of the inflationary impact, they are certainly underestimated and certainly a budget that is not in balance in a period of high economic upturn is, I would say, hardly the way to fight inflation.

Would you not agree, whether or not a deficit in your budget in times of a high economic upturn is a very poor way of fighting inflation?

Mr. ACKLEY. The deficit that is expected in fiscal 1967, which is the new budget period we are talking about, is a substantially smaller deficit than we have had in a long time.

Representative CURTIS. I am not talking about that. I am saying any deficit. In fact, that is the whole point. I thought the theory of balancing the budget over a business cycle made very good sense, particularly as Federal revenues were derived primarily from income taxes, and it partly was countercyclical. Then the Council of Economic Advisers came forward with this new concept of not balancing the budget in an economic upturn, but only at full employment. Now we have full employment and you still aren't balancing the budget.

All I am pointing out is, if you meant what you said in your statement, or what the President said in his statement, that inflation is the No. 1 problem, it seems to me you have prepared a budget that doesn't treat the problem; in fact, it aggravates it.

In other words, you have an inflationary Federal budget that the President has presented to us certainly in 1966 and maybe less in 1967. I would get into some of the details of that and suggest that the 1967 budget is probably even more inflationary than 1966 because among other things it relies on its so-called cuts in expenditures by selling capital assets to a large degree.

So does the fiscal 1966 budget. Even to keep it down to $6.9 billion, you count on selling off $3.3 billion of capital assets. That is only one of the items in this thing, so that is why I have made the remarks publicly that the President has said one thing about inflation while his proposals presented to the Congress are actually going the other direction.

Mr. ACKLEY. I am not sure, Mr. Curtis, that I was asked a question, but I wonder if I could comment anyway.

Representative CURTIS. Yes. What I was asking in my question was—I was implying it—in case you disagree, that this was an inflationary budget and how you figured that presenting this goes in accord with what the President has said, that inflation is the No. 1 problem that is facing our economy, to paraphrase him.

I could get the actual quote.

Mr. ACKLEY. Yes, I think the President has said that the greatest danger we face is inflation. I think we should not exaggerate the extent to which we may have had inflation in spite of the price increases to which you have referred. If you look at the increase in the Wholesale Price Index over the past 12 months from December to December, it is 3.4 percent, but of that the largest factor was farm and food prices——

Representative CURTIS. Could I interrupt just a minute?

Mr. ACKLEY (continuing). Where industrial prices——

Representative CURTIS. I wanted to point out to you that beginning in September of 1965 expenditure policy changed. That is when I see the factor entering in; so it is those last 4 months, Mr. Ackley, if you would direct attention to them.

Mr. ACKLEY. We can direct attention to those last 4 months. I would point out that between November and December, the last month of the period, the index of wholesale prices for industrial products did not change at all.

Over the past 12 months the index of industrial prices, that is, nonfarm, nonfood, increased 1.4 percent. If you look at the Consumer Price Index, which is up 2 percent December to December, again if you take nonfood commodities, the increase is eight-tenths of 1 percent, one-tenth of 1 percent between November and December.

I would suggest that what we have faced in this past year was primarily a problem in the farm and food area. There are good reasons to believe that that kind of experience will not be repeated to the same extent in 1966.

Representative CURTIS. If that were the case, then I am surprised at this action taken by the President in regard to copper, steel, and aluminium, because this was not just your wage-price guidepost. This was actually the administration interposing in steel pricing, interposing through, and I say without authority, in the procurement practices of the Military Establishment.

This was stated at the time it was done deliberately. In copper where we had a shortage, it was a misuse, I would argue, of the stockpile which we tried to set up under law so that it could not be used for this purpose. It was supposed to be for defense, and the same thing could be argued for aluminum. I am happy in one respect, that the administration does recognize that inflation is serious and has actually tried to curb it.

I disagree with the methods the President has used, because I think the proper methods to curb inflation are to put the fire out or dampen it, and that means paying attention to Federal expenditures in relation to Federal revenues. It doesn't seem to me that your arguments can stand up in light of these actions, because surely the President thought a long time before he moved in in these three particular areas, did he not?

Mr. ACKLEY. Yes, indeed. Perhaps one of the reasons that industrial prices did not rise more in the latter half of the year is that the President made clear his view that the industries which——

Representative CURTIS. Exactly.

Mr. ACKLEY (continuing). The three you mention, and others, that the guideposts really ought to be taken seriously.

Representative CURTIS. Exactly. My time is up and I will come back, but let me make the point. In other words, the economic forces at play, inflationary forces, which would have produced this rise were checked through the Government controls. I will come back to the question of what damage is created economically by the use of controls.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Earlier, Dr. Ackley, you indicated that your expectation was that productivity would increase about 2.8 percent the coming year, as it did last year.

You indicated that your wage-price guideline was going to be about 3.2 percent. This gives me a new appreciation of what your wage guideline is. It is not simply a statement of your expectation of productivity and it is not apparently an attempt to make the effect of labor costs neutral.

What it is—in this case at least—is that you have taken a position which would provide for a positive, but a moderate, push from wages on prices if industry throughout the country observes your wage-price guidelines. In other words, if your productivity is 2.8 percent and the wage increases average around 3.2 percent, then there would be some positive effect on wage costs; small, quite small, but definite and there would be this somewhat modest inflationary bias even if the wage-price guidelines are abided by. Is that correct?

Mr. ACKLEY. The expectation that is built in our forecast is a 3-percent increase in productivity in the private economy this year. The guidepost is supposed to represent——

Senator PROXMIRE. Three percent. Last year it was 2.8. You say in your report that you expect it to be the same this year.

Mr. ACKLEY. I think we suggest it is likely to be closer to the trend, which is somewhere around 3 to 3.3 percent. We have tried to tie the guideposts to the trend of productivity rather than the year-to-year change, and if indeed wage increases were 3.2 percent this year and there were only a 3-percent gain in productivity, there would be a 0.2 of 1 percent increase——

Senator PROXMIRE. You aren't trying to be precise and exact because you feel this isn't the kind of area where you can be, and would indicate that there probably is at least a small upward bias, upward push, from wages if wages do conform with the wage-price guideline?

Mr. ACKLEY. That certainly would seem to be true for the total private economy. However, in the past several years, in the manufacturing sector, wage and fringe benefit increases have been somewhat less than the rise in productivity and unit labor costs in manufacturing have been slightly declining.

Senator PROXMIRE. The report points to the sharp increases in recent years in medical costs. It shows that those have moderated somewhat in the last 4 or 5 years. Then it points to medicare as a limit which is going to greatly increase demand for these medical services.

You then dismiss how you are going to handle that problem in one short sentence which says: "There is an urgency for public policy to augment medical care resources and to improve their organization for efficient use."

What are these public policies?

Mr. ACKLEY. There have been a number of them, Senator Proxmire. They include the provisions for building hospitals, such as Hill-Burton, the various kinds of financial assistance to medical schools and medical students and to so-called paramedical personnel, and programs of assistance in the education and training of such people.

Senator PROXMIRE. I realize that we have tried, and I think very wisely, to make the medicare program effective in July 1966 so that there can be an anticipation in building nursing homes, and hospitals, and so forth, but recognizing all that doesn't it seem likely, in view of the terrific impact we are likely to get from medicare, that without some new policies we are likely to get quite an inflation in this area?

Mr. ACKLEY. We certainly were pointing to the existence of this long-term problem in the medicare area.

Senator PROXMIRE. But you don't know of any new policies or any new ideas to help keep down prices in this area?

Mr. ACKLEY. I am not sure what new initiatives may be suggested this year.

(The following material was later supplied for the record by the Council of Economic Advisers:)

To help meet the rising demand for medical services, the administration will propose a number of new programs this year. As indicated in the 1967 budget (appendix, p. 485) new legislative authority will be sought for the following purposes:

"1. To reorient support of health activities so as to provide effective coordination between the Federal programs and those of State and local groups. A major purpose would be to achieve a more effective and economical utilization of scarce manpower and other resources through cooperative arrangements among the Federal Government, the States, and local governmental units and nonprofit agencies. Grants will be available for comprehensive State and local area planning for services, facilities, and manpower. It is also proposed to convert several existing categorical programs to general grants, to support and stimulate comprehensive health services.

"2. To undertake new programs to improve the quality and efficiency of medical services by developing and applying new systems and concepts to the delivery of medical care services.

"3. To commence detailed planning for modernization of obsolete hospital and health care facilities, especially in urban areas.

"4. To begin an education and training program to overcome existing critical shortages of medical technologists and other allied health professionals.

"5. To improve Federal health organization and provide its personnel with a comprehensive career development and training system."

A common feature of several of these programs is the major emphasis on (1) improving the organization, utilization, and delivery of medical services and (2) identifying and overcoming those shortages of facilities and manpower which appear most critical in terms of the Nation's total health needs.

In addition, many existing programs designed to augment the supply of medical services will be expanded substantially in the near future. For example, Federal expenditures for the construction of hospitals and health facilities are scheduled to rise from $468 million in fiscal 1966 to $672 million next year; outlays for medical training will increase by almost $100 to $546 million; and spending in support of regional medical programs will be almost doubled.

Senator PROXMIRE. This morning's newspapers reported a finding by the National Foreign Trade Council and in identifying the people who made these recommendations, they say the Council's balance-of-payments group consists of 40 financial specialists of leading U.S. international companies.

They have had some very, very optimistic predictions. They predicted that trade in general would rise 10 percent. They predicted that exports would rise substantially more rapidly than imports, and that our trade surplus, therefore, would improve. They also concluded that the balance of payments will be between half a billion and $1.2 billion in the coming year.

They didn't specify which measure. I presume they are talking about liquidity measures. At any rate, does this pretty much meet your expectations?

Mr. ACKLEY. We certainly expect further improvement in the balance of payments this year and the President has stated the objective of trying to eliminate the deficit in 1966. We do anticipate a stronger trade surplus than we had in 1965, which was held down by several special events, including the dock strike, the stockpiling of steel, and the absence in 1965 of a major wheat sale to the Iron Curtain countries such as we had in 1964.

These factors seem to have accounted for much of the drop of more than a billion and a half in the trade surplus in 1965 as compared with 1964.

In the absence of new factors like dock strikes or a large rise in steel imports to meet a threatened strike shortage, we would expect improvement in the trade balance in 1966.

Senator PROXMIRE. From a strictly theoretical and academic standpoint, it would seem that the President's voluntary limitation program on foreign loans and the interest equalization tax together particularly would tend to have a discouraging effect on exports. That is, there is a tendency for people to want to finance their exports and many critics of these programs have argued that the loan restrictions do have this retarding effect on exports.

On the basis of the experience we have had to date, do you think that this is—it has worked out that way?

Mr. ACKLEY. I think it is very difficult to show that there has been any shortage of financing of exports. There have been allegations that people who wanted to export were unable to find financing, but there is very little evidence to suggest that actually was the case.

I suppose to some extent very indirectly the reduction in the dollar flow abroad through a slower rate of growth in our foreign investment may tend to reduce buying in the United States. There is probably some feedback from our investment to our trade, but certainly it is not a 1-to-1 relationship. To the extent that we reduce the flow of foreign investment, we are getting a good net advantage on our total balance of payments.

Senator PROXMIRE. You say, in your annual report—it is the most emphatic statement I have heard an agency make in this regard—and I quote: "A comprehensive set of vacancy statistics"—speaking of job vacancies—"comparable to those collected in other countries, would be a most useful tool of analysis."

I wouldn't expect you to have this available, but for the record in writing would you indicate in what countries, how accurate and comprehensive these statistics are, how they are compiled, and what they cost?

The reason I ask is because, as you know, we are working hard to try and develop those statistics here and there has been a lot of concern about these limits that I have suggested in connection with them.

Mr. ACKLEY. We will try to.

(The following material was supplied by the Council of Economic Advisers in response to Senator Proxmire's request:)

The Bureau of Labor Statistics conducted a study of foreign job vacancy statistics programs in 1963–64. The study is based primarily on replies to an airgram questionnaire sent out in September 1963 to U.S. embassies in 23 foreign industrial countries—Australia, Austria, Belgium, Canada, Denmark, Finland, France, West Germany, Great Britain, Greece, Ireland, Israel, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, and Turkey. Personal interviews were also conducted in four countries. The airgram questionnaire covered such subjects as the general nature and purpose of the foreign country's job vacancy statistical program, the method of obtaining job vacancy data, the method of defining a job vacancy, the proportion of total job vacancies covered by the statistics, and the uses made of the statistics. A report on the study was prepared for a National Bureau of Economic Research (NBER) conference on the measurement and interpretation of job vacancies held in February 1965.

Replies were received from 22 of the 23 countries surveyed (no reply from New Zealand). Twenty of the twenty-two countries have national job vacancy statistics programs (only Greece and Portugal do not tabulate and publish national job vacancy statistics). In all 20 countries with national programs, the major, and in most instances the only, job vacancy statistics are administrative statistics representing job vacancies registered by employers with local employment offices in connection with their job placement activities. Four countries—Sweden, Canada, Japan, and the Netherlands—also obtain some information on job vacancies through establishment surveys. In addition, the Netherlands employment offices make annual estimates of total hard-to-fill—i.e., excluding frictional—vacancies.

No country obtains job vacancy statistics that are substantially complete and comparable with a similar complete estimate of unemployment. With the exception of a few instances where legal requirements to register vacancies may be strictly enforced, the administrative statistics cover only those vacancies voluntarily registered by employers because they seek the assistance of the employment offices in locating workers. Not only are the statistics imcomplete, but none of the countries knows accurately what proportion of all vacancies is covered by their statistics and few countries are even willing to make estimates. In the four countries which collect job vacancy statistics through establishment surveys, the surveys are limited in coverage, for example, to certain industries or to establishments with more than a specified number of workers.

The survey of foreign programs did not obtain information on the cost of collecting job vacancy statistics. However, the administrative statistics on registered job vacancies are a byproduct of the normal placement activities of employment offices and are tabulated in part as a measure of employment office activities. Even if cost information were available for foreign countries, it would not be valid indication of what the cost would be in the United States for an adequate comprehensive estimate.

Senator PROXMIRE. I am almost through. In your report you confess—and it is good to see a confession—a bad underestimate of growth in the GNP for this past year. Last year the Council's report estimate was $38 billion. It actually was $47 billion in growth. The estimate was off nearly 25 percent, which is a pretty big error, I think you would agree.

What does this tell us? I know that you are extraordinarily competent and the other members of the Council are, too, but I wonder what this tells us about the ability of economists to know the effect of favorable fiscal and monetary policies to which you refer, to be off that much.

Mr. ACKLEY. I certainly agree that our ability to forecast is far from perfect. In defense—and I don't make too much of it—the error in terms of the level of GNP was much less percentagewise than the error relative to the increase in GNP. But we ought to be able to do better than that on the increase in GNP.

And we hope we are closer this year than we were last. We try to improve our methods. We try to use all the information that is available, but certainly we will never have a perfect record in forecasting.

Senator PROXMIRE. But that is $9 billion out of $38 billion. What was the reason for it?

Mr. ACKLEY. $9 billion out of nearly $700 billion and——

Senator PROXMIRE. Yes; that is true, but out of the increase. Why did you miss that way?

Mr. ACKLEY. The largest error in our forecast related to private plant and equipment expenditures, which were about $4 billion above our estimate. This is one of the most difficult areas to predict. We don't fully understand all the factors determining business investment.

Senator PROXMIRE. I thought that we had now from the corporations that do most of the investing, the thousand corporations, a pretty good estimate. Their estimates were off? Was that the trouble? Or you were too cautious?

Mr. ACKLEY. When we make our forecast we have available their projections for the first half of the year, and then in later surveys we get information for the rest of the year. Moreover, the projections by the corporations themselves were repeatedly revised upward during the year.

Each time the corporations were asked about their actual expendirures and their expected expenditures for the remaining quarters, they came out higher, which indicates some of the difficulties even when one does have a complete survey of expected expenditures.

Senator PROXMIRE. This certainly disturbs those of us who hope for as precise estimates as possible because this is the one area of estimating which I understand has been called a gem, that these statistics available from business of their plans for plant and expenditures were, I thought, considered to be one of the most valuable, useful, and precise on the basis of past record.

Mr. ACKLEY. They certainly are, indeed, Perhaps Mr. Okun could make a comment or two along that line.

Mr. OKUN. Yes; I think one does have to distinguish between the period which is covered by the survey and on which we do get a good deal of accuracy, and the longer horizon which we don't have at hand at the time we have to make our annual forecast.

For this year, for example, we still have no estimates from the Commerce-SEC survey for the second half of the year, and there is a good deal of uncertainty about it. I think the whole issue of how fixed investments would respond to a strong upsurge in the economy, approaching full employment levels was new last year. We hadn't seen anything like it in a decade, and our statistical experience with this type of development just was no longer reliable.

We found that business responded strongly to the improvements in sales, profits, and operating rates, and that they revised their plans upward, as the year progressed. But the key missing element was the absence of any definitive survey on plans for the second half of the year.

I think one also has to take into account that $1 billion of our error was directly in Government expenditures, reflecting the unforeseen rise in defense spending. Actually, it was more than that in the second half of the year.

Defense spending was running behind schedule until midyear and then surged ahead. This was a particularly big billion dollars, I think, in affecting the environment of business expectations and plans for investment. It is very hard to tell now just how much of the strong upward revision in business investment during the second half of the year was related to the changing defense picture.

Senator PROXMIRE. Thank you.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Mr. Ackley, last week, the president of the New York Federal Reserve Bank, Mr. Alfred Hayes—and incidentally it was his bank that originated the suggestion that the discount rate be raised—in a speech to the New York State Bankers Association made the following statement:

> In our presently highly developed economy, all income groups participate importantly in saving and benefit directly or indirectly from the flow of interest payments. Under these conditions, it is pretty hard to tell whether the greater social benefit will follow from lower or higher interest rates, per se.

We have heard this before from representatives of the Federal Reserve that the suggestion that maybe higher interest rates actually are good for the majority of Americans, and that one is doing them a favor by raising interest rates, which may provide a clue to the actions of the Federal Reserve Board in the last 10 years:

I would like your comment on this statement. What do you think about the general proposition that interest payments in this country pretty much wash out, or do you think that is a fallacy and that interest payments actually do result in redistribution of income from one class to another?

Mr. ACKLEY. In an overall sense, as much interest is received as is paid, obviously. I think the more important question is who pays and who receives.

We do know that a number of people in low-income groups do receive interest income and benefit from interest-rate increases. I think some 500 savings and loan associations are estimated to have raised their dividend rates since the discount action.

Our statistics on the redistributive impact of higher interest rates are incomplete. It would be very difficult to trace through all the flows through insurance, pension funds, and the rest. Some interest rates operate much more flexibly than others, and when bank rates go up, it may be that the kind of interest that lower income groups receive lags behind.

It is also true in the other direction, of course, that when interest rates go down, the interest rates which constitute incomes for some of the lower income groups which hold assets may not go down as fast, either.

But on the basis of any information I have seen, and I think our information is incomplete, there probably is some redistribution through higher interest rates.

Representative REUSS. I realize it is unfair to have asked you the question I just did and expect a definitive answer offhand.

Would you at this point in the record put in, in the most complete detail possible, the Council of Economic Advisers' view, supported where possible by statistics, of the impact of interest payments on various income groups, particularly addressing yourself to the proposition of whether in recent years interest payments may not have become a greater burden on lower income groups than before?

I am thinking of the fact that somebody who used to pay rent now owns a house and, hence, pays mortgage interest on it. Somebody who used to take a trolleycar now owns a jalopy on time and pays interest on that. The fellow who used to pay rent and owns a house now has to pay through his real estate taxes for the higher local costs of borrowing.

Finally, there may be, though here I am only conjecturing, some slight movement in savings patterns. I just don't know. I have heard, for example, that some two-thirds of the American families have assets of either nothing or under $1,000. To the extent that this is true, obviously they are not receiving very much in interest.

It would be interesting to know, as you say, who pays it and who gets it because if it should turn out to be that you are not really doing good work by having higher interest rates, like the Federal Reserve seems to think, then maybe their entire policy of the last 10 years has been based upon a fallacy.

At least, it would be very interesting and I would hope you would let us know.

(The following material was supplied for the record by the Council of Economic Advisers:)

American households made interest payments of about $19 billion and received $20 billion of interest income. (Both figures have nearly doubled since 1959.) Those are direct payments and receipts: Indirectly, because of interest payments, households are enabled to receive services at less than cost from financial institutions; some receive dividends on the stock of financial corporations which, in turn, derive their earnings from interest receipts. Finally, a large amount of interest income is received by financial institutions and credited to pension fund and life insurance reserve accounts which ultimately come to households.

Because of the many indirect channels through which interest is paid and received, it is difficult to assess the full effect on income distribution of changes in interest rates and volume of debt. Moreover, there are additional problems in gaging the short-run impact of any change in interest rates. For example, when interest rates increase, many recipients of interest income may be adversely affected by capital losses on existing long-term bonds which they hold. On the other hand, people with previously contracted debts are not immediately harmed by higher interest rates.

High-income families undoubtedly receive more interest than they pay and low- and middle-income families pay more than they receive. However, the data indicate that the most significant aspect of interest payments is a transfer from young families generally to older families.

The major burden of increased debts and interest rates falls primarily on young families who tend normally to incur debt early in life. It is at this time that the purchase of homes and durable goods is heaviest, and it is these goods that are most directly connected with the incurrence of personal debts. Over time such debts are reduced relative to asset holdings; income and savings normally rise and the net worth of the family also increases. Thus, for any given income level, older families tend to be the largest holders of financial assets. Consequently, higher interest rates result in a transfer of income from younger families to older families.

The following table presents a profile of the household sector by age, income, and net worth at the end of 1962. The distribution of net worth (assets less liabilities) is positively related to both age and income. Although the net worth totals include many types of assets, like common stock and homeownership, which do not bear interest, the general situation depicted is thought to be a fairly valid indicator for the issue at hand.

The profile as a whole shows that 25 percent of all families have a net worth less than $1,000, and about 18 percent have a net worth in excess of $25,000. Young families (age of head less than 25) however have about 80 percent in the low net worth category and have almost none in the high bracket. In contrast older families (head at least 45 and in peak earning period) have less than 20 percent in the low bracket and over 25 percent in the high bracket.

Supplementary Table 1

Net worth of consumers within specified groups, Dec. 31, 1962

Group characteristic	All families	Percentage distribution of families, by net worth											Mean (dollars)	Median (dollars)
		Negative	0 to $999	$1,000 to 4,999	$5,000 to 9,999	$10,000 to 24,999	$25,000 to 49,999	$50,000 to 99,999	$100,000 to 199,999	$200,000 to 499,999	$500,000 to 999,999	$1,000,000 and over		
All families	100	8	17	17	14	24	11	5	1	1	(1)	(1)	22,588	7,550
1962 income:														
0 to $2,999	100	12	31	16	15	17	7	1	(1)	(1)	(1)	(1)	8,875	2,760
$3,000 to 4,999	100	15	22	22	12	17	8	3	(1)	1	(1)	(1)	10,914	3,320
$5,000 to 7,499	100	7	14	21	17	28	8	4	1	(1)	(1)	(1)	15,112	7,450
$7,500 to 9,999	100	3	5	19	16	37	14	5	2	(1)	(1)	(1)	21,243	13,450
$10,000 to 14,999	100	1	3	9	13	34	24	11	4	1	(1)	(1)	30,389	20,500
$15,000 to 24,999	100	(1)	(1)	2	8	18	30	26	7	7	1	(1)	74,329	42,750
$25,000 to 49,999	100	1	(1)	(1)	1	2	7	20	31	30	5	3	267,996	160,000
$50,000 to 99,999	100	(1)	(1)	(1)	(1)	(1)	1	3	13	37	27	20	789,582	470,000
$100,000 and over	100	(1)	(1)	(1)	(1)	(1)	(1)	(1)	1	4	61	35	1,554,152	875,000
Age of family head:														
Under 25	100	33	48	14	5	(1)	(1)	(1)	(1)	(1)	(1)	(1)	762	270
25 to 34	100	18	26	25	15	13	3	1	(1)	(1)	(1)	(1)	7,661	2,080
35 to 44	100	8	13	18	18	28	8	5	1	1	(1)	(1)	19,442	8,000
45 to 54	100	7	10	19	10	29	16	6	2	1	(1)	(1)	25,459	11,950
55–64	100	2	14	10	14	29	16	9	4	2	(1)	(1)	34,781	14,950
65 and over	100	2	17	13	17	25	16	6	1	2	1	(1)	30,718	10,450
Employment—housing status:														
Nonfarm homeowner	100	1	2	15	19	36	16	7	2	1	(1)	(1)	31,478	15,100
Self-employed	100	(1)	(1)	4	8	26	23	21	9	6	2	1	96,385	38,250
Employed by others	100	2	3	17	20	37	14	5	1	1	(1)	(1)	22,026	13,150
Retired	100	(1)	2	11	24	33	22	5	1	2	(1)	(1)	29,752	16,150
Nonfarm renter	100	19	39	21	8	7	3	1	1	(1)	(1)	(1)	8,092	720
Self-employed	100	7	12	10	4	23	27	7	2	2	4	1	73,691	20,500
Employed by others	100	22	35	24	9	6	2	1	(1)	(1)	(1)	(1)	5,268	760
Retired	100	5	54	11	14	11	1	2	(1)	1	(1)	(1)	10,827	660
Farm operator	100	(1)	5	6	12	26	29	16	3	3	(1)	(1)	43,973	26,250
Region:														
Northeast	100	9	16	15	14	28	10	5	2	1	(1)	(1)	23,980	8,600
North Central	100	6	14	14	15	29	13	5	1	2	(1)	(1)	23,632	10,150
South	100	10	20	22	15	18	9	4	1	1	(1)	(1)	18,318	4,640
West	100	7	18	18	12	21	14	6	2	1	(1)	(1)	26,192	7,650

[1] No cases reported or less than ½ of 1 percent.

(Reproduced from March 1964, Federal Reserve Bulletin)

NOTE.—All data are preliminary and are subject to revision. Details may not add to totals because of rounding.

Representative REUSS. I have one other question: I would like your evaluation, both on their individual merits and as examples of selective policies so as to avoid unnecessary across-the-board increases in interest rates, of the following measures to prevent inflation. I will mention five of them. If you care to comment now, fine. If you would prefer to wait and put your remarks into the record, that is fine with me. The measures are:

1. Restoring controls over the terms of consumer credit to the Federal Reserve Board of Governors;
2. More aggressive use of stock margin controls. For example, the present margin requirement is only 70 percent, the same as it was back in 1958–60 when the Dow-Jones was 300 points lower than it is now;
3. Increasing the low or nonexistent reserve requirements against the certificates of deposit, promissory notes, and security-purchase agreements, as a method of controlling credit expansion;
4. Use of the Federal Reserve's power to shut the discount window, at least partially, in order to prevent interest arbitrage as an alternative to raising the discount rate; and
5. Giving the President discretionary authority to vary the investment tax credit, thus providing the administration with a flexible tool which affects directly and selectively the important total of business investment.

All of this is quite a mouthful. Having said it all, it occurs to me that you perhaps would prefer to answer it at leisure. But if you have any thoughts now, you may proceed.

Mr. ACKLEY. I could comment on a few of them. I think it would be more useful, however, if we did take a little time to gather our thoughts and give you a more systematic treatment than I could offhand.

(The following material was subsequently supplied for the record by the Council of Economic Advisers:)

1. Selective controls over consumer credit may have significant advantages in two types of situation—when military priorities clearly require a sizable diversion of resources away from consumer uses or when inflationary pressures are strongly concentrated in consumer durable goods industries such as automobiles. At the present time, neither of these situations exists.

2. Active use of stock margin requirements to curb dangerous speculation without imposing overall monetary restraint is an important part of current credit policy. There is no obvious relationship, however, between the level of margin requirements and the level of stock prices since stock prices are influenced by many factors other than speculative borrowing. Furthermore, variation in these requirements is likely to have very limited effects on the demand for goods and services.

3. Increasing reserve requirements against particular types of bank liabilities poses complicated issues that should be considered in terms of the effectiveness of general monetary policy actions and the efficiency of competition among various types of financial institutions.

Adjustment of particular reserve requirements is not a selective credit control device in the same sense as margin requirements or consumer credit controls since reserve adjustments would have their primary impact through their effect on total required reserves and hence on general credit conditions, in the absence of offsetting open market operations.

4. Use of the Federal Reserve's power to ration the volume of discounting, as an alternative to raising the discount rate, could have advantages in very special circumstances in which the Federal Reserve wished to prevent banks taking advantage of temporary opportunities for interest arbitrage without changing the established discount rate. However, since rationing discounts would limit the

growth of reserves, it would exert its most significant impact on general credit conditions, rather than on a particular sector or particular type of borrowing.

5. Discretionary Presidential authority to vary the investment tax credit could be a powerful tool for influencing a sector of demand that has on occasion been destabilizing. This tax credit was intended, when enacted, as a structural reform in the tax system directed not only toward increasing investment's contribution to total demand, but also toward other objectives, such as stimulating the growth of productivity, and improving international competitiveness through modernization of the capital stock. Any consideration of the desirability of altering the investment tax credit should take account of the possible effects on all of these objectives of policy.

Chairman PATMAN. Would you yield there for a moment?

Representative REUSS. Yes.

Chairman PATMAN. Would it be satisfactory if members of the committee who desire to do so may submit questions to you before you look over the transcript and you will answer them in the transcript?

Mr. ACKLEY. We will be very glad to do so.

Chairman PATMAN. Without objection, it is so ordered.

Representative CURTIS. Can we figure out what our deadline is? When do we have to have our report?

Chairman PATMAN. March 1. We ought to do this within a week, I think. Do you think so?

Representative CURTIS. That doesn't give much time for them to answer.

Chairman PATMAN. I mean a week to submit them.

Representative CURTIS. And then let them have another week?

Chairman PATMAN. Yes, let them have the time that they would take on the transcript anyway.

Representative CURTIS. I am thinking in terms of preparing our reports.

Chairman PATMAN. We should have them done by the 15th of February. Today is the first day of February. Would the 15th of February be satisfactory?

Mr. ACKLEY. We will do our best. Particularly if we can get the questions quickly, we will be able to respond by that time.

Chairman PATMAN. That would be about 2 weeks from tomorrow.

Mr. ACKLEY. We will do our best.

Chairman PATMAN. That is satisfactory.

Representative REUSS. I have no further questions.

(Additional questions and answers appear following Mr. Ackley's testimony.)

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. I wanted to get into this discussion of the danger that is caused when we don't use fiscal and monetary policy, and go to these various control techniques.

First, though, on raising taxes themselves. If our studies were accurate in July 1964 on Federal excise taxes, that showed these taxes were economically damaging, then that is a penalty we are paying if we go backward again. And certainly this would be true if we move backward on our Federal income tax rate cuts.

I have already expressed myself that I would prefer the damage there rather than what I think is a greater damage by putting more of a burden on the Federal debt. But this is an area of judgment.

I think we make a mistake if we don't recognize that this is going to create some economic damage. I think you would agree, would you not, that if we moved this way that this would be a deterrent on the economy?

Mr. ACKLEY. Certainly the purpose of a tax increase would be to restrain demand and would be a sacrifice for the taxpayers. Certainly we all prefer lower taxes to higher ones, both in terms of the effect on purchasing power and individual welfare, and in terms of the effect on incentives, to which we have referred.

Representative CURTIS. I wasn't thinking so much of demand. I know your theories on demand. I am concerned about the structural impact. I think all too many business judgments are made today not on the basis of economics, but on the basis of their tax impact. As one who is in the taxwriting field, I find that every time we alter a tax just a little bit, it has considerable economic consequences and has prevented us for years from getting into what I would regard as essential tax reform.

This just puts off that day if we have to go the way of increasing rates. That is what I am pointing out.

Mr. ACKLEY. Could I make some comment on this question of tax changes and these two theories of taxation?

Representative CURTIS. Surely.

Mr. ACKLEY. It doesn't seem to me that these have to be mutually exclusive theories.

I think we all agree that tax rates, per se, quite apart from their effect on purchasing power, do affect incentives to work and invest, not only in the aggregate but also may distort their composition in ways that are not always fortunate.

But it doesn't seem to me that recognizing the incentive effects precludes recognition of the fact that taxes also reduce purchasing power. Reduction of tax increases purchasing power and buying ability, and, therefore, demand.

Representative CURTIS. I think I want to say I agree with that. But I don't think it is just the semantics, whether you approach your tax policy on the assumption you are trying to get the revenues necessary to run the Government with a minimum of economic impact as opposed to using your tax structure intentionally to produce these results, particularly when you use it in this area of aggregate demand.

But certainly I agree that it does have that side effect. To me that is a byproduct, but it is a byproduct that one seeks to minimize either way if one adopts the approach I do.

Your investment tax credit is the reverse, you see. There we have deliberately used tax policy to impede something. The whole theory of protective tariffs are for that purpose. Likewise, you can use taxes, as I believe the Council of Economic Advisers have recommended, to to try to produce, or increase aggregate demand in the society.

It is in this area that I feel there is grave error in using taxes. I would prefer to use expenditure policy, because then we can zero in on the full ramification of economic consequences openly and aboveboard.

Mr. ACKLEY. I would make the same point about expenditure policy. Expenditures also have both purchasing power effects and the other kinds of effects to which you refer. Really, what we have to think about is the effect of taxes and expenditures, both on the supply of output and on the demand for output.

Representative CURTIS. But, you see, if we use expenditures as our affirmative policy for Government, then our tax policy relates to what is necessary in order to pay for these things, the goods and services, we decide to procure through the Government sector. I think this is a very fundamental difference in approach to government, and one reason I sought to go over a lot of background, because I find herein lies much of our difference in some of these specifics.

Mr. ACKLEY. I would certainly agree that if the economy were always producing at full capacity, whenever we raised expenditures and tried to divert some of our total output into public uses, it would be necessary to offset that by an increase in taxes, so as to free extra resources to produce for those public uses.

But actually, over the past dozen years we have not been steadily at full employment and we have to take account of the effects on demand.

Representative CURTIS. But you are stating a theory, which is perfectly proper. This is a theory with which I disagree. I think in order to show this so-called growth gap, the Council has not used careful guideposts. At any rate, this is an area of dispute.

Let me go on to a specific again. I would argue that if we were going to repeal a tax cut surely that tax which was put on in 1962 to stimulate expenditures in the investment area at the time of heated-up economy would be the first to remove at a time when the economy was heating up.

I am surprised the administration has not recommended that certainly ahead of reimposing a very regressive tax such as the excises on transportation and communications we remove an actual tax subsidy which primarily accrues to the larger and more prosperous business.

Mr. ACKLEY. I think the whole question of the investment tax credit is one that is very complex. A great deal has been said on both sides. Our view is that, at least in the present economic circumstances, the investment tax credit still performs a useful function in stimulating the growth of capacity we need to supply the additional output called for by Vietnam and our increasing civilian demands.

Representative CURTIS. One of the points I made to the Secretary of the Treasury is that this, of course, gives an incentive for management to buy machines in competition, I might say, with labor.

I will refer to another area, what I think is very bad tax policy, of overloading the payroll tax, which is a tax on jobs. I use the term "overloading" because I think it is. We have three basic programs, or three programs which are based upon the payroll tax: social security, unemployment insurance, and I would argue workmen's compensation upon analysis is based upon that, too.

But this payroll tax is a tax on jobs, and jobs compete with machines. If we are going to have an investment tax credit which gives management more than 100 percent return over and above their depreciation allowances of 100 percent for investment in new machinery, surely we should have the concomitant tax credit for what I call "human investment," the money that is spent by management in training and retraining manpower.

I think the first tax is bad, but if you are going to keep it, I think you have to do something to balance this off vis-a-vis employment of human beings.

Mr. ACKLEY. A tax credit for training purposes, of course, would encourage further expenditures on training. I think there are very difficult administrative problems in a tax credit for training, because we don't know to what extent the training that would qualify for the credit is additional bona fide training activity.

Representative CURTIS. I will send you my bill and see if you don't think it doesn't meet those administration problems. I think it does. Anything can be perfected. But if the idea is economically sound, I think we better get to it. There is emphasis in your report on the need for training and retraining which, to me, is the crying need in our society or any society that is moving forward rapidly, technologically and otherwise.

Mr. ACKLEY. On training, I think we have the choice of more direct public expenditures for training programs, versus the tax credit to stimulate private training. The question is which is more efficient.

I think, in the case of the investment credit, that choice is not really available because the Federal Government does not directly spend for private investment purposes.

Representative CURTIS. We have the Manpower Development Training Act, which is the Government doing it. I happened to have had a lot to do with getting that through and conceiving it. But it was an emphasis on the governmental sector. Yet the bulk of training and retraining does go on, and I think it should go on, in the private sector. Therefore, the human investment act is pointing this up.

I see my time has expired.

Chairman PATMAN. You may go ahead, Mr. Curtis. I will yield my time to you.

Representative CURTIS. Thank you. I hope to get through with these questions.

Moving further into the damage which results from imposing control——

Chairman PATMAN. Excuse me.

Senator Proxmire?

Senator PROXMIRE. No, I am all through.

Chairman PATMAN. Thank you.

Representative CURTIS (continuing). Of using controls to prevent inflation, which I think you have done in certain degrees in the three areas I happen to mention: steel, copper, and aluminum. Just in the area of steel we have a Subcommittee on Military Procurement of the Joint Economic Committee and we have been urging for years the establishment of good guidelines for our Government purchasing practices.

Yet here we have seen those guidelines completely thrown out the window and the Secretary of Defense saying to a steel company that didn't agree with him on the economic analysis of whether they should raise prices, that they weren't going to procure from that company.

Not only is that illegal, I would argue, but this is the very dangerous process of substituting for private economic judgment in the marketplace, Government judgment.

This is one of the damages.

Let's go to copper, though, because I think it illustrates a point. As I understand it, we have a shortage of copper. One way the marketplace reacts to take care of shortages is through increasing prices. This encourages increased production.

If one imposes controls, price controls, on any area, whether it is rent or what, it is a deterrent to increasing productive capacity, is it not?

Mr. ACKLEY. It certainly can be under some circumstances; yes.

Representative CURTIS. I thought that was particularly true in copper at this time. The main thing I am trying to discuss is the fact that if we do go to controls, whether it is the wage-price guidelines technique, with this backup kind of Government power, or anything else, I think you would agree as an economist that this is a short-run palliative, that it is certainly nothing that will correct the economic imbalance in the long run.

In fact, it will create further imbalance, will it not—the use of controls?

Mr. ACKLEY. Certainly, if we are talking about a situation of general price-wage controls to repress overall inflationary gaps. Someday, such measures might become necessary, but certainly that is not what we are talking about today——

Representative CURTIS. But isn't it even worse in selective controls by zeroing in on an independent industry like steel, copper, or aluminum?

Mr. ACKLEY. Well, I wonder if I can speak for a moment to the cases you mentioned.

In the first place, I would not like to have it suggested that steel, copper, and aluminum are the only industries in which the guideposts have had any effect. On the contrary, I would argue that they have been effective voluntarily and without publicity in a large number of industries. These happen to be three which came to public attention.

In the case of steel, I believe that the only thing that the Secretary of Defense ordered was that, when companies offered to sell steel of a particular type at different prices, the purchases should be made from the companies with the lower prices. I believe that is standard procurement policy in any case.

In the case of copper, certainly a higher price might, indeed, stimulate additional supply. I believe we have to look at the economics of the copper industry, however, and our views on the desirability of stable prices are shared by the copper industry, itself.

In the longer run, supplies of copper should be quite adequate to hold prices at or lower than present levels, which are indeed somewhat higher than they were a couple of years ago. Copper producers have found that, in periods of temporary shortage, when they have raised the price substantially, they have lost permanently some uses of copper to a substitute metal.

The companies themselves, quite apart from Government encouragement, have felt it was sound economic policy for them to hold the price at a reasonable level during periods of temporary shortage in order not to lose customers permanently to aluminum, plastic, and other materials.

I believe the industry itself had no objection, and no quarrel with the release of material from the stockpile for the purpose of filling some part of the temporary gap between supply and demand associated with the reduction of foreign supplies and the temporary defense needs.

Raising the price might indeed have brought out some small additional supply in the very short run. It might in the long run have done the industry damage.

Representative CURTIS. I can see why the big companies might not have liked it, that is true, but there were, as you say, some marginal copper producers, as I understand it, that were ready to move in and could have moved in to increase productive capacity.

The main point of this, though, is that you are interposing Government judgment in the field of economics for that of the marketplace. Furthermore, I can see why some of the big copper people have been perfectly happy to release some of that stockpile, knowing that the demand from the military might be greater. But the stockpile was created for the defense of this country, not for the purpose of messing around with the market or stabilizing it in any way.

Congress, as I thought, and as I tried to review the record, tried to make it clear that the stockpiles were not to be used in this nature.

Well, I wanted to examine that a bit.

One other area of controls, and relating it to the damage caused, is the interest equalization tax. This is a control over the flow of private investment abroad.

One of our plus assets in the balance of payments is the earnings that we have on our investment portfolio and other investments abroad, is it not?

Mr. ACKLEY. It is indeed.

Representative CURTIS. Certainly you would say that in the long run this would be damaging from that standpoint, would it not?

Mr. ACKLEY. In the long run, of course, it could.

Representative CURTIS. What is the long run?

We have had it on here for how many years—3 years?

Mr. ACKLEY. Two years, I think.

Representative CURTIS. Some of the questions Senator Proxmire was directing, as to how this relates to our exports, are important. The Brookings Institute study that came out, I think, last July, I thought fairly clearly documented how our exports are dependent upon and tied in with the amount of our foreign investment.

So here is another area we are damaging, I would say, by these controls. The point I am getting to is, shouldn't we begin to get at the basic problems behind the imbalance of international payments rather than to use these palliatives which actually, in the long run, hurt our position in the international balance of payments?

Mr. ACKLEY. I think the problem with the balance of payments is the necessity for something to be done to achieve balance. Some of our expenditures have to be cut back or some of our receipts increased.

Representative CURTIS. Exactly. May I suggest one? The Government investments abroad. That is the one area we have not cut back on.

Mr. ACKLEY. I think the evidence would show that indeed there has been a substantial reduction in the outflow associated with our military expenditures abroad, in spite of substantially increased commitments.

Representative CURTIS. You are talking about one area but not the total. I might add that is a very dangerous area, on military procurement, where you have eliminated offshore procurement which was much more economical and substituted a sort of "Buy American" program, which has upped the military expenditures considerably.

These are the kinds of penalties I think we pay for poor economic policy. But I am talking about the overall balance, of which military is one part. Our foreign aid programs, and particularly our lending programs through the Development Loan Fund and so forth, have increased, not decreased.

Here is a substitution, I would argue, of Government capital for private capital, and maybe that is what the administration really has in mind—a substitution of Government capital going abroad for private capital. Would you say that is the policy?

Mr. ACKLEY. No, I don't think so. I think the policy is to use every instrument available to achieve balance in our external payments, which means operating on every part of the accounts. It means particularly operating on that part which has contributed to the very sharp rise in deficit in recent years; namely, private investment abroad.

Representative CURTIS. That is the healthy part; and the part that is really causing the trouble, I would argue, is in the Government sector.

I was pleased in this one statement in the President's message on foreign aid to Congress today where he said:

> I propose to carry forward the best of what we are now doing in the less-developed world and cut out the worst.

I think if we follow that policy and cut out the worst and get into the heart of expenditure policies, we probably would be reducing from a $3 to $4 billion annual expenditure to around a $1.2 billion expenditure. If we did, we would have solved this deficit in the balance of payments.

The main point I again direct attention to is the longrun damage that results from use of controls through the interest equalization tax and that which, I would argue, is illegal, the so-called voluntary restraint programs.

Because time is growing late and you have been very generous, Mr. Chairman, and so have you, Mr. Ackley, in answering these questions, I simply want to refer to one area of expenditure policy where I mentioned I thought there was overheating, just as I feel there is overheating in the area of Government foreign aid programs.

We are spending Government money in a redundant fashion in many areas. We are competing with private investment. The net results are not good.

I think in this very important area of manpower, of training and retraining, we have redundant policies, duplicating, and the good results are not showing up at all, but bad results are. I will list some:

The failure to relate the Manpower Training Act to unemployment insurance programs. We on Ways and Means felt that the way to treat long-term unemployment is not through just lengthening the time the unemployed are on the insurance, but to get them into training and retraining.

Yet the administration in presenting its recommendations and in your Economic Report does not even relate the unemployment insurance program to manpower training.

In the area of trade adjustment benefits, this is completely duplicating, manpower training, unemployment insurance, and other programs. There is no recognition of the relationship of these programs with each other in the Federal Executive's message.

Federal vocational education, a program of 1917 in origin, heavily oriented toward agricultural training, not to this day really updated except on a piecemeal basis.

The failure to relate apprenticeship training with vocational education; apprenticeship training in the Department of Labor, vocational education in the Department of Health, Education, and Welfare.

Then, on top of all these things, are the poverty programs, which likewise seem to be trying to move into this area in a scatterbrained and uncoordinated way. Much of this inquiry I will direct to the Secretary of Labor when he will be here, but I use this area of manpower training to illustrate the point that I am trying to make. If we would zero in on expenditure policy and see how we are spending Federal money, we might very well find that my premise, my theory, that we are flooding the engine, is quite sound, and that the way we would best move forward happens to be the same way we should move forward on fiscal policy, by more intelligent spending, which would mean right off the bat considerably less spending, and directing spending to the specific areas on a rifle-shot principle as opposed to the short-range, scatter shot of a blunderbuss principle the administration seems to follow.

Much of your report goes into specifics in the field of agriculture, but what you have said was said by former Secretary Benson. It has been said ever since I have been here. I think it is very true—the analysis—but we don't seem to relate the fact that the shift of employment in agriculture, some 42-percent decline in 10 years, really identifies the area where we need extensive training and retraining, and not in agricultural skills. Yet, the Federal vocational education program, started in 1917, is still oriented to training agricultural skills.

I will conclude my remarks by saying I believe that we can afford both the cost of the Vietnam war and butter, but I think in order to do it, we have to start restructuring our expenditure policies, and certainly we have to get our fiscal policy and monetary policy on a more even keel.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Ackley, and the gentlemen accompanying you. We are glad to have them, too.

We appreciate your testimony, Mr. Ackley. You have been very helpful to us. If we desire further information from you, we will submit the questions to you in writing.

Thank you, sir.

Mr. ACKLEY. Thank you very much.

Chairman PATMAN. The committee will stand in recess until 10 o'clock in the morning, here in this room, at which time we will hear the Director of the Budget.

(Whereupon, at 4:15 p.m., the committee recessed, to reconvene at 10 a.m., the following day, Wednesday, February 2, 1966.)

(The following material was subsequently submitted by the Council of Economic Advisers in response to committee questions.)

REPLIES OF THE COUNCIL OF ECONOMIC ADVISERS TO QUESTIONS SUBMITTED BY HON. HENRY REUSS

RE ANTITRUST AND RELATED PROBLEMS

Question 1. In the 1965 annual report (pp. 131–135) the Council considered "the increasing influence of large firms" in the economy as the result of the postwar merger movement and also took note of the role antitrust enforcement can play in preserving competition. However, in the 1966 report there is not a word about this important problem. Are you no longer concerned with this issue?

Answer. In our 1965 annual report we took note of the increasing share of large firms in total output, and of the lack of any apparent trend in concentration within industries. These opposing movements—of large firms' percentages of total value added and of shipments in particular industries—were explained in part by conglomerate mergers and by expansion of large firms into new product lines. The effects of these movements on competition were thought to be "difficult to establish." There is no basis in last year's experience for changing this opinion. The absence of a discussion of antitrust in our 1966 report simply reflects the fact that we must be selective in our coverage of economic problems and issues in any year's report.

Question 2. Senator Hart's Antitrust and Monopoly Subcommittee brought out in their hearings last year that:

> Between 1948 and 1964, according to the FTC, 720 large firms (each with assets of more than $10 million) disappeared through merger and the number has been rising in recent years.
>
> As a result of these mergers the number of manufacturing companies with assets of $10 million to $25 million was reduced by one-fourth.
>
> Since 1950 the 200 largest manufacturing companies alone have bought more than 2,000 concerns with combined assets of $18 billion.
>
> The trend to conglomerate mergers continues to accelerate. The 42 most active acquiring corporations among the 100 largest manufacturers made nearly 200 acquisitions between 1950 and 1963. Four out of five of the companies bought were in industries differing from that of the acquiring company.
>
> Additional evidence was presented to challenge the assumptions that (*a*) concentration—bigness—is essential for technological innovation, and (*b*) big, multiplant companies are more efficient than smaller firms.
>
> Concentration in individual markets has not declined but rather has tended to increase despite the fact that modern technology appears to have made smaller plants more efficient than larger plants.

In the face of these facts, does there not appear to be a strong argument for a stepped-up antitrust enforcement program?

Answer. The statements brought out in the Antitrust and Monopoly Subcommittee hearings do not lead the Council to revise the position taken in the 1965 report. Conglomerate mergers can have either advantageous or detrimental effects on competition; they may be either "the most effective source of active or potential competition * * * or may be able to reduce competition. The disappearance of a medium-sized firm by conglomerate merger has to be analyzed for its economic effects in order to reach a judgment. We believe the Justice Department is dealing effectively with these problems in its present energetic program of antitrust enforcement.

Question 3. If antitrust enforcement is to be adequate to the challenge, I wonder whether the budget sufficiently allows for this. According to the 1967 budget, neither the Antitrust Division nor the FTC has been authorized any increase in the number of permanent personnel. Moreover, the Antitrust Division anticipates that it will file fewer cases in fiscal 1967 than in 1966. The FTC estimates that it will file only half as many complaints involving restraints of trade (monopolies, mergers, and the like) in 1967 as in 1966. Is antitrust enforcement adequate?

Answer. It is not possible to measure the effectiveness of antitrust by the number of personnel in the Antitrust Division or the FTC, or by the number of cases filed. A single crucial decision may, by "setting the example," prevent the occurrence of anticompetitive behavior to a much greater extent than the filing of hundreds of complaints. Strong leadership in the Antitrust Division and the FTC provides every expectation that significant progress in antitrust, and in maintaining competition, will take place this year.

RE EFFICIENCY IN TRANSPORTATION

Question 1. What measures are being considered to bring about a more competitive and economically efficient use of our transportation network?

Question 2. What measures are under consideration, specifically, to reconcile the cost structures of our different systems so that competitive allocation of traffic can take place?

Answer. As you know, the President is recommending a new Department of Transportation, in order more effectively to coordinate the planning for Government promotional, research, and similar activities in the transportation field. It would be premature to indicate what specific policies the new Department might develop to improve transportation efficiency.

Nor do we know what specific plans the regulatory agencies may have for the evolution of their policies in directions which would better promote a more efficient use of our transportation systems.

In our own view, as we suggested in our annual report, further moves toward cost-oriented rates seem promising as a way to increase efficiency and competition in transportation—in order to remove the remaining instances in which rates are unnecessarily high as a carryover of antiquated pricing; to enable shippers to reach new markets; to place for-hire carriers in a more competitive position with private carriers; to increase flexibility in carrier pricing; and to rely more heavily on the marketplace. We also pointed to the increased efficiency that could accompany more liberal standards for altering the scope of service offered by a carrier. This applies to both contraction and expansion—easing the abandonment of unneeded railroad service, and capitalizing on the flexibility of motor carriers to expand and vary routes, commodities, and areas served.

The imposition of adequate and equitable user charges on all classes of users of highways, waterways, and airways would also surely promote economically efficient utilization of our transportation network. Rigorous benefit-cost analysis of proposed Federal investment in basic transportation facilities is another important step toward greater future efficiency of our transportation system. Federal support for research and development in transportation also is a route to improved efficiency.

Question 3. More generally, what does the Council identify as the major elements of a national transportation policy?

Answer. A national transportation policy should aim for a fast, safe, convenient, and efficient transportation system which would assist in our economic growth and stability at the lowest cost consistent with the effective use and conservation of our national resources and with the preservation of our national security.

REPLIES OF THE COUNCIL OF ECONOMIC ADVISERS TO QUESTIONS SUBMITTED BY THE JOINT COMMITTEE AS A WHOLE

Reference: Executive Director James W. Knowles, letter of February 8, 1966.[1]

Question 1. The discussion of productivity has been largely in terms of labor productivity. Because of the method of computing this statistic, will labor productivity rise more or less according to changes in capital per worker? If so, would a combined measure of labor-capital productivity, adjusted for quality changes in capital, be a more appropriate measure for the purpose?

Answer. For the purpose of the guideposts, we consider output per man-hour a more appropriate measure of productivity than any other concept that is available. We base this judgment on such criteria as consistency with competitive market behavior, meaningfulness for the maintenance of price stability, and ease in estimation

Despite a long-term increase in the capital-labor ratio and continuing improvements in the "quality" of capital, the market has historically generated essentially constant share for labor and capital in the national product. This suggests that long-run market forces tend to reward both labor and capital in accordance with the trend of output per man-hour.

Observance of the wage guidepost as formulated in terms of output per manhour is consistent with the constancy of unit labor costs and assures the absence of upward cost pressures on prices. This direct link between productivity and unit labor costs would not necessarily be maintained by other concepts of productivity.

[1] In committee files.

The problem of quantifying the degree of "quality" change in capital still defies the professional skill of economists and statisticians. Further formidable problems arise in any attempt to weight a number of inputs in order to calculate combined productivity measures. It could well prove impossible for any industry to estimate its own productivity on some of these concepts or for any Government agency to do so.

There could be unusual cases where productivity surges ahead in a particular industry as a result of especially large increases in capital-output ratios. A careful interpretation of the price guidepost would be required in such instances. Indeed, this possibility is one reason why the Council has refrained from suggesting exactly how fast prices should be expected to decline in industries where productivity gains exceed the national average.

Question 2. Are the present guidelines pragmatic at the cost of equal treatment? For example, market power is not confined to old, slow-growing industries; nor is it confined to large firms since it is sometimes associated with location or with wage setting and membership exclusion policies of local unions.

Answer. In our judgment, the call for responsible price and wage decisions applies with equal force to old and new industries, slow growing and rapid growing industries. We do not view these differences as obstacles to the effective implementation of guideposts.

On the other hand, special problems do arise from the exercise of local market power by some local firms and unions. Private decisionmakers in such situations have a clear responsibility to recognize the public interest in noninflationary wage and price behavior. But the administration is not always in a position to express the public interest effectively in the many specific cases where local market power may be exercised irresponsibly. State and local governments and the press must be counted on to do their share in calling attention to the importance of responsible decisions in local cases. It is encouraging to find many local firms and unions which are aware of their responsibility, as evidenced by inquiries to the administration regarding the appropriate interpretation of the guideposts in the determination of their prices and wages.

Question 3. The decision as to the adequacy of profit (wages) so as to attract sufficient capital (labor) is extremely complex. Shouldn't any such decision, if not made in the market, be based on a full hearing of all sides of the question and provide for review or redress?

Answer. It is possible that in some cases it may be very difficult to say with complete certainty whether profits are adequate to attract capital or wages high enough to attract needed labor. When and if instances arise which pose this problem, the Council would wish to give full consideration to all aspects of the issue before expressing any udgment. But this has not been an important or frequent issue in cases that have arisen. And it is clear why this is so. As our 1966 annual report indicates, the exceptions referred to in this question rarely apply to the industries with which the guideposts are primarily concerned. Thus the industries where unions have a substantial degree of market power are generally high wage industries with attractive job opportunities; they rarely face general problems of recruiting new workers. And, analogously, large firms have ready access to extra sources of capital as well as substantial internal sources.

Question 4. Is it likely that prices will fall in oligopoly industries as a result of above average increases in productivity when such price reductions may severely disrupt the market?

Answer. As the question suggests, certain types of oligopoly market situations may generate tendencies for avoidance of price reductions. The possibility of such situations represents one of the reasons why guideposts have been formulated: to provide standards for judgment of market situations where competition may not operate with sufficient force and speed to assure desirable economic results.

For a variety of reasons—interindustry competition, foreign competition, differing preferences among the firms for expansion of output, antitrust legislation, interfirm rivalry for market shares—prices of oligopolistic industries do frequently go down when productivity gains are high. The formulation of guideposts was meant to provide another stimulus for such price reductions in situations of high productivity advances. The more public opinion reaffirms and supports the guidepost principles, the more price reduction we can expect in such situations.

FEBRUARY 7, 1966.

Hon. GARDNER ACKLEY,
Chairman, Council of Economic Advisers,
Executive Office Building, Washington, D.C.

DEAR GARDNER: In the 1966 Annual Report of the Council of Economic Advisers, you show in graphs on pages 41 and 43 the GNP gap and high-employment saving relative to actual investment. Would you provide us with the data from which these graphs were constructed? Further, in evaluating the fiscal impact of the 1967 budget, it would be most helpful to have your projections of the high-employment surplus by half year through the first half of calendar 1967. Lastly, explanation of the assumptions and procedures used in deriving potential GNP additional to that given in the report would be of assistance in interpreting the high-employment surplus projections.

We would like to include these materials in the record of the hearings on the Economic Report if it is possible for you to get them to us in time.

Sincerely yours,

JAMES W. KNOWLES, *Executive Director.*

THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
Washington, February 16, 1966.

Mr. JAMES W. KNOWLES,
Executive Director, Joint Economic Committee,
Washington, D.C.

DEAR JIM: In response to your letter of February 7, I am enclosing:

1. The data underlying chart 3 [1] of our report on the GNP gap;
2. Data underlying chart 4 [2] on high employment saving relative to actual investment; and
3. A note of explanation prepared last year on our assumptions and procedures in calculating potential GNP—this is still current since we did not alter our methods in the 1966 report.

You may feel free to use any of this material for the record.

You also requested projections of the high employment surplus by half year through the first half of calendar 1967. The Budget Bureau and Council are still working to refine our estimates of the timing and phasing of the budget program. We would be happy to discuss our work in this area with you. However, our current quantitative estimates are still sufficiently in flux that we are not yet prepared to release them. What they appear to show confirms the qualitative statements made in our testimony: the full employment surplus was essentially eliminated in the second half of 1965; it remains roughly unchanged during 1966, moving to a small surplus by the end of the fiscal year.

Please let me know if I can be of further assistance. Best regards.

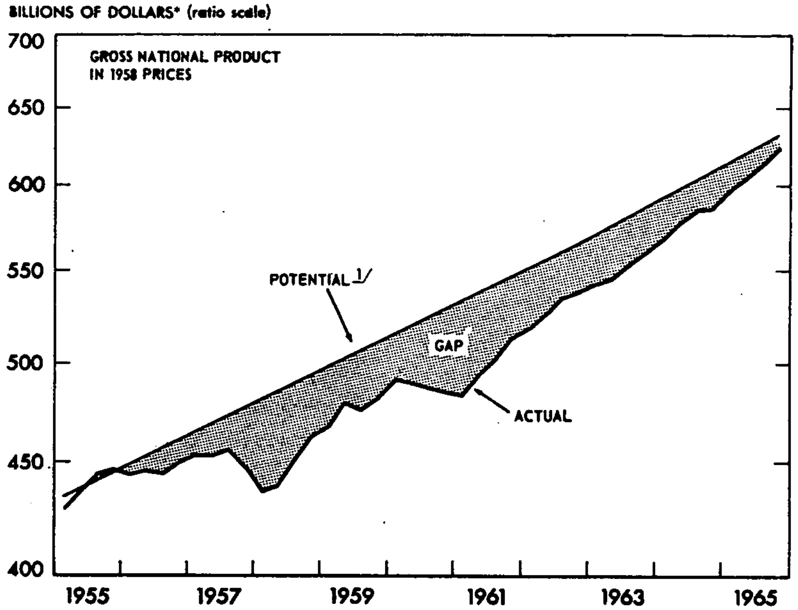
Sincerely,

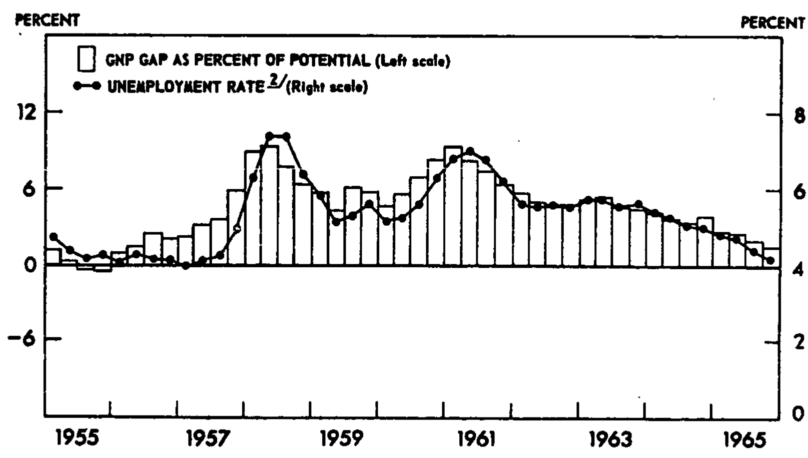
GARDNER ACKLEY.

[1] See pp. 100–101, this volume.
[2] See p. 102, this volume.

Chart 3

Gross National Product, Actual and Potential, and Unemployment Rate





* SEASONALLY ADJUSTED ANNUAL RATES.

1/ TREND LINE OF 3½% THROUGH MIDDLE OF 1955 TO 1962 IV; TREND LINE OF 3¾% THEREAFTER.

2/ UNEMPLOYMENT AS PERCENT OF CIVILIAN LABOR FORCE; SEASONALLY ADJUSTED.

SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR, AND COUNCIL OF ECONOMIC ADVISERS.

TABLE 1.—*Gross national product, actual and potential, and unemployment rate*

[Seasonally adjusted]

Period	Actual GNP	Potential GNP [1]	GNP gap [2]	GNP gap as percent of potential	Unemployment rate [3]
	Billions of dollars, 1958 prices, annual rate			Percent	
1955: I	428.0	433.2	5.2	1.2	4.74
II	435.4	436.9	1.5	.3	4.39
III	442.1	440.7	−1.4	−.3	4.17
IV	446.4	444.5	−1.9	−.4	4.27
Year	438.0	438.8	.8	.2	4.41
1956: I	443.6	448.3	4.7	1.0	4.08
II	445.6	452.2	6.6	1.5	4.27
III	444.5	456.1	11.6	2.5	4.18
IV	450.3	460.0	9.7	2.1	4.16
Year	446.1	454.2	8.1	1.8	4.18
1957: I	453.4	464.0	10.6	2.3	4.00
II	453.2	468.0	14.8	3.2	4.14
III	455.2	472.0	16.8	3.6	4.27
IV	448.2	476.1	27.9	5.9	4.97
Year	452.5	470.0	17.5	3.7	4.32
1958: I	437.5	480.2	42.7	8.9	6.29
II	439.5	484.3	44.8	9.3	7.37
III	450.7	488.5	37.8	7.7	7.35
IV	461.6	492.7	31.1	6.3	6.39
Year	447.3	486.4	39.1	8.0	6.82
1959: I	468.6	497.0	28.4	5.7	5.84
II	479.9	501.3	21.4	4.3	5.14
III	475.0	505.6	30.6	6.1	5.33
IV	480.4	510.0	29.6	5.8	5.63
Year	475.9	503.5	27.6	5.5	5.49
1960: I	490.2	514.4	24.2	4.7	5.19
II	489.8	518.8	29.0	5.6	5.28
III	487.4	523.3	35.9	6.9	5.61
IV	483.8	527.8	44.0	8.3	6.30
Year	487.8	521.1	33.3	6.4	5.57
1961: I	482.7	532.4	49.7	9.3	6.80
II	492.9	537.0	44.1	8.2	7.01
III	501.6	541.6	40.0	7.4	6.79
IV	511.9	546.3	34.4	6.3	6.21
Year	497.3	539.3	42.0	7.8	6.71
1962: I	519.7	551.0	31.3	5.7	5.63
II	527.9	555.8	27.9	5.0	5.55
III	533.6	560.6	27.0	4.8	5.61
IV	538.5	565.4	26.9	4.8	5.56
Year	530.0	558.2	28.2	5.1	5.58
1963: I	541.2	570.6	29.4	5.2	5.78
II	544.9	575.9	31.0	5.4	5.74
III	553.7	581.2	27.5	4.7	5.58
IV	560.0	586.6	26.6	4.5	5.65
Year	550.0	578.6	28.6	4.9	5.71
1964: I	567.1	592.0	24.9	4.2	5.45
II	575.9	597.5	21.6	3.6	5.29
III	582.6	603.0	20.4	3.4	5.08
IV	584.7	608.6	23.9	3.9	5.02
Year	577.6	600.3	22.7	3.8	5.22
1965: I	597.7	614.2	16.5	2.7	4.85
II	603.5	619.9	16.4	2.6	4.71
III	613.0	625.6	12.6	2.0	4.46
IV	624.4	631.4	7.0	1.1	4.20
Year	609.6	622.8	13.2	2.1	4.57

[1] Trend line of 3½ percent through middle of 1955 to 1962 IV; trend line 3¾ percent thereafter.
[2] Potential GNP minus actual GNP.
[3] Unemployment as percent of civilian labor force.

Sources: Department of Commerce, Department of Labor, and Council of Economic Advisers.

TABLE 2.—*Investment and high-employment saving*

[Billions of dollars, seasonally adjusted annual rate, current prices]

Period	Trend GNP [1]	High-employment saving						Actual gross investment [3]
		Total	Private [2]	State and local government surplus	Federal Government full employment budget			
					Surplus	Receipts	Expenditures	
1955: III	401.0	66.3	63.2	−0.9	4.0	72.3	68.3	68.7
IV	407.2	66.6	64.1	−.9	3.4	72.4	69.0	70.6
1956: I	415.1	69.5	65.4	−1.0	5.1	74.9	69.8	70.0
II	422.4	70.2	66.5	−.9	4.6	76.4	71.8	70.8
III	431.5	73.7	68.0	−.7	6.4	78.7	72.3	72.0
IV	438.8	74.1	69.1	−.8	5.8	79.9	74.1	73.6
1957: I	447.3	74.2	70.4	−.7	4.5	82.6	78.1	72.8
II	454.4	74.8	71.6	−1.3	4.5	84.2	79.7	72.2
III	462.6	78.0	72.9	−1.4	6.5	85.9	79.4	73.7
IV	469.0	79.3	73.9	−2.0	7.4	87.2	79.8	66.4
1958: I	476.8	79.5	75.1	−2.4	6.8	89.0	82.2	57.7
II	482.8	78.0	76.0	−2.3	4.3	90.4	86.1	55.8
III	489.0	78.0	77.0	−2.8	3.8	91.8	88.0	61.4
IV	495.7	77.9	78.1	−1.7	1.5	92.7	91.2	67.8
1959: I	502.5	82.1	79.1	−1.9	4.9	95.4	90.5	69.9
II	508.3	85.4	80.1	−1.7	7.0	96.6	89.6	77.3
III	515.2	88.9	81.1	.2	7.6	97.8	90.2	70.3
IV	520.7	91.0	82.0	.0	9.0	99.4	90.4	75.3
1960: I	527.8	97.4	83.1	.1	14.2	103.5	89.3	82.7
II	534.4	98.2	84.2	.4	13.6	104.8	91.2	77.3
III	541.1	99.0	85.2	.6	13.2	106.6	93.4	75.3
IV	548.9	100.8	86.5	.1	14.2	108.3	94.1	71.2
1961: I	555.3	99.8	87.5	−.5	12.8	109.8	97.0	68.3
II	561.2	99.4	88.4	−.4	11.4	111.2	99.8	73.3
III	566.0	99.0	89.1	−.5	10.4	111.9	101.5	76.6
IV	574.2	99.6	90.4	−.8	10.0	113.3	103.3	80.8
1962: I	580.8	98.2	91.5	.4	6.3	114.0	107.7	82.3
II	586.4	99.3	92.4	1.0	5.9	115.6	109.7	85.9
III	593.1	102.8	93.4	1.2	8.2	117.3	109.1	87.2
IV	600.5	103.7	94.6	1.5	7.6	118.7	111.1	87.0
1963: I	608.3	106.5	95.8	.9	9.8	122.8	113.0	84.5
II	616.2	111.2	97.1	.9	13.2	124.5	111.3	88.3
III	622.5	111.6	98.0	1.0	12.6	126.1	113.5	90.8
IV	632.4	114.6	99.6	1.3	13.7	128.0	114.3	96.9
1964: I	641.1	110.3	101.0	1.0	8.3	125.1	116.8	95.9
II	647.7	105.1	102.0	1.2	1.9	120.9	119.0	95.7
III	657.3	110.3	103.5	1.5	5.3	123.0	117.7	98.7
IV	667.0	113.1	105.1	1.9	6.1	124.5	118.4	103.9
1965: I	675.6	114.7	106.4	1.1	7.2	126.9	119.7	106.8
II	686.8	116.5	108.2	1.1	7.2	127.4	120.2	107.8
III	695.7	112.2	109.6	2.2	.4	125.7	125.3	110.9
IV	705.3	113.4	111.1	2.1	.2	127.2	127.0	111.8

[1] Real GNP at 3½ percent trend line through mid-1955 to 1962 IV; 3¾ percent trend line beginning 1962 IV to 1963 I and continuing through 1965, adjusted to current prices by actual GNP deflators.
[2] 15¾ percent of trend GNP.
[3] Gross private domestic investment plus net foreign investment.

Sources: Department of Commerce and Council of Economic Advisers.

THE GROWTH OF POTENTIAL GNP: AN EXPLANATORY NOTE ON THE COUNCIL'S 1965 ANNUAL REPORT

From the March 1961 testimony of the Council before the Joint Economic Committee through the 1964 annual report, potential GNP (at 4-percent unemployment) was represented by a trend line drawn through the actual real GNP of mid-1955 with a constant annual growth of 3½ percent per year. The 1965 annual report presented the same estimate once more for potential GNP in 1955–62, but it estimated the growth of potential at 3¾ percent a year beginning in 1963. The report stated:

"It now appears that the growth of potential has recently stepped up: A real growth rate of actual GNP somewhat greater than 3½ percent has been required to prevent a rise in the unemployment rate. * * * The best estimate of recent potential growth must be placed somewhat above 3½ percent and below 4 percent. In line with this conclusion, chart 12 shows the growth rate of potential GNP as 3½ percent from 1955 through 1962 and 3¾ percent thereafter."

As the report indicated, the trend rate of potential growth was estimated—as in previous Council efforts—by finding the rate of growth required to hold the unemployment rate constant. This method of "leaping" from unemployment to potential output and the statistical findings that emerge are discussed in Arthur M. Okun, "Potential GNP: Its Measurement and Significance," 1962 proceedings of the Business and Economic Statistics Section of the American Statistical Association. (Reprinted as Cowles Foundation Paper No. 190.)

A number of pieces of evidence suggested the basic conclusion that the growth rate required to prevent a rise in the unemployment rate has recently execeded 3½ percent.

1. In Okun's 1962 paper, the following equation is presented:

$$\log N_t = \log \frac{N_f}{P_o^a} + a \log A_t - (a\ r)\ t$$

where N_t = the employment rate.

- N_f = the employment rate at "full employment," taken to be 96.
- P_o = potential GNP at time zero.
- A_t = actual real GNP.
- t = a time trend.
- a = the "output elasticity of the employment rate."
- r = the estimated potential growth rate.

For the period 1953 IV–1960 III, this equation yields a potential growth trend of 3.5 percent. For the period from 1960 IV–1964 III, the rate is slightly higher at 3.6 percent. This technique cannot be expected to yield meaningful results for shorter periods, so that one cannot examine the subperiods of the current expansion.

2. A more flexible if less elegant approach is to take actual growth rates over a period of time and to try to infer potential growth by adjusting for the changes in the unemplyoment rate. The adjustment involves adding a percentage increment equal to 3.2 times the change in the unemployment rate to the actual growth of real GNP and then converting the "adjusted growth" to an annual rate. Since the adjustment is only approximate, it is best to find initial and terminal dates which have nearly identical unemployment rates. Here are the results of several of these calculations:

[In percent]

Period:	Growth rate
1959–63	3. 70
1959–64	3. 54
1959 II–1964 II	3. 51
1960 I–1964 II	3. 78
1960 II–1964 III	3. 71

All of these exceed 3.5 percent.

3. The 1962 Okun paper presented an alternative potential GNP estimate constructed by expanding actual GNP by a percentage equal to 3.2 times the excess of the unemployment rate over 4 percent. As the chart in that paper showed, the alternative measure of potential fluctuated around the 3½-percent trend line in a cyclical pattern. But its performance in this expansion relative to the 3.5-percent trend line has been unusual in that the "alternative potential" remained consistently above the trend line for more than 3 years. The average deviation from 1963–I to 1964–III was $2 billion, again suggesting that the trend line needed to be pulled up.

None of these estimates is decisive on just when to bend the trend line or exactly how much to raise the estimated growth rate. But the relevant range of rates does seem to be 3.6 to 3.8, and the relevant range of dates for the acceleration is 1961 to 1963. A 3¾-percent rate starting in 1963–I is an appropriate and reasonable choice. No more than this is claimed for it.

A rise in the growth rate of potential must reflect a higher rate of trend productivity growth, a more rapid normal growth of the labor force, or both. In view of the short period since potential growth apparently began stepping up, the Council report is explicitly agnostic on the sources of the recent gain. Research is now underway to distinguish the factors at work. Whether or not the "normal" growth of the labor force has already increased, studies by the Bureau of Labor Statistics indicate it will be considerably higher in 1964–70 than it was in 1955–64. Taking this into account, the Council tentatively concluded that the annual growth of potential GNP is likely to average around 4 percent in 1965–70.

JANUARY 1966 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 2, 1966

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

The joint committee met at 10 a.m., pursuant to recess, in room S–407, the Capitol, Representative Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Reuss, and Curtis; Senators Douglas, Sparkman, Proxmire, and Jordan.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority counsel; and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order.

Today we will hear from the able Director of the Bureau of the Budget, Mr. Charles Schultze.

The Federal budget has a tremendous effect on the economy. Federal expenditures are equal to about 20 percent of total national income and the way that the Federal Government spends its money has extensive significance for the economy.

We are glad to have you with us this morning, Mr. Schultze, and I know that you can help us in our appraisal of the economy. You may identify for the record the gentlemen accompanying you, if you please.

STATEMENT OF CHARLES L. SCHULTZE, DIRECTOR, ACCOMPANIED BY SAMUEL M. COHN, ASSISTANT DIRECTOR FOR BUDGET REVIEW; AND WILLIAM B. ROSS, CHIEF, FISCAL ANALYSIS, BUREAU OF THE BUDGET

Mr. SCHULTZE. On my right is Mr. Sam Cohn, who is Assistant Director for Budget Review. On my left is Mr. William Ross, who is, up through this week at least, my Chief for Fiscal Analysis, but as of next week will be Deputy Under Secretary for Plans and Programs in the New Housing Department. I am getting my last ounce of flesh.

Chairman PATMAN. Do you have a prepared statement?

Mr. SCHULTZE. I do, sir. I will read at least a good part of it, but will attempt to shorten my reading to keep it within a reasonable time limit.

Chairman PATMAN. Yes, sir, because the members want to ask you questions.

Mr. SCHULTZE. I realize that.

Chairman PATMAN. You may proceed as you desire.

Mr. SCHULTZE. Thank you, Mr. Chairman, and other members of the committee.

It is a pleasure for me to appear before you today to discuss the President's 1967 budget. If this were 20 years ago the terms of our discussion would, I am certain, be quite different. But over the two decades which span the existence of the Employment Act of 1946, the quality of public discussion and controversy about matters of fiscal policy has been vastly improved. Members from opposite sides of the aisle may still disagree with each other, and with the administration, on specific fiscal issues.

But this dialog contributes vastly more to the formulation of sound public policy than was possible in the years before this committee came into existence. I congratulate this committee and its staff on two decades of continuously productive work. While it may be more difficult to identify the results of that work as neatly as in the case of a legislative committee, no one can gainsay the proposition that the quality of public economic policy has been sharply raised by the deliberations of this committee.

Today I would like to discuss two central topics with you—the fiscal strategy of the 1967 budget and the program strategy reflected in the budget. I will also mention briefly the efforts underway this year to strengthen Government management and to improve the budget presentation. Since Chairman Ackley has already presented the overall fiscal policy aspects of the administration's program in some detail, I will only touch lightly upon that topic and concentrate my remarks on the program strategy of the 1967 budget.

FISCAL STRATEGY OF THE 1967 BUDGET

The central story of the 1967 budget, in its fiscal aspect, is the change in emphasis from economic stimulation to economic restraint. Fiscal policy is a two-edged weapon. This administration—as you are, of course, aware—has not hesitated to employ fiscal policy, primarily through tax reduction, as a means of preventing the waste of unemployed resources.

The fiscal 1967 budget shows that we are also prepared to shift the emphasis of fiscal policy away from economic stimulation toward restraint as conditions in the economy change. Reasonable men may differ on whether the shift in emphasis is too great or too little. But the fact of the shift is undeniable.

Five years ago, the American economy was operating significantly below its potential. The unemployment rate in February 1961 was 6.9 percent; industrial plant and equipment was operating at only 78 percent of capacity, compared to the optimum rate of 92 percent which, on the average, most firms desire to maintain; the gap between actual output and the economy's potential was $50 billion.

One of the principal reasons for that waste of economic resources through enforced idleness was the fiscal drag created by a tax structure under which the revenues generated under high employment conditions were too large relative to governmental expenditures.

Sound fiscal policy called for elimination of this fiscal drag. Two routes were open: a reduction in tax rates or an increase in expenditures relative to GNP. The administration chose the former route. Tax reductions of some $20 billion were proposed and adopted by the

Congress. Expenditure increases in the administrative budget were held below the rate of increase in GNP. In fact—leaving aside the added costs of the recent buildup in Vietnam—all other Federal expenditures in the administrative budget will have risen only about half as rapidly as GNP in the 6 years between fiscal 1961 and 1967.

It is, naturally, difficult to prove causality in economic affairs. Nevertheless, I think the results of this policy speak for themselves.

Real gross national product has risen without interruption and at an average annual rate of over 5 percent since 1961. Even while new industrial capacity rose rapidly, idle capacity was sharply reduced. The unemployment rate has fallen virtually to 4 percent. Productivity has increased at a very substantial clip, and living standards have risen with it.

We face the year ahead with a substantially different set of conditions than those under which previous budgets in recent years have been formulated. The major factor, of course, is the economic impact of the conflict in Vietnam.

The costs of these operations will add some $10½ billion to Federal expenditures between 1965 and 1967. These increases come at a time when economic activity—while still not completely up to economic potential—is closely approaching it. Taken together with the projected course of private spending, they call for a fiscal policy shift away from economic stimulation in the direction of economic restraint.

At the same time, the 1967 budget had to be formulated under conditions of great uncertainty. No one can honestly claim to predict with accuracy the course of future events in Vietnam. We have presented budget estimates which reflect all the costs of Vietnam operations as we can best foresee them.

Expenditures, however, may ultimately turn out to be either higher or lower than those estimated in the budget. The actual course of events turns heavily on the actions of our adversaries. Under these circumstances, a fiscal policy had to be developed which permits an unusual amount of flexibility.

The 1967 budget, therefore, is designed to effect a shift in emphasis toward restraint under conditions of ususual uncertainty about future events:

First, outside of Vietnam, budget expenditures will rise by only $0.6 billion—about one-half of 1 percent. This increase reflects not an arbitrary holding the line on every program, but a selective mixture of expenditure increases and decreases which approximately offset each other. I will discuss this at greater length at a later point.

Second, several measures have been proposed to increase revenues:

(*a*) A graduated withholding plan for personal income tax collections;

(*b*) A step-up in the already scheduled acceleration of corporate income tax payments;

(*c*) A rescission of the excise tax cuts on passenger automobiles and telephone services which took effect January 1, plus a temporary postponement of further scheduled reductions.

In total, these measures are estimated to yield $1.2 billion in the current fiscal year and $4.8 billion in 1967.

Third, the combined impact of expenditure restraint and tax revenue increases will reduce the administrative budget deficit to $1.8 billion in 1967 and produce a cash surplus of half a billion dollars in the same year.

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Since this budget was announced, a number of criticisms have been leveled at it on the ground that the major tax measures it proposed yielded only temporary increases in revenues.

The fact is correct. The inference is wrong. These particular tax increases were chosen by the President precisely because their efforts are temporary. I mentioned earlier the uncertainties facing us as the budget was formulated. The nature of the tax measures is a response to those uncertainties.

If a settlement is reached in Vietnam, we will not have made any unneeded changes in our tax structure. Conversely, if events in southeast Asia so develop that additional funds are needed, the President has stated, in his budget and economic messages, that he will not hesitate to ask for them, and at the same time to propose such fiscal actions as are required to maintain economic stability.

This budget, then, does provide for a significant shift in the thrust of fiscal policy—away from stimulation and toward restraint—in a way which takes into account the uncertainties of the situation. It is, I submit, a highly responsible budget.

Budget totals: Using the three major Federal financial measures, the totals in the 1967 budget are given in table 1.

TABLE 1.—*Budget totals*

[In billions]

	Fiscal year		
	1965 actual	1966 estimate	1967 estimate
Administrative budget:			
Receipts	$93.1	$100.0	$111.0
Expenditures	96.5	106.4	112.8
Deficit	−3.4	−6.4	−1.8
Consolidated cash budget:			
Receipts	119.7	128.2	145.5
Expenditures	122.4	135.0	145.0
Deficit	−2.7	−6.9	+.5
National income basis:			
Receipts	119.6	128.8	142.2
Expenditures	118.2	131.0	142.7
Deficit	+1.2	−2.2	−.5

Administrative budget receipts are estimated at $111 billion in fiscal 1967, an increase of $11 billion over 1966. Of this increase, $3.6 billion reflects the effect of President Johnson's proposed revenue measures, while the remainder results mainly from the vigorous economic growth during the past year.

Total administrative budget expenditures are estimated to rise from $106.4 billion in 1966 to $112.8 billion in 1967. The administrative budget deficit, therefore, is expected to be $1.8 billion in 1967, substantially less than the estimated deficit for the current year and only about one-half the actual 1965 deficit.

In fiscal year 1966, $4.7 billion of administrative budget expenditures is for special Vietnam costs while $101.7 billion is for all the other functions of the Government. In 1967, $10.5 billion is estimated for special Vietnam costs and $102.3 billion is for regular budget expenditures.

Thus, of the $6.4 billion increase in total administrative budget expenditures from 1966 to 1967, $5.8 billion represents the added costs of Vietnam. Expenditures for all other functions of the Government are expected to increase by only $0.6 billion.

Some 5 years ago, the Bureau of the Budget—under one of my predecessors, Mr. Maurice Stans—issued a report on the longer run outlook for Federal expenditures. The report pointed out that the likely growth in Federal nondefense expenditures, arising chiefly from the rising population and income of the Nation, should be expected to run $2 to $2½ billion per year. Had the President in his 1967 budget allowed this growth of expenditures to be added to the additional costs of Vietnam and refrained from requesting the tax measures he has proposed, the 1967 budget would have showed not a $1.8 billion deficit, but something in the neighborhood of $9 billion.

Containing Federal expenditures, outside of Vietnam, to an increase of only $0.6 billion was not, as I indicated earlier, accomplished by an arbitrary holddown of every program. The change of $0.6 billion actually reflects many increases and decreases.

For example, the 1967 budget provides for $5.3 billion of expenditure increases. These increases include:

(1) $3.2 billion for Great Society programs, primarily in education, health, and the war on poverty;

(2) $0.8 billion for higher interest costs and $0.3 billion for the added costs over 1966 of the military and civilian employee pay raises enacted last October; and

(3) $1 billion for other unavoidable workload and contractual commitments, such as expenditures for construction projects started in earlier years.

Against these increases there are reductions of $4.7 billion included in the 1967 budget. These consist partly of—

(1) $1.6 billion in defense activities excluding the added Vietnam costs and

(2) $1.5 billion in savings through pruning lower priority programs, through management improvements, and the nonrecurrence of certain costs. The remaining $1.6 billion reduction stems from increased sales of mortgages and other financial assets or conversion of direct Federal loans to guaranteed private loans—the substitution of private for public credit.

On the more comprehensive consolidated cash budget basis—including such trust funds as social security, medical care for the aged, aid for highway construction, and so on, which are financed by special trust fund receipts—payments to the public in 1967 are estimated to be $145 billion. Cash receipts are projected at $145.5 billion in 1967.

Thus, in spite of the heavy added costs we are incurring in Vietnam, it is estimated that we will realize a $0.5 billion cash surplus in 1967, the first such surplus in 7 years.

On a national income accounts basis, Federal outlays are estimated to rise to $142.7 billion in 1967. This concept most clearly indicates the direct economic impact of Federal finances on the economy. It excludes financial and other transactions which do not directly enter into the national income accounts. The major part of Federal national income account expenditures is for direct purchases of goods and services, which will amount to an estimated $74.4 billion in 1967.

Federal receipts on a national income account basis will rise from $128.8 billion in 1966 to $142.2 billion in 1967. While 1966 expenditures will exceed revenues by $2.2 billion on the national income accounts basis, the deficit will be reduced to only $0.5 billion in 1967.

PROGRAM STRATEGY OF THE 1967 BUDGET

As President Johnson said in his budget message, a budget is not simply a financial schedule. It is also a plan of action for the future. It reflects more than dollars and cents, it reflects the hopes and aspirations of hundreds of millions of people.

The President's program in the 1967 budget is based on two major premises:

(1) The United States will do everything within its power to seek peace. But, we are also prepared to bear the cost of meeting our commitments abroad.

(2) We will continue to press forward with high priority programs which will move us toward the Great Society. We will do so, however, in a manner which clearly recognizes the claim of our commitments abroad upon our great, but limited, resources.

The estimates presented in the 1967 budget provide for both of these purposes. But, as I indicated earlier, there are many uncertainties which could greatly alter the course of events, particularly with respect to our commitments in Vietnam. We have done our best to make the most realistic and reliable estimates possible.

While the composition of the total spending proposed for a given year is an important aspect of a budget, another significant element is the change from year to year. In spite of added costs for meeting our heavy military needs, the budget provides for continued progress toward the Great Society through the war on poverty and through stepped-up efforts in education, health, manpower and training, and housing and community development.

It is a difficult task to allocate scarce resources among many competing needs and provide a desirable balance between the various programs. One way—perhaps the easiest—is to simply stand pat and avoid any significant changes in the composition of the budget program.

A more difficult approach—the one which was followed in the 1967 budget—is to change the composition of Federal spending by doing more of some things of immediate urgency and less of other lower priority things. This, essentially, is what we accomplished with the increase of $5.3 billion in 1967 expenditures and the decrease of $4.7 billion, resulting, as I stated earlier, in only a net increase of $0.6 billion in budget expenditures, excluding special Vietnam costs.

There are two additional factors which have helped to finance program expenditures within a relatively stable total level. First, upon the continued insistence of the President, every agency and department of the Government has intensified its efforts to obtain a dollar's value for a dollar spent in each of their functions. As a result, savings are being made through management improvements, reorganizations, and better utilization of manpower resulting in increased productivity. On the basis of specific cost reduction reports from each Government agency, we estimate that the 1966 and 1967 budget programs would each cost $3 billion more, if agencies were operating at their 1964 level of efficiency.

Second, expenditure reductions are being made from increased sales of mortgages and other financial assets or conversion of direct Federal loans to guaranteed private loans. This substitution of private for for public credit, wherever consistent with program objectives, is a continuation of a policy supported by the last three Presidents.

Table 2 illustrates the results of the change in composition of our Federal budget over the past 3 years. Between 1964 and 1967, administrative budget expenditures, excluding the special costs of Vietnam, will rise by $4.6 billion, an increase of only 1½ percent per year.

Within the total, however, there are sharply varying trends. Between 1964 and 1967, expenditures for the major Great Society programs will increase by $6.2 billion. Interest costs will increase by $2.1 billion. All other Federal administrative budget expenditures, however, will decline by $3.7 billion over this 3-year period.

TABLE 2.—*The changing Federal budget*

[Fiscal years. In billions]

	Administrative budget expenditures, excluding special Vietnam costs				
	1964 actual	1965 actual	1966 estimate	1967 estimate	Change, 1964 to 1967
Interest	$10.8	$11.4	$12.1	$12.9	+$2.1
Health, labor, education, housing and community development, economic opportunity program, and aid to the needy	6.7	7.3	10.8	12.9	+6.2
All other	80.2	77.6	78.8	76.5	−3.7
Total	97.7	96.4	101.7	102.3	+4.6

I would like to examine briefly each of these major expenditures categories.

HEALTH, EDUCATION, WELFARE, AND RELATED PROGRAMS

The 1967 budget, though heavily influenced by the situation in Vietnam, will enable us to make substantial progress in improving the health, knowledge, skills, and welfare of the American people.

Health.—The first session of the 89th Congress enacted 12 major health measures which will bring us far along toward the goal of a better and healthier life for all our citizens. The 1967 budget now provides funds for making substantial headway in implementing these and other health programs.

Cash outlays for health services and research are estimated at $6.1 billion in 1967, an increase of $3.6 billion over 1966. This includes payments of $3.3 billion for the new programs benefiting older people which are financed from the hospital and supplementary medical insurance trust funds.

In the 1967 budget we have given particular attention to the problem of the supply of medical services, both facilities and human skills. Among the more important recently enacted programs directed to this end are those which provide:

Assistance to help educate more doctors, dentists, nurses, and other health personnel;

Assistance for the construction of medical schools;

Increases in the number of community health centers and help in supporting their staffs; and

Regional programs to improve planning, facilities, and manpower utilization in the treatment of heart disease, cancer, stroke, and related diseases.

The 1967 budget also proposes new and expanded programs for (1) helping communities to modernize and replace older hospitals, (2) combating the problem of polluted water, and (3) extending training assistance to medical assistants and other health personnel.

Chairman PATMAN. Mr. Schultze, would you suspend just a moment please? Mr. Reuss and I are compelled to go to a meeting of the Rules Committee. We have a very important bill, the banking merger bill, and we have asked for a rule on it. We will have to go. I will ask Mr. Proxmire to preside, if he will, until we get back. Since it is possible we may be unable to return to these hearings this morning I would not like to have to ask you to come back this afternoon on that account, I would like to have an understanding with you that it will be all right for us to submit questions to you. Will that be satisfactory?

Mr. SCHULTZE. Perfectly satisfactory, Mr. Chairman.

Chairman PATMAN. And you will answer them and make them a part of the record when you examine the transcript?

Mr. SCHULTZE. I will be very happy to do so.

Chairman PATMAN. Thank you. Without objection it will be done that way then.

Senator PROXMIRE (presiding). I might say that Senator Sparkman is on his way up. I am sure there will be other members who will be a little late. Mr. Schultze, you may resume.

Mr. SCHULTZE. Thank you, Mr. Chairman.

Education.—It would be difficult to exaggerate the importance of education to our economic growth and development and its vital role in eliminating poverty. Education is an investment in human resources that yields benefits for many years to come.

The 89th Congress passed legislation of great significance for all levels of education. The 1967 budget gives high priority for carrying out the new programs to improve the Nation's educational system.

Expenditures in 1967 are estimated to rise, net, by $1.3 billion—about 85 percent—over the 1965 level. This estimate includes the effect of proposals to make greater use of private credit in the college housing, academic facility, and student loan programs. Outlays in 1967 will provide for—

(*a*) An increase of $900 million in school aid under the Elementary and Secondary Education Act of 1965, mainly to improve education for more than 7½ million disadvantaged children;

(*b*) A Teacher Corps of more than 3,700 members to help schoolchildren from low-income families;

(*c*) Scholarships, loans, and part-time work for well over 1 million college students;

(*d*) Loans and grants to help more than 1,300 colleges build needed academic and housing facilities;

(*e*) Supporting science education and basic research;

(*f*) University extension and research activities to help solve such community problems as housing, poverty, recreation, employment, youth opportunities, transportation, health, and land use; and (*g*) College library expansions and aid to smaller institutions with inadequate staff and finances.

Economic opportunity programs.—The Economic Opportunity Act of 1964 provided the foundation for a concerted attack on poverty in the United States—its symptoms and causes. Expenditures are expected to reach $1.6 billion in 1967, compared to $1.2 billion in 1966 and $0.2 billion in 1965. The major goal of the economic opportunity programs is to help people help themselves through development of their skills and abilities. The 1967 budget does this by providing assistance for—

(1) Community action programs in about 900 cities and multi-county areas to focus local resources on the roots of poverty;

(2) Project Headstart which will provide preschool instruction programs for over 700,000 poor children;

(3) The Job Corps to help more than 45,000 out-of-school youths who need vocational and prevocational training and education;

(4) Work and training programs for helping over 400,000 poor youths and adults by providing full- and part-time jobs, basic education, and vocational training; and

(5) Helping many of the 400,000 migrant workers, making loans to rural families and farmers, providing adult literacy training, and offering services to the poor through 4,500 Volunteers in Service to America (VISTA).

Manpower and training.—The Manpower Development and Training Act has played a major role in helping the unemployed to develop skills necessary for finding jobs. In 1967, more emphasis will be placed on the training of persons who now have little or no skill.

Special attention will also be given to training for skills in particularly short supply. In addition to raising the earnings of the poor, this program will increase the supply of productive labor to meet the demands of our expanding economy.

Housing and community development.—Two major housing acts were passed during the last session of Congress: The Housing and Urban Development Act of 1965 and the act creating a new Cabinet Department of the same name. In order to implement the new programs authorized by this legislation, the 1967 budget provides funds for—

(*a*) Maximum use of existing housing in the low-rent public housing program;

(*b*) Assistance for well-planned water and sewer systems;

(*c*) Beautification of our cities; and

(*d*) Construction of social service facilities in low-income neighborhoods.

The 1967 budget further provides for (1) grants to help cities finance mass transportation facilities, and (2) approval in 1967 for over 160,000 additional housing units for low- and moderate-income families and elderly individuals.

The President, in the Demonstration Cities Act of 1966, has proposed a new program to make possible a major attack on the problems of our cities. Through a coordinated effort by the Federal Government, States, local governments, and private groups, those cities which are prepared to undertake imaginative and efficient programs to provide a decent and livable environment for their poorer citizens will be given the necessary assistance to do so.

National defense.—Total expenditures for national defense are now estimated to rise to $60.5 billion in 1967, an increase of $4.0 billion over 1966 and $10.4 billion over 1965. This reflects the greater intensity of the conflict in southeast Asia. If special Vietnam costs are removed from these amounts, regular national defense expenditures are expected to decline by $1.7 billion from 1966 to 1967.

Most of this decrease is in the Department of Defense, including the military assistance program. However, expenditures by the Atomic Energy Commission are also expected to decline by $90 million in 1967 to a level of $2.3 billion. This decrease can be made without diminishing our defensive strength because of the stockpile of nuclear weapons and materials accumulated in recent years.

Other Federal programs.—Outlays for many portions of the remaining Government programs will be reduced this year for a number of reasons:

Vigorous cost reduction efforts.

Careful pruning or postponement of less essential programs.

Substitution of private for public crédit.

Encouragement of increasing productivity.

Realization of benefits from earlier heavy investments.

The National Aeronautics and Space Administration will spend $300 million less in 1967 than it did in 1966—the first such reduction since that agency was established 5 years ago. In part, this reflects the fact that many of our space activities have moved beyond the expensive phase of development and that the scope of the 1967 program has been shaped according to carefully chosen overall priorities.

Expenditures of the Department of Agriculture are estimated to decline by $1.1 billion in 1967. The proposed substitution of private for public credit in Farmers Home Administration programs accounts for a large part of the reduction. But expenditure decreases in a number of other agriculture programs are also incorporated in the budget.

Lower expenditures are expected in the food-for-peace program. The shift from the more costly price supports to direct income supplements for many farm commodity programs will reduce the costs of sending surplus agricultural commodities abroad to hungry peoples by $162 million from 1966—while actually permitting an increase in the volume of such shipments.

Other sizable decreases include the Post Office Department ($123 million) and the Small Business Administration ($440 million—reflecting the proposed sales of shares in pools of loans).

Investment in human resources.—I mentioned earlier the shift in the composition of budget expenditures over the past 3 years. Large increases have been budgeted in areas such as health, education, the war on poverty, and similar programs. In a number of other areas expenditures have been reduced. Perhaps the central characteristic of this shift is its emphasis on investment in human resources.

Increasingly, the evidence of recent research has pointed to the impressive returns obtainable from investments in the Nation's human resources. As a result, the emphasis of Federal programs has been moving further in the direction of greater support for augmenting the health, education, and training of our people.

The benefits flowing from these outlays are "investments" in the true sense of the term, i.e., they require a current expenditure of funds but promise a return, in the form of increased productivity and other national benefits, which stretch into the future.

Two recent studies among many others have attributed as much as one-third of the growth in productivity between 1929 and 1957 to increased education.

The author of one of these studies, Prof. Theodore W. Schultz of the University of Chicago, has concluded that "during the last three decades, schooling has been a larger source of growth than material capital represented by structures, equipment, and inventories * * *."

Regardless of the specific contributions that investments in physical or human assets have made, the sizable returns to human investment are striking:

Professor Schultz has placed the rate of return on investment in a college education at about 11 percent per year. Other calculations place the return in the same general neighborhood—and show an even higher rate of return on investment in elementary and secondary education.

Prof. Edward F. Denison has estimated that between 1960 and 1980, education and the "advance of knowledge" will account for over 40 percent of our economic growth.

The importance of health as an investment has been underlined by Dr. Selma Mushkin, who has calculated that the increase in life expectancy between 1900 and 1960 give the United States a 25-percent larger work force in 1960. The accumulated value of increased labor output due to this longer life expectancy is estimated at more than $800 billion.

These valuations, of course, do not take into account the more intangible benefits which accrue to both the individual and society from higher levels of education, health, and related aspects of our environment. To this extent, the returns are greatly understated.

Recent trends in Federal programs reveal the greater emphasis which these highly productive investments have received. Education and health programs have been among the most rapidly rising segments of total Federal outlays. Education, training, and related outlays for 1967 have risen by $3.2 billion or 60 percent from 1965.

Medical and health outlays have nearly doubled over the same period. The net total for these programs reaches nearly $18 billion in 1967, about double the amount 2 years earlier, including, of course, the cash payments from the trust fund. Altogether, education and health programs will comprise about 12 percent of our cash payments to the public in fiscal year 1967 compared to around 8 percent in 1965.

Individual programs also reflect the greater attention given to health and education. For example, human investment activities of this nature play an important role in the attack on poverty. Within the totals cited above, Federal expenditures for programs which assist the poor through education and training in 1967 will total $2.8 billion, an increase of $2.4 billion over 1965.

Health programs specifically assisting the poor will likewise total $2.8 billion, an increase of $1.7 billion over the same period. All Federal expenditures for the poor will increase almost $4 billion over 1966, alone; three-fourths of this increase will be for education, training, and health programs.

Our efforts abroad will also reflect the President's conviction that "healthy and educated people are the most important resource a nation can possess."

Noting the role which education has played in our own growth, the expansion of education and health activities in our international programs may be an important factor in the future economic progress of developing nations throughout the world.

GROWING PUBLIC RESPONSIBILITIES

Economic growth, population expansion, and rising living standards have been accompanied by increasing demands for more and better public services.

Between 1957 and 1967 visitors to our national parks will have more than doubled; the number of acres of land requiring reforestation will increase more than sixfold; the number of passport applications will nearly triple; the number of pieces of mail handled by the Post Office will increase by nearly 13 billion. In addition, the adoption of urgently needed new programs and the modest expansion of other high priority programs impose additional workloads on Federal agencies.

Despite rising workloads in nearly every category of Government activity, increases in Federal expenditures have been kept down by persistent improvements in management and by the continued progress of Government agencies in improving productivity.

IMPROVING GOVERNMENT MANAGEMENT

In light of the great tasks before us at home and abroad, we cannot afford to dissipate our resources through waste nor to shackle our energies through inefficiency.

Cost reduction and improved organization.—The President's search for increased effectiveness in Government operations has been a never-ending one. He has established for the Government a standard of cost consciousness which demands careful judgment and responsible concern in the management of public funds.

Ways have been sought to reduce costs or eliminate unnecessary spending including: curtailing or eliminating activities of declining importance, closing marginal branch offices or installations, simplifying administrative organization, and adopting more efficient and up-to-date systems and equipment which increase employee productivity.

The savings and productivity improvements which have already been achieved through these efforts have helped make needed additional resources available for expanding our war on poverty, for strengthening our defense effort, and for advancing programs to combat ignorance, disease, and blight. As I stated earlier, without such continued efforts at cost savings, the cost of budget programs in 1966 and 1967 would be $3 billion higher than currently anticipated.

Planning-programing-budgeting system.—The most recent—and perhaps the most promising—innovation in devising more effective budgeting techniques has been the introduction of a new planning, programing and budgeting system within all of the major departments and agencies.

This new budgeting system will help focus attention more concretely and more precisely on program objectives. It will permit a broader evaluation of more effective and less-costly alternatives and will link longer term planning efforts more directly to budget decisions.

BUDGET PRESENTATION

In order to enhance the usefulness of budget for analytical purposes, various special analyses have been presented in recent years as part of the budget document. This year, a special analysis on education has been prepared in addition to the 12 others presented last year. Because of the particular interest which such analyses have stimulated, the ones prepared on the basis of the 1967 budget have been published in a volume separate from the regular budget document.

(Publication referred to, subsequently received from the Bureau of the Budget, follows:)

SPECIAL ANALYSIS K

PRINCIPAL FEDERAL STATISTICAL PROGRAMS

Reprint of Pages 144 to 151 From the Special Analysis,
Budget of the United States, 1967

Detail will not necessarily add to totals because of rounding

BUREAU OF THE BUDGET
January 1966

Special Analysis K

PRINCIPAL FEDERAL STATISTICAL PROGRAMS

This analysis summarizes the principal statistical programs of the Federal Government in the 1967 budget. The programs are presented in two categories: Current and periodic. Fiscal 1967 recommendations for current programs, reflecting continuing year-to-year statistical activity in the various agencies, provide for a total of $121.6 million. Recommendations for periodic programs—the large-scale census-type surveys characteristically taken once or twice a decade—amount to $13.3 million in obligations for 1967.

Objectives of these programs are to provide accurate, comprehensive, and timely data that are required for operations and policy decisions of the Government, and that furnish the public with information about the functioning of the economy and welfare of the people. The functions of collecting, processing, and analyzing current general-purpose statistical information are often closely related to other agency objectives. To indicate the interrelationships of the statistical programs carried out by different agencies and to aid in evaluating the Government's overall statistical system, the significant components of current Federal statistical activity are brought together and classified by broad subject areas in this special analysis. These areas and the amounts involved for the current program are summarized in table K–1. Information by agencies for both the current and periodic programs is shown in table K–2.

The current statistical programs represent the entire programs of some agencies but only that portion of the programs of other agencies constituting general-purpose statistical activity. This year's presentation reflects two important changes: The inclusion of funds for the statistical work of the Office of Economic Opportunity and a substantial increase in the research and statistical activities of the National Center for Educational Statistics as a result of a reorganization and reassignment of functions not previously included.

A brief description of the major program changes is shown below by broad subject areas. The agencies which contribute to each subject area are shown in table K–1. Adjustments made for savings resulting from increased productivity and for additional amounts required for increased pay costs are not itemized in descriptive statements but are reflected in the totals.

LABOR STATISTICS

Manpower and employment data.—Following several years of planning and testing, the Bureau of Labor Statistics plans to initiate surveys during 1967 which would provide current estimates of employment by occupation within industries. About 125 occupations have been identified as those requiring substantial periods of training, those subject to rapid change, or critical to defense or national welfare. Information is already available on some half of these occupations

Table K-1. **OBLIGATIONS FOR PRINCIPAL CURRENT STATISTICAL PROGRAMS, BY BROAD SUBJECT AREAS** (in millions of dollars)

Program	1965 actual	1966 estimate	1967 estimate
Labor statistics (Departments of Agriculture, Interior, and Labor; National Science Foundation)	23.6	26.2	29.8
Demographic and social statistics (Departments of Agriculture, Commerce, and Health, Education, and Welfare; National Science Foundation; Office of Economic Opportunity)	18.3	24.9	34.7
Prices and price indexes (Departments of Agriculture, Commerce, and Labor)	5.7	5.7	5.9
Production and distribution statistics (Departments of Agriculture, Commerce, Defense, and Interior; Civil Aeronautics Board; Interstate Commerce Commission)	35.0	37.1	37.6
Construction and housing statistics (Departments of Commerce and Housing and Urban Development; Federal Home Loan Bank Board)	3.1	3.9	3.9
National income and business financial accounts (Departments of Agriculture, Commerce, and Treasury; Securities and Exchange Commission; Federal Trade Commission)	9.9	9.2	9.7
Total, principal current programs	95.6	107.0	121.6

from existing sources. In order to provide current annual estimates of employment by occupation and to develop information on the changing occupational composition of major industries, a series of industry surveys ($190,000) would be undertaken for the remaining occupations. It will be 3 years or more before the program is in full operation and information available on the full list of 125 occupations.

Funds ($120,000) are recommended for the Bureau of Labor Statistics to support a program of manpower research in depth which would subject existing data to more fundamental analysis in order to study and understand better the problems of accelerating economic growth, reducing unemployment, and assuring a better balance of manpower resources and requirements.

Funds are recommended ($500,000) for the Statistical Reporting Service, Department of Agriculture, to strengthen the monthly estimates of employment of farmworkers—operators, hired workers, and unpaid family workers—and quarterly estimates of the wage rates paid hired farm labor. This program has been developed in response to the recommendations of the President's Committee To Appraise Employment and Unemployment Statistics (Gordon committee).

The Labor Department has been experimenting with a variety of methods for obtaining job vacancy information from nonagricultural employers. This experience indicates that collection of such data is feasible, although the exact procedures to be used depend on the results of further testing during 1966. Information on job vacancies would be used (1) for developing statistical series on current demand for labor, and (2) for the guidance of employment service operations, educational authorities, and others concerned with the training and placement of the labor supply in localities. With the funds recommended ($2,500,000) quarterly estimates of job vacancies will be developed for large standard metropolitan statistical areas, and possibly for the States and the United States, showing information by occupation and the wage rates offered. This is a cooperative Bureau of Employment Security, Bureau of Labor Statistics, and State employment security agency program.

Wages and industrial relations.—Funds are recommended ($267,000) for an annual survey by the Bureau of Labor Statistics of salaries of a representative sample of occupations in States, county, and municipal governments. This survey will supplement the annual survey of professional, technical, and clerical occupations in private industry.

BLS has planned a regular collection of information on employer expenditures for fringe benefit payments to workers. Biennially, estimates would be prepared for the manufacturing and nonmanufacturing segments of the private economy, with separate detail for production and nonproduction workers. In alternate years, special studies would be made of specific industries having significant national interest. During 1966, a start was made on the specific industry studies. The additional funds for 1967 ($308,000) would provide for the biennial surveys. In addition, an annual report would be made on the value of major collective bargaining settlements, including both the cost of wage increases and of changes in fringe benefits.

The annual survey by the Bureau of Labor Statistics of occupational wage rates in the machinery industries is being placed on a biennial basis to conserve funds ($75,000) and reduce reporting burden.

Productivity measurement.—An amount of $100,000 is included for the Bureau of Labor Statistics to increase the number of major industries for which separate productivity estimates are prepared. Bureau of Labor Statistics presently prepares estimates for 30 separate industries. Possibly five to seven industries would be included the first year of the expanded program, some in manufacturing and some in nonmanufacturing. The manufacturing estimates would be prepared from information now available, but the nonmanufacturing estimates may require the collection of additional data, for which planning would be done with the funds requested for 1967.

DEMOGRAPHIC AND SOCIAL STATISTICS

Health and vital statistics.—The 1967 budget for the National Center for Health Statistics includes a recommended increase of approximately $900,000. This includes $800,000 about equally divided between (1) a decennial revision in scope and design of the health interview survey which would support development of health data for States, metropolitan areas and other smaller areas and population groups, and for areas and people with particular health problems; and (2) surveys of the medical manpower and health facilities of the Nation to provide information needed in relation to the health insurance, medical assistance, and poverty programs. The recommendation also includes $100,000 for printing and distributing standard birth, death, marriage, and divorce certificates to the States, for revised printing of the physicians handbook, and for necessary work to adapt the World Health Organization decennial revision of the international classification of diseases for use in the United States in indexing of hospital records and for classification of morbidity and mortality data.

Population statistics.—The Census Bureau is exploring the use of administrative records to improve current estimates of family income and other population characteristics and to provide prompt, economical, and consistent estimates of population and family incomes for small areas such as counties and standard metropolitan statistical areas for intercensal years. Use of large-scale automatic data processing techniques is required. Funds ($350,000) are recommended to extend this developmental program during 1967.

Educational statistics.—The reorganization of the Office of Education has provided for more centralization of both survey work and data processing in the National Center for Educational Statistics. The 1967 budget includes $750,000 for expanding and improving both the regular statistical program and further development of the analytical model of the educational systems of the United States. The sum of $2.9 million is included for developing a new program of collecting educational achievement data on a uniform nationwide basis for the purpose of assessing the quality of education, for the purchase of data to be collected as a supplement to the current population survey, and to initiate a survey of adult education and training for employment. Additional funds of $500,000 are recommended to cover administrative costs of greatly increased functions and for machine tabulating and printing.

Social security statistics.—An increase of $1 million is recommended for 1967 for an expansion of the research and statistics program. A major part of this increase is a result of the 1965 amendments to the Social Security Act which established a new program of hospital and supplementary medical insurance for the aged.

An additional increase of $260,000, for the program of economic and social survey contracts, would provide funds for two major studies: The retirement history study, a longitudinal study following a sample of aged persons through a series of periodic interviews for about 10 years; and the study of beneficiaries in nursing homes and other long-stay institutions, a supplement to the national study of the disabled.

Welfare statistics.—Primary emphasis in 1967 will be on reassessment of the series of statistical reports required by the Bureau of Family Services from the State public welfare agencies, including methods of obtaining and processing data. Particular attention will be given to statistics related to new medical programs administered by the Welfare Administration and to increased use of sampling and computerized processing of data. The Welfare Administration will also conduct a nationwide study of family living conditions from a sample of open and closed AFDC (aid to families with dependent children) cases and families who applied for but did not receive assistance. This study will provide information on the demographic, social, and economic characteristics of these families; on the effects of specific eligibility requirements; and on living arrangements and housing conditions. The total recommended increase is $900,000.

Economic opportunity.—In recognition of the substantial volume of statistical data required to support the antipoverty program of the Office of Economic Opportunity this activity appears for the first time in this analysis. While the major part of the data is obtained

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from other agencies, there is need for statistics specifically directed toward securing analytical detail with respect to the low-income population and appraising the effectiveness of the program.

The increase in funds ($2 million) for 1967 is for the purpose of planning, testing the feasibility, and for preparatory work in connection with prospective large-scale surveys which would both probe poverty in depth and be integrated with the 1970 censuses so that changes can be effectively measured.

PRICES AND PRICE INDEXES

An increase of $75,000 is requested to expand research by the Bureau of Labor Statistics in the wholesale price area, principally for commodities entering into foreign trade. Slight reductions will be effected by elimination of the breakdown in the wholesale price index by stage of processing and by discontinuance of the weekly wholesale price index. Although weekly data on the small samples which had been used for the latter will no longer be collected weekly, data will be collected for the week falling in the middle of the month as an advance indicator of the monthly index.

An increase of $125,000 was appropriated for 1966 for work by the Bureau of Labor Statistics on standard budgets for city workers' families. A further increase of the same amount is requested for 1967. This will provide for the compilation of current standard budgets for selected types and sizes of families at two levels of living—"minimum adequate" and "modest but adequate."

PRODUCTION AND DISTRIBUTION

The major program changes in this area are in activities of the Department of Agriculture. An amount of $113,000 is requested to complete the long-range program for improving crop and livestock estimates by the Statistical Reporting Service. This repeats the 1966 budget request for this work. Recommended program increases for the Economic Research Service include $650,000 for intensified research on rural economic development, with principal emphasis on depressed rural areas, and $150,000 for economic analysis of water management and use problems in agriculture. These amounts are partially offset by increased productivity and by a $200,000 decrease for a one-time study in 1966 of the away-from-home market for food. Changes are also planned in the content of present programs as a result of completion or cutbacks in individual research and analytical projects and the initiation or expansion of others.

The only change recommended in the program of the Bureau of the Census in this area would provide approximately $70,000 to initiate an annual series on retail trade by merchandise lines similar to those on which data were obtained in the 1963 Census of Business.

CONSTRUCTION AND HOUSING

This area continues during 1967 at substantially the 1966 level. There will, however, be some change in content of the program as some projects are completed and others are initiated.

The Department of Housing and Urban Development will extend its program of statistical data on housing markets and costs. It will also conduct studies of specific aspects of urban development, markets for specialized types of housing, and financing and cash-flow requirements of various types of construction enterprises.

The Bureau of the Census will continue during 1967 to institute improvements in its value of construction-put-in-place statistics. Extension of progress reporting on nonresidential construction to the Western States will become fully operational. Development of new construction patterns for 1–4 family residences, begun in 1966, will be completed and made operational in 1967.

NATIONAL INCOME AND BUSINESS FINANCIAL ACCOUNTS

The major changes proposed for this area are for work by the Office of Business Economics, as described below. In addition, a small increase ($50,000) is recommended for the Economic Research Service for basic statistics and related research on farm income parity.

National economic accounts.—Program increases of $400,000 are recommended for the Office of Business Economics to improve the balance-of-payments statistics, to expand the work on input-output, and to initiate a program for a comprehensive accounting of the Nation's capital stock.

Extensive improvements on balance-of-payments work, including those suggested by the Budget Bureau's Balance of Payments Review Committee (Bernstein) and by the congressional Joint Economic Committee, are required for adequate presentation of major types of international transactions and for analyses of balance-of-payments developments. This work includes particularly the establishment of an inventory of foreign investments. $200,000 is recommended for this program.

The expansion of input-output work pertains mainly to the calculation of a 1963 table involving the expansion of industry detail to more than double the number of industries in the previous (1958) table. This is expected to provide a considerably more useful tool for market analysis and add flexibility to the use of input-output for general economic analysis. $100,000 is requested for this work.

In connection with the program for measurement of national wealth, the Office of Business Economics will expand its work on the measurement of fixed business capital, business inventories, and consumer assets; and initiate measures of Government real wealth. Part of this program will involve construction of complete balance sheets for the Nation and the major sectors of the economy. The Office of Business Economics is also expected to provide guidance to the Census Bureau and other agencies collecting primary data pertaining to wealth. $100,000 is requested for these activities.

PERIODIC PROGRAMS

In 1967, work on the 1963 Economic Censuses and the 1964 Census of Agriculture will be completed. The 1967 budget also provides for continuation of work on the preparation for the economic censuses and census of governments covering the calendar year 1967, for which the main task of data collection will be reflected in the 1968 budget.

Table K-2. **OBLIGATIONS FOR PRINCIPAL STATISTICAL PROGRAMS, BY AGENCY** (in millions of dollars)

Agency	1965 actual	1966 estimate	1967 estimate
CURRENT PROGRAMS			
Department of Agriculture:			
Economic Research Service	10.9	12.1	12.5
Statistical Reporting Service	11.9	12.4	12.9
Department of Commerce:			
Bureau of the Census	15.2	15.7	16.2
Office of Business Economics	2.3	2.5	3.0
Department of Defense: Corps of Engineers: Domestic shipping statistics	1.0	1.1	1.1
Department of Health, Education, and Welfare:			
National Center for Educational Statistics	2.1	3.5	7.6
National Center for Health Statistics	6.3	7.2	8.2
Social Security Administration: Statistical and research activities	4.6	5.9	7.3
Welfare Administration: Statistical and research activities	1.5	1.7	2.6
Department of Housing and Urban Development: Urban studies and housing research	.4	.8	.8
Department of the Interior: Bureau of Mines: Mineral statistics	2.4	2.7	2.6
Department of Labor:			
Bureau of Employment Security: Statistical activities	2.5	3.1	5.2
Bureau of Labor Statistics	18.5	20.0	20.8
Office of Manpower Policy, Evaluation, and Research: Statistical activities	3.7	4.0	4.1
Treasury Department: Internal Revenue Service: Statistical reporting	6.1	5.0	5.0
Civil Aeronautics Board: Statistical and research activities	.5	.6	.6
Federal Home Loan Bank Board: Statistical activities	.7	.8	.9
Federal Trade Commission: Financial statistics	.3	.3	.3
Interstate Commerce Commission: Reports and statistics	.9	.9	.9
National Science Foundation: Statistics and special analyses	3.5	4.0	4.2
Office of Economic Opportunity: Statistical and research activities	---------	2.4	4.4
Securities and Exchange Commission: Operational and business statistics	.3	.3	.3
Total, current programs	95.6	107.0	121.6
PERIODIC PROGRAMS			
Department of Commerce: Bureau of the Census:			
1963 economic censuses	5.8	2.7	.1
1964 Census of Agriculture	15.5	5.8	1.8
1967 economic censuses	---------	1.2	3.2
1967 Census of Governments	---------	.2	1.4
Preparation for 19th Decennial Census	.9	2.3	3.2
Registration and voting statistics	---------	1.2	---------
Modernization of computing equipment	---------	---------	2.0
Department of Agriculture: Statistical Reporting Service: Computer purchase and related costs	---------	1.7	.5
Department of Health, Education, and Welfare: National Center for Health Statistics: Computer purchase and related costs	---------	---------	1.1
Total, periodic programs	22.2	15.1	13.3
Total, principal statistical programs	117.8	122.1	134.9

Preparation for 19th Decennial Census.—Work will continue on establishing the basis for collecting a large part of the 19th Decennial Censuses of Population and Housing by mail. A computer-based geographic coding system will be developed to assign individual addresses to the geographic areas which must be identified in the census publications. Other planning work will include problems of census taking in hard-to-enumerate areas, questionnaire design under self-enumeration conditions, the development of statistical measures relating to the condition of housing and pilot testing of proposals for new or alternative census questions.

Computers.—All amounts recommended for the purchase of computer and related costs are contained in the periodic statistical program. Although some of this equipment is used to process current statistics their purchase is included under the periodic program since the amounts represent long-term capital investment and for analytical purposes the total cost should not be charged to the current statistical program.

Mr. Chairman, this concludes my formal statement. I am ready for questions.

Senator PROXMIRE. Mr. Schultze, in the first place, I want to recognize that you are probably in the toughest job in Government.

You have to be the "no" man. You have to be the fellow who makes the Members of Congress angry because you deny their pet projects and you have to take a lot of criticism.

I think this is a very fine and constructive job you have done for us this morning. I would like to start off on some critical aspects of it.

You stress throughout here, in the first part of your statement at least—"The central story of the 1967 budget, in its fiscal aspect, is the change in emphasis from economic stimulation to economic restraint." And then you continue in that theme.

You say, "Taken together with the projected course of private spending, they call for a fiscal policy shift away from economic stimulation toward economic restraint."

Yesterday, when the Chairman of the Council of Economic Advisers was here, he agreed with me that, whereas there was fiscal drag in 1958 through 1965 virtually—or 1964—now the budget is pretty much neutral; there was restraint, now there is none.

The fact is, that if you examine your table 1—and if in 1965 we had the same level of unemployment that we have today; and if in 1966, the fiscal year, for the whole period there was the same level of unemployment as projected for 1967—you would be showing a greater surplus on the national income basis, which is the best indication of the effect of the budget, as I understand it, on the economy than you show in 1967, so that if this is a restraining budget it is one that restrains less than it did before.

Mr. SCHULTZE. It seems to me, Mr. Chairman, that you have to take this into account.

You have to take into account the situation in which this budget was prepared. Between the time my predecessor appeared here last year and now, our estimates of expenditure needs for the conflict in Vietnam have increased by $10½ billion.

In essence, what this budget does is provide for noninflationary financing of that increase. Instead of continuing the scheduled tax reductions in the excise tax area that were coming forward, it asks for postponement of those reductions.

It asks for some speedup in collections, both personal and corporate, as a modest means of restraining and a means of raising revenues; so in this sense, the budget does move from stimulation—the history, if you will, of the past 4 years—toward restraint in the context of providing the appropriate financing and fiscal offset to the relatively large—but by no means, of course, overwhelming—increase in expenditures for Vietnam. This is the context.

Senator PROXMIRE. I assume the budget was largely prepared before you could anticipate the escalation in Vietnam—much of it, or at least you didn't know what escalation you would have—and before you fully realized how sharply unemployment might drop and how strong the inflationary forces might develop. While you did moderate it by the proposals which the President made on taxes and so forth, it still, as compared with the previous budgets, has less drag and as a matter of fact is more stimulative, if you want to put it that way, than the previous budgets?

Mr. SCHULTZE. No, sir; I did not mean to leave the impression at all that we did not know in preparing the budget what the estimate of the Vietnam cost was; no sir.

What I did say was the context in which this budget was put together was to provide a restraint against the impact on the economy of the increase in expenditures for Vietnam. That is what I said. No, we did take that fully into account in preparing the budget.

Senator PROXMIRE. Well, there is less restraint than there was in preparing past budgets. The story here, as I say, if you assume the same level of unemployment in each of these years, the full employment surplus concept which the economists have been trying to get us to apply, would indicate that the 1965 and 1966 budgets are more restrictive than the 1967 budget?

Mr. SCHULTZE. No, I would say the 1966 budget—in particular, the last half of calendar 1965—does move toward a larger full-employment deficit than in the prior period, but then this pattern shifts again in 1967 to a much lower deficit, and the deficit tends to decline in 1967 throughout the fiscal year, moving toward even more active restraint at the latter part of the period.

Senator PROXMIRE. Secretary McNamara appeared before a subcommittee of this committee a few days ago and what he said was pretty much affirmed again by Mr. Ackley, and that is that the Vietnam war, while it is a tragic and terrible situation and men are making a terrific sacrifice and it has been able to seize the Nation's attention, really isn't having much of an economic impact on this enormous economy of ours.

McNamara pointed out that in 1965, and I think that was affirmed by Mr. Ackley yesterday, 7.6 percent of our gross national product will go to defense and in 1967 it will be 7.7 percent, practically no increase at all; furthermore, that the amount spent in past years was substantially greater.

I have seen a chart that shows between 1955 and 1964 we never spent less than 8.2 percent of our gross national product on defense; that in 1956 we spent 8.8; in 1957, 8.9; in 1958, 8.9, and so forth, so this—in terms of the impact of the defense effort, including Vietnam, on the economy—is more of a peacetime economy in that narrow sense than before.

To argue that it was Vietnam that is causing us to be concerned, it seems to me is to overlook, deemphasize, the other factors.

Mr. SCHULTZE. This is why—in a sense, Mr. Chairman—this is an attempt to present a budget which takes a balanced view of this. On the one hand, you are quite correct, compared, for example, to the impact of the buildup in Korea, the buildup in Vietnam is much smaller.

Another way to look at it is that the increased expenditures for Vietnam over the 2-year period, 1965 through 1967, represent roughly one-eighth of the increase in gross national product.

If you take administrative budget expenditures, they rise roughly $10 billion over a 2-year period, with an $80 to $95 billion rise in gross national product, so that while it is significant, it is not of the order of magnitude of Korea. It is much less than that. It has an impact on the economy but a much smaller impact certainly than was the case in Korea.

Senator PROXMIRE. It has a smaller impact than it had throughout the peacetime period, from Korea until last year?

Mr. SCHULTZE. The fact that it is rising; you are quite correct that the total expenditures will be a smaller percentage of GNP, but they are a slightly rising percentage. So, I say this budget attempts to take a balanced view of this—on the one hand, recognizing the increase in expenditures in Vietnam, but, on the other hand, not going overboard, if you will, on the assumption that this is the same order of magnitude that we had in Korea. As I say, it is an attempt to take a balanced view of it.

Senator PROXMIRE. There has been a lot of discussion about the sale of assets as a means of holding down spending.

Mr. SCHULTZE. Yes, sir.

Senator PROXMIRE. As I understand it, $4.7 billion of the negative spending, that is, the amount that you reduce the spending administrative budget, is simply a matter of selling assets.

How does this compare with past policy, past policy in the Kennedy administration and the Eisenhower administration? Is this an extraordinary record of sale, or is it comparable?

Mr. SCHULTZE. Let me give you the figures.

In 1967, the estimate is $4.7 billion. In 1966, it is $3.3 billion; and in 1965, it was $1.6 billion. In 1964, it was $1 billion. There has been a steady record of increases.

It has, as I indicated in my testimony, been a policy affirmed by all of the last three Presidents. President Eisenhower in a number of cases, made provision for the sale of assets.

In 1963, an interdepartmental committee appointed by President Kennedy reported on Federal credit programs and in that report, urged that private credit be substituted for public credit wherever possible and that the Federal Government in essence should use the private credit mechanism as much as possible.

In 1962 or 1963—I am not sure of the exact date—the minority of the Ways and Means Committee urged that the administration increase its sale of assets. We believe that this is an effective means of, on the one hand, holding down Government expenditures, and, on the other hand—perhaps, even more importantly—utilizing the private market mechanism as much as possible in these credit programs.

Senator PROXMIRE. Will you give us your judgment, as a competent economist, of a comparison of the effect of this kind of activity on the part of the Federal Government on inflation and the level of prices, the economic impact, with the effect of reducing spending or with the effect of increasing taxes? Is it of a different order?

Mr. SCHULTZE. It is of a different order, that is correct, sir. It is of a different order.

Senator PROXMIRE. Well, to what extent?

Mr. SCHULTZE. I can't give you a number, but it is a different order of magnitude.

Senator PROXMIRE. It has little effect? Would it be better if we want to measure the impact of this budget to pretty much discount it? In other words, consider it a deficit of $6.5 billion rather than the $1.8 billion roughly.

Mr. SCHULTZE. No, sir. I think the best way to look at this is to look at the Federal sector of the national income and product accounts, which excludes both the positive side of Federal credit programs and the negative side; namely, the sale of financial assets. Those numbers you have before you, and they show a half billion dollar deficit in 1967 in the national income accounts, which omit both aspects of this credit picture.

What sales really do is make the administrative budget closer to the national income accounts budget. Essentially, it tends to net out Federal purchases and sales of financial assets, so it makes the administrative budget closer in concept and in actual figures to the national income accounts budget, which in general—although none of these is perfect, of course—tends to be a better measure of economic impact.

Senator PROXMIRE. My time is up, but I would like to ask the permission of the committee to ask one brief question on this; and that is, can you give us any notion of what this is doing to the Government obligations in terms of guarantees?

As I understand, in the case of the Small Business Administration and other areas the Federal Government instead of providing the money itself will encourage the banks to provide the money. The Federal Government steps in with a guarantee.

How big is the guarantee program becoming as an obligation of the Federal Government?

Mr. SCHULTZE. Table E-2, from our Special Analyses booklet, covers Federal credit programs; there are figures provided for all Federal credit programs, both in direct loans and guarantees. If you look at the 1967 estimate, you can see for any given program the magnitude of the outstanding guarantees and the magnitude of the outstanding direct loans.

(Table E-2 follows:)

TABLE E-2.—*Outstanding direct loans and guaranteed and insured loans for major Federal credit programs classified by agency or program*

[In millions of dollars]

Agency or program	1965 actual		1966 estimate		1967 estimate	
	Direct loans	Guaranteed and insured loans	Direct loans	Guaranteed and insured loans	Direct loans	Guaranteed and insured loans
Office of Economic Opportunity	17		47		71	
Department of Agriculture:						
Commodity Credit Corporation	2,115	419	1,874	819	542	1,225
Rural Electrification Administration	4,072		4,262		4,456	
Farmers Home Administration	1,990	727	2,054	1,249	1,444	1,997
Department of Commerce:						
Economic Development Administration	126		183		246	3
Maritime Administration	109	419	101	454	92	488
Department of Defense: Military assistance credits	79		40	110	75	287
Department of Health, Education, and Welfare:						
Office of Education	538		758	2	848	7
Public Health Service	13		38		59	
Department of Housing and Urban Development:						
Federal National Mortgage Association	2,121	300	1,427	1,930	1,042	4,505
Federal Housing Administration	527	49,042	490	52,448	451	56,960
Public housing program	60	5,033	59	5,541	59	6,124
College housing program	1,927		2,170		1,651	
Urban renewal program	196	1,382	214	1,647	251	1,867
Other major programs	342		421		441	
Department of Interior: Reclamation loans	90		105		118	
Department of State: Agency for International Development	8,997	144	10,510	306	12,030	492
Treasury Department:						
Loans to District of Columbia	139		149		193	
Foreign loans	3,763		3,728		3,627	
Veterans' Administration	1,649	30,951	868	30,097	605	28,924
Export-Import Bank of Washington	2,490	2,617	2,091	3,447	1,888	4,418
Small Business Administration	1,147	104	1,072	209	662	302
Total by type of assistance:						
Major agencies or programs	32,507	91,138	32,661	98,259	30,851	107,599
Other agencies or programs	547	276	450	288	614	256
All agencies	33,054	91,414	33,111	98,547	31,465	107,855

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

Congressman Curtis?

Representative CURTIS. I would like to pursue this a bit so as not to lose the continuity, since the Senator is certainly bringing forward some basic points.

First, let me reiterate what the minority in the Ways and Means said. I certainly am pleased to see this movement toward substituting private capital for public for structural reasons, but I would argue that this is going to create further pressures in the private capital market and thus create pressures for increased interest rates. I see you shake your head. Why would you argue that it won't?

Mr. SCHULTZE. The major reason is that as you sell these assets you tend to reduce the Federal deficit.

Representative CURTIS. But we aren't. If we were doing that I would agree with you, but we are not. You see, you are increasing expenditures. In this very outdated system of Federal accounting, the sale of assets is entered as a reduction in expenditures, but it really isn't. You have increased your expenditures really, haven't you, and then said you have reduced them because you have sold assets?

Mr. SCHULTZE. Well, may I respond to that in two different ways?

Representative CURTIS. Certainly.

Mr. SCHULTZE. First, this does reduce the Treasury's requirements to borrow from the public. Hence, the pressure on the capital markets is offset. It isn't an exact wash, because these aren't exactly the same investors—in one case selling out and in the other case having the Treasury borrow—but the impact on the capital markets, while not exactly the same, is fairly close.

Representative CURTIS. Yes, but let me interrupt again because I want to zero in on this. If you were actually doing that and cutting expenditures, really cutting expenditures, I would agree with you, but you are not. You have entered this in the budget as if there is a reduction in expenditures, which it isn't at all. Your wash has occurred in the Federal budget where you have sold capital assets and increased expenditures. But then you say it washes because you have done it. You can't use the same item twice and then come on over and say it doesn't have an inflationary effect. If we could take this money and apply it on the Federal debt then it would be what you say, but we aren't doing that, not in the budget you have presented us.

Mr. SCHULTZE. But, Mr. Curtis, what happens, of course, is that by entering these the way we do as a negative entry on the expenditure side we are presenting the net impact on the taxpayer of these credit programs.

For example, we have over the past years accumulated $33 billion worth of expenditures charged to the Federal Government on the positive side, which is the value of the net loans outstanding. What this does is present in the Federal Government's account the same thing that a bank does when it shows its statement—the net increase in assets. Essentially this is what we have here, and it is a perfectly legitimate way of doing it. We show the net increment—the net load, if you will, on the taxpayers—of a Federal credit program by showing the net increment in credit outstanding.

Representative CURTIS. In one sense you show it. In another sense you hide the very critical thing, which is that your Federal expenditures have increased. Instead, you show a wash item. All I am arguing is that when we are talking about the impact of the budget you have presented, when you substitute $3.3 billion of private credit without reducing the Federal debt by $3.3 billion, because you have increased your expenditures by the $3.3 billion, the net result is an inflationary effect on the private sector.

Mr. SCHULTZE. Again, let me come back to the point. Just as in the case of the private monetary system, for example, if you show during a given year a zero increase in net loans outstanding, it is the best measure of the impact. We think here that the net figure is the best measure of the impact. That is point No. 1.

Point No. 2, with respect to the inflationary impact, is that you can't look at any one set of expenditures and say they are inflationary.

I think the best point is: given the net results of all of this—both the plus and the minus of the Federal budget and the rest of the economy—we show whichever you want to use—a $1.8 billion deficit on the administrative budget, a half billion surplus in the cash budget, a half billion deficit in the national income accounts budget—all associated with a $722 billion GNP, plus or minus $5 billion, which we think is noninflationary. So, putting them all together, we do not think it is inflationary.

Representative CURTIS. What you are doing is just assuming that expenditures must go up, and this is the critical issue. When you increase Federal expenditures as you are doing and you have us accept such a thing you argue this is the best way to handle it in a mix of new taxes, additional Federal securities being sold, or selling off capital assets. But what I am saying is that the increased expenditure itself is the thing that is creating the inflationary effect and if, instead of issuing Government bonds, you move into the private capital market by asking them to substitute private capital for Government capital, you have tightened the capital market.

Mr. SCHULTZE. Let me put it another way.

Representative CURTIS. Don't you agree with that syllogism?

Mr. SCHULTZE. No, sir.

Representative CURTIS. I don't understand.

Mr. SCHULTZE. What you are telling me is that you believe—and obviously reasonable men can differ about this—that we should have reduced Federal expenditures elsewhere by whatever you want—$2, $3, or $4 billion.

Representative CURTIS. We did get into that argument. Yes, indeed, I am arguing that, but I am simply saying on your presentation of increasing expenditures that this is the real thing that creates the inflationary effect.

Then when we go into the area of how we finance it through additional taxes, additional Federal debt, or selling off capital assets; however you finance it, it is going to be inflationary.

Mr. SCHULTZE. This is where I disagree, Mr. Curtis.

Representative CURTIS. Except for taxes. Increased taxes won't, but the other two would.

Mr. SCHULTZE. I guess maybe our definitions of "inflationary" differ. What I am saying is that we do not think that—taking all of these into account together: the expenditures including the impact of sale of assets and the tax measures, taken in context with the behavior of the economy—this budget is inflationary.

We do believe that it tends to give us approximately the right balance we need to maintain noninflationary growth. You are arguing, and—as I say, reasonable men can differ—that this is still inflationary, but I don't think you can do that solely from taking a look at the sale of assets. I think you have to look at the whole budget.

Representative CURTIS. You have taken one of the components, which I have always argued we should do, anyway. But inasmuch as your side has usually dealt in aggregates, I think I am certainly justified in presenting to you this aggregate, and you are now defending it by saying if you go into components you might find that it isn't inflationary.

Mr. SCHULTZE. No, sir.

Representative CURTIS. I think that is where we are, but let us leave that dialog here for the moment. One thing I would have liked to have received is the capital accounting of the Federal assets. This is something Ways and Means has each time asked. When we zeroed in on this and recommended that we get rid of some of these capital accounts, we always referred to the various levels.

I think we were starting out with a figure—and I am not sure of the year, either—but something around $27 billion, weren't we, not all of which are marketable, of course?

Mr. SCHULTZE. Oh, you mean the total volume. I think it is about $33 billion actually.

Representative CURTIS. Is it about $33 billion? Yes. I would like to have for the record, going back to, say, 1960, or going back 5 years or so, what our capital accounts are in this area that we are talking about; what it has been each year, and particularly what it will be after we sell off $3.3 billion; and then after we sell off $4.7 billion, realizing at the same time you are generating more capital of this nature.

Mr. SCHULTZE. I have the figures here for 3 years.

Representative CURTIS. Would you give them to us?

Mr. SCHULTZE. Taking the grand total—which includes of course the loans of AID and other things—but taking the grand total the portfolio of direct loans, mortgages, et cetera, was $33.1 billion at the end of fiscal year 1965; $33.3 billion at the end of fiscal year 1966; and $31.5 billion at the end of fiscal year 1967.

Representative CURTIS. That is helpful. Then if you go back——

Mr. SCHULTZE. Go back a few years; yes, sir.

(The table which follows was subsequently supplied by the Bureau of the Budget.)

Outstanding direct loans of Federal credit programs fiscal years 1961–67

[In millions of dollars]

	1961 actual	1962 actual	1963 actual	1964 actual	1965 actual	1966 estimate	1967 estimate
Office of Economic Opportunity					$17	$47	$71
Department of Agriculture:							
Commodity Credit Corporation	$917	$1,353	$1,768	$2,437	2,115	1,874	542
Rural Electrification Administration	3,367	3,525	3,694	3,869	4,072	4,262	4,456
Farmers Home Administration	1,087	1,293	1,551	1,759	1,990	2,054	1,444
Department of Commerce:							
Economic Development Administration		1	25	71	126	183	246
Maritime Administration	154	131	126	113	109	101	92
Department of Defense: Military assistance credits	57	181	185	53	79	40	75
Department of Health, Education, and Welfare:							
Office of Education	131	206	296	406	538	758	848
Public Health Service					13	38	59
Department of Housing and Urban Development:							
Federal National Mortgage Association	3,461	3,324	2,883	2,623	2,121	1,427	1,042
Federal Housing Administration	448	556	633	596	527	490	451
Public housing program	97	97	94	48	60	59	59
College housing program	958	1,188	1,476	1,700	1,927	2,170	1,651
Urban renewal program	79	143	129	151	196	214	251
Other major programs	66	104	158	262	342	421	441
Department of Interior: Reclamation loans	35	52	67	78	90	105	118
Department of State: Agency for International Development	4,216	5,169	6,121	7,410	8,997	10,510	12,030
Treasury Department:							
Loans to District of Columbia	34	73	105	121	139	149	193
Foreign loans	[1] 4,010	[1] 3,957	3,873	3,784	3,763	3,728	3,627
Veterans' Administration	1,618	1,804	1,630	1,694	1,649	868	605
Export-Import Bank of Washington	3,369	3,569	3,296	2,706	2,490	2,091	1,888
Small Business Administration	481	694	817	924	1,147	1,072	662
Total major programs	24,576	27,420	28,926	30,805	32,507	32,661	30,851
Other agencies or programs	508	534	533	521	547	[1] 615	614
All agencies	[1] 25,084	[1] 27,954	29,459	31,326	33,054	[1] 33,276	31,465

[1] Revised.

Representative CURTIS. And, to the extent you can, give us the breakdown.

Incidentally, on the sales of $3.3 and $4.7 billion, are any of these in the realm of international economics?

Mr. SCHULTZE. Yes, sir; the Export-Import Bank is selling some of this, but these, of course, are fairly hard loans. We do not have in here the sale of any——

Representative CURTIS. No, I don't think anyone would buy them. I am very pleased at this substitution of private capital for public, but I wish we would extend the same principle into foreign economics. I have felt that there we are going in the opposite direction. We are really drying up private capital investment abroad and substituting something very questionable. I don't know whether you can even call them loans. They are not really loans at all.

They are grants, I regret to say, but there seems to be a different policy for the domestic economy from that of the international, and yet one of our big problems is our international balance of payments.

I see my time is up and I do want to come back. One thing I want to direct attention to when I come back is the budget for 1966. Too much emphasis has been on 1967. We are talking about inflation right now and whether or not this $6.9 billion imbalance for fiscal 1966 at the time of high economic activity isn't very highly inflationary.

Senator PROXMIRE (presiding). Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Schultze, in your statement you talk about the optimum rate of 92 percent which most firms desire to maintain in their productive capacity. You did not indicate what you think it is now. Where are we now?

Mr. SCHULTZE. Eighty-nine percent, as of December.

Senator JORDAN. Approaching the optimum; lacking about 3 percent?

Mr. SCHULTZE. Correct, sir. It was 88 percent a year ago, 89 percent now, but compared to 92 percent.

Senator JORDAN. The President's budget message states that because of the rising costs of war in Vietnam certain defense programs will be deferred. Which programs are these?

Mr. SCHULTZE. The major one, Senator, is the deferral of a number of construction and family housing programs that the Department had. It deferred those programs wherever they weren't really directly and urgently needed. I may have to correct this number for the record, but my recollection is that the appropriations amount involved on that is about $620 million. The expenditure effect is about $325 million. That is the largest one. I would actually have to give you for the record what some of the others are, because I don't have the rundown.

Senator JORDAN. Will you supply it, please?

Mr. SCHULTZE. Yes, sir.

(The following was later provided for the record by the Department.)

Because of the heavy financial requirements of our military operations in southeast Asia, a number of Defense programs not critical to shortrun combat effectiveness have been deferred or "stretched out." The most significant and identifiable actions concern:

(1) *Military construction.*—Deferral of authorized noncombat projects not related to the support of military operations in southeast Asia (e.g., replacement of administrative and school buildings, bachelor officers' quarters,

barracks, etc.) is estimated to reduce new obligational authority requested for fiscal 1967 by $460 million and expenditures by $220 million.

(2) *Family housing.*—The 8,500 units funded in fiscal 1966 have been deferred specifically because of the southeast Asia situation, and no new units are requested for 1967 for the same reason. It is estimated that 1967 new obligational authority requested is $160 million lower, and expenditures $105 million lower than they would otherwise be but for these actions.

These programs were already approved and authorized by the Congress; their deferral is relatively easy to characterize. For several reasons it is not possible to characterize as due to southeast Asia the many other individual programs deferred in preparation of the 1967 budget. In the course of the joint Office of the Secretary of Defense-Budget Bureau review of the military service budget requests, well over 1,000 individual "subject issue" or "program change proposal" decision documents were prepared and acted upon in arriving at the Department's budget request. Because the budget review process was premised on a required higher level of justification and more stringent than usual screening of priorities, program reductions were generally made without specification of the character of the reduction.

Senator JORDAN. The administration proposes revenue increases next year, the bulk of which represent changes in the timing of tax payments?

Mr. SCHULTZE. Right, sir.

Senator JORDAN. Not changes in final liabilities?

Mr. SCHULTZE. Correct, sir.

Senator JORDAN. To what extent do you think these changes will restrain private demand?

Mr. SCHULTZE. Again I can't give you a precise number on that, Senator. We think that they do restrain private demand, but that they clearly, on the other hand, restrain it less than if tax rates themselves had been increased.

Now, where between zero and the full effect of the tax rate increase this would fall, I couldn't give you a number. We did take this into account in estimating the volume of private investment and the like that goes into our projection of gross national product in the coming year, but I can't give you a specific amount.

Senator JORDAN. Could you make an estimate or guess for the record? Obviously, if businesses are paying accelerated withholding, these funds are not going to be available, for example, for capital expansion, for plant expansion.

Mr. SCHULTZE. It is a restraining influence on plant expansion.

Senator JORDAN. Yes.

Mr. SCHULTZE. Except, having taken that into account our estimates would still indicate that manufacturing capacity would expand about 6 percent next year, which is, I think, the largest expansion in quite some period of time.

In other words, investment will rise significantly. The expansion of capacity will occur, although without these tax measures there may have been some more expansion by a number that I couldn't possibly give you.

Senator JORDAN. The Economic Report shows that manufacturing in the fourth quarter of 1965 was operating at the rate actually of 91 percent. You gave me a figure of 89 percent. Does your 89 percent cover the whole year, or is the 91 percent wrong in the Economic Report?

Mr. SCHULTZE. We are looking at two different pages in the Economic Report. If you take a look at manufacturing capacity which is given in table 9 of the report, industry by industry and with a total, you will notice that the output as a percentage of capacity in December 1965 is 89 percent. The 91 percent I must say I am not familiar with, Mr. Jordan.

Senator JORDAN. Let us see. Table C–34, about halfway down, shows a utilization rate of 91 percent in 1965; and down further, in the fourth quarter, 91 percent, too.

Mr. SCHULTZE. Yes, sir. This is where you get into differences among statisticians. The figures in table 9 are taken primarily from the McGraw-Hill Co., which runs a survey of industry.

The figures in table C–34 represent another technique of getting at this very complicated measure, and there is a 2-percent difference between them. But if you want to compare optimum rate with actual rate, you have to use McGraw-Hill because they ask both questions of manufacturers: Where would you like to be? and where are you?

Senator JORDAN. I see.

Mr. SCHULTZE. I apologize for differences among statisticians.

(Both tables are reprinted herein for clarification of the issue:)

TABLE 9.—*Manufacturing capacity utilization, 1964–65*

Industry	Output as percent of capacity [1]		Preferred rate (percent) [2]
	December 1964	December 1965	
Total manufacturing [3]	88	89	92
Iron and steel	88	75	91
Nonferrous metals	98	103	95
Machinery	87	91	91
Electrical machinery	84	91	93
Autos, trucks, and parts	95	93	96
Other transportation equipment	80	93	88
Fabricated metals and instruments	87	94	92
Stone, clay, and glass	80	85	88
Chemicals	85	85	90
Paper and pulp	94	93	97
Rubber	96	94	94
Petroleum and coal products	91	91	95
Food and beverages	86	84	86
Textiles	96	98	96
Miscellaneous manufacturing	88	89	94

[1] Data for 1964 except iron and steel from McGraw-Hill; estimates for iron and steel for 1964 and all industries for 1965 by Council of Economic Advisers after consulation with McGraw-Hill.
[2] From McGraw-Hill survey of business plans for new plant and equipment, April 1963.
[3] Not comparable with data in table C-34 because of differences in methods of computation.

Sources: McGraw-Hill Publishing Co., Board of Governors of the Federal Reserve System, and Council of Economic Advisers.

TABLE C–34.—*Manufacturing capacity, output, and utilization rate, 1948–65*

Period	Capacity [1]	Output (1957–59=100)	Utilization rate (percent) [2]
1948	80	69	86
1949	84	65	78
1950	87	76	88
1951	90	82	91
1952	94	85	90
1953	100	93	93
1954	104	86	83
1955	108	97	90
1956	113	100	88
1957	119	101	85
1958	122	93	76
1959	126	106	84
1960	131	109	83
1961	134	110	82
1962	139	119	86
1963	145	125	86
1964	151	133	88
1965 [3]	160	145	91
	Seasonally adjusted		
1961: I	133	103	78
II	134	108	81
III	135	112	83
IV	136	115	85
1962: I	137	117	85
II	138	119	86
III	139	120	86
IV	141	120	85
1963: I	142	121	85
II	144	125	87
III	145	126	87
IV	147	127	87
1964: I	148	129	87
II	150	132	88
III	152	135	89
IV	154	136	88
1965: I	156	141	90
II	159	143	90
III	161	146	91
IV [3]	163	148	91

[1] For description and source of data see Frank de Leeuw "The Concept of Capacity," Journal of the American Statistical Association, December 1962, vol. 57, pp. 826–884, and Peter Gajewski "Manufacturing Capacity Measures and Current Economic Analysis," a paper presented at the 1964 American Statistical Association meetings. See also McGraw-Hill surveys on "Business Plans for New Plants and Equipment" for data on capacity and operating rates.
[2] Output as percent of capacity; based on unrounded data.
[3] Preliminary.

Source: Board of Governors of the Federal Reserve System (output) and sources in footnote 1 (capacity and utilization rate).

Senator JORDAN. How would you describe the pattern of day-to-day coordination which now exists between the Federal Reserve Board and the officials of the executive branch? Do you have any suggestions on how that coordination might be improved?

Mr. SCHULTZE. I think over the period of the past 5 years that coordination has been in general good. As you, of course, know, we think there was a fall from grace, if you will, in December. We think this was primarily a matter of bad timing. We think the mechanisms for coordination are good. The Federal Reserve Board is an individual body, and even with good coordination judgments will differ. I have no specific suggestions for better mechanisms of coordination.

Naturally, I would hope that we would be able to coordinate our timing better in the future.

Senator JORDAN. In your opinion does the administration favor the continuation of the independence of the Federal Reserve Board, or would it like to see the Federal Reserve Board under the control of the executive branch?

Mr. SCHULTZE. I believe that the present arrangement, which, I guess, is best described as independent, should be continued.

Senator JORDAN. The President's budget message states that between 1964 and fiscal 1967 budget expenditures other than interest and Great Society programs decreased by \$3.7 billion. How much represents savings in the Defense Department?

Mr. SCHULTZE. I don't believe I have that information with me. I can furnish it; perhaps \$2 billion, but I may have to correct that for the record.

Senator JORDAN. Yes; will you supply that, please?

Mr. SCHULTZE. I will be glad to.

(The following information was provided for the record:)

The expenditure reduction between 1964 and 1967 for the Department of Defense, aside from military assistance and added Vietnam costs, was \$2.8 billion.

Senator JORDAN. How much of this decrease is now being made up in special Vietnam costs which I gather, were excluded from that analysis?

Mr. SCHULTZE. I am not sure this is quite responsive, but, as I understand the question, special Vietnam costs, of course, far more than offset these reductions because they go to a \$10½ billion figure in terms of expenditures in 1967.

Senator JORDAN. Yes.

Mr. SCHULTZE. This was an attempt to analyze the budget outside of special Vietnam costs.

Senator JORDAN. When Secretary McNamara was before our subcommittee the other day I believe he said that the savings in the Defense Department had just about offset the cost of the war in Vietnam for the first 2 years of our effort there.

Mr. SCHULTZE. That is correct. The Secretary has a cost reduction program in which he has identified \$4.8 billion worth of savings, if I remember correctly, in 1965. The cost of Vietnam in 1966—so these are two different years—in the Defense Department is about \$4½ billion.

Senator JORDAN. About an offset in that area?

Mr. SCHULTZE. That is right.

Senator JORDAN. The President states economic stimulus is no longer appropriate, and you have dealt with a good deal of change in attitude of budget making to be now one of restraint. However, the New York Times said that the budget will be at least mildly expansionary and Business Week said the entire budget appears to have been structured so as to promise much more restraint than it will in fact deliver.

The point of both analyses is that the expenditure increases are unrealistically low and the increases in revenue as well as reductions in spending through sales of financial assets will do little or nothing to restrain private demand.

You have covered that somewhat in your colloquy with Congressman Curtis, but do you care to address yourself to that?

Mr. SCHULTZE. Let me first take the increase in revenues. You will recall, the increase in revenues from 1966 to 1967 is \$11 billion.

Of that increase, I believe $3.6 billion is the additional impact of the tax measures the President has recommended, leaving you something like $7½ billion other, you know, in addition to this.

Mr. SCHULTZE. Let me first take the characterization of the increase in revenues as being unrealistically low. You will recall, the increase in revenues from 1966 to 1967 is $11 billion. Of that increase, I believe $3.6 billion is the additional impact of the tax measures the President has recommended, leaving you something like $7½ billion other, you know, in addition to this.

The $7½ billion is about the normal rate of growth in revenues which we get from an economy growing normally. It is slightly higher than that because there is about a $600 million increase in receipts from seigniorage involved in that, but with the revenue estimates composed therefore of the new measures, an increase in seigniorage, and the growth that we get in revenues from the normal growth of the economy. The amount of growth that is projected in this budget is in normal line with what has been happening in the past. So in that sense, I see nothing unrealistic about this growth in revenues.

Senator JORDAN. Thank you, Mr. Schultze. Thank you, Mr. Chairman.

Senator PROXMIRE. Senator Sparkman?

Senator SPARKMAN. Mr. Schultze, in your statement you say that:

> All Federal expenditures for the poor will increase almost $4 billion over 1966 * * *.

Could you give use some idea as to what the total under that classification would be?

Mr. SCHULTZE. $21.4 billion, counting that part of the trust fund which can be allocated as going to the poor.

Senator SPARKMAN. $21.4 billion. Could you give us a little breakdown of that—not in too much detail but the principle items?

Mr. SCHULTZE. Yes, sir.

The principal items: $2.8 billion for education and training directed toward the poor. You will recall that the title I, of the Elementary and Secondary Education Act passed last year allocates funds precisely on criteria aimed at going into poorer school districts.

In the area of health, including hospital insurance for the aged, it is $1.6 billion.

In the social security cash benefit payments, the allocated part—to the best of our statistical ability—which goes to the poor is about $7.3 billion. Other cash benefit payments, very heavily public assistance, is $4.7 billion. That is primarily but not solely public assistance, plus some of the veterans payments which again are allocated on the basis of recipients with low incomes.

And other services, training, and the like, come to $2.8 billion. You add those up, and you get to the 21.4 I indicated.

Senator SPARKMAN. In making up this budget you include as a part of revenues, sale of assets to what extent?

Mr. SCHULTZE. We include as an offset to expenditures $4.7 billion worth of financial asset sales.

Senator SPARKMAN. I wonder if you could give in broad outline what they are?

Mr. SCHULTZE. Yes, sir. I have a copy and I will give it to you. It is in our special analyses booklet, which is the analysis of Federal credit programs; table E-4 gives it to you in detail, sir.

Senator SPARKMAN. That is good enough. Mr. Chairman, I would like that table included in the record.

Senator PROXMIRE. Without objection, that table will be included in the record at this point.

(The table referred to follows:)

TABLE E–4.—*Direct sales and participation sales of loans by major Federal credit programs*

[In millions of dollars]

Agency or program	1965 actual		1966 estimate		1967 estimate	
	Direct sales	Participation sales	Direct sales	Participation sales	Direct sales	Participation sales
Department of Agriculture: Farmers Home Administration	35	--------	40	--------	15	[1] 600
Department of Health, Education, and Welfare: Office of Education	--------	--------	--------	--------	--------	[1] 100
Department of Housing and Urban Development:						
Federal National Mortgage Association	264	200	182	485	49	[2] 520
Federal Housing Administration	6	--------	15	--------	65	--------
Public housing program	4	--------	--------	--------	--------	--------
College housing loans	12	--------	5	--------	5	[1] 820
Public facility loans	11	--------	5	--------	5	[1] 80
Veterans' Administration:						
Direct loan revolving fund	61	93	60	625	80	154
Loan guarantee revolving fund	266	7	260	200	290	106
Export-Import Bank of Washington	124	450	60	975	25	975
Small Business Administration	31	--------	45	[1] 350	--------	[1] 850
Total by type of sale	814	750	672	2,635	534	4,205
Grand total	1,564		3,307		4,739	
Present programs	1,564		2,957		1,889	
Proposed legislation	--------		350		2,850	

[1] Under proposed legislation.
[2] Includes $400,000,000 under proposed legislation.

Senator SPARKMAN. Let me say this, Mr. Schultze, I am one who has favored the sale of Government assets. I think we ought to sell them so far as feasible, but I wanted to ask you whether this would further tighten the money situation and produce pressure toward higher interest rates, which would be harmful to the smaller businessmen who have to rely on credit for running their business?

Mr. SCHULTZE. As I indicated in a colloquy earlier with Mr. Curtis, in general it will not—although you can't get this exactly—because this reduces the Treasury's requirements for borrowing. So the impact on the capital market, while not a complete wash, is fairly close to neutral.

Senator SPARKMAN. You feel that it is a pretty close offset?

Mr. SCHULTZE. Pretty close offset. I can't say it is an exact offset because these are not the same instruments that are being sold and factors like that. The capital market is a pretty complicated beast, but, in general, it is a fairly close offset.

Senator SPARKMAN. By the way, we do have rising interest rates at the present time, don't we?

Mr. SCHULTZE. They are certainly higher than they were 6 months ago or a year ago; that's correct.

Senator SPARKMAN. Did the December action on the part of the Federal Reserve Board produce higher rates?

Mr. SCHULTZE. Yes, sir. I think so. Well, it was a combination of response to higher rates elsewhere in the market and that action—in and of itself, I would presume—also had an impact.

Senator SPARKMAN. Aren't those higher rates going to have an adverse effect on small operations, small businesses that rely on credit to help carry on their business?

Mr. SCHULTZE. I would hesitate to call myself an expert on the specific impact of higher interest rates as between large business and small business.

I think it is probably more in terms of the kind of business rather than whether it is large or small. A small business which is earning good profits is in one situation compared to a large business which isn't.

I think, if pressed, I would probably have to say that it may have proportionately a larger impact on small business than on large, but I would hesitate to put myself out as an expert on this.

Senator SPARKMAN. How about such activities as homebuilding, home mortgages, and so forth? Is it bound to create a drag there?

Mr. SCHULTZE. Let me make two points with respect to that, Senator.

First, I think most objective observers would probably say that the impact of tighter money on housing is greater than its impact, let us say, on manufacturing investment. That's No. 1.

No. 2, in terms of having an adverse impact in the sense that housing construction would be less than it otherwise would have been, I think that is also the case. But, how much and how much this is adverse in the current state of the economy, again, I would hesitate to draw a final conclusion; but, I think you are correct in the sense that it does affect housing more than other parts of the economy.

Senator SPARKMAN. And, as a matter of fact, housing starts have been dragging for some time now, have they not?

Mr. SCHULTZE. That is true. My recollection is in December, the last report we have, they jumped again.

Senator SPARKMAN. Yes.

Mr. SCHULTZE. How much of this is seasonal, I don't know. For instance, it was an unusually mild December, unlike January. Again, whether this is a straw in the wind or just a freak, I don't know.

Senator SPARKMAN. Some time back—I believe it was in the latter part of November or December—Senator Proxmire held some hearings of the Small Business Subcommittee of the Banking and Currency Committee and we had a representative of the Bureau of the Budget. Who was it that appeared?

Mr. SCHULTZE. I appeared, Senator.

Senator SPARKMAN. I was thinking it was one of your assistants.

Mr. SCHULTZE. Excuse me. If you were talking about the participation sales legislation, I was there; but if it was some other hearing——

Senator PROXMIRE. I think that was the hearing.

Senator SPARKMAN. Well, we went over this question then about the deplorable situation that prevails in the small business field today in which business loans have been cut off since about October, wasn't it?

Mr. SCHULTZE. That's about right, sir.

Senator SPARKMAN. The Small Business Administration discontinued taking applications in October for business loans for small business. What is the situation now?

Mr. SCHULTZE. Senator, two points on that: one, as you know, of course, the Small Business Administration has not ceased making loans. It has ceased taking new applications to work off the backlog.

Senator SPARKMAN. It ceased making loans in excess of $100,000.

Mr. SCHULTZE. That is correct, but I mean it is still making loans. It is not taking new applications.

Senator SPARKMAN. I think we ought to bear in mind that the limit the Congress put on it was $350,000 and they are making backlog loans with $100,000 as a maximum.

Mr. SCHULTZE. I think maybe I can put this a little bit in perspective. In 1965, the total volume of business loans of various kinds—this does not include the so-called poverty loans or disaster loans, but business loans, the section 7(A)—was $340 million. This budget in 1966 provides funds for making loans of $355 million—an increase—and next year for $428 million.

This is the program that is contemplated in the budget, so there is an increase over all previous years. What happened, of course, is that in the early part of the year, there was a tremendous flood of applications into SBA.

The actual amount of funds which were used early in the year was quite high, and in order to stay within this total—which is an increased total—it was necessary to (*a*) reduce the level of loans which could be made on a direct basis and (*b*) also, in order to work off that backlog, stop taking new applications. But I did want to stress that—while again, obviously, people can differ on the total amount of funds allowed for SBA—it isn't a question of cutting their funds.

The budget provides in both years for an increase.

Senator SPARKMAN. Of course, that starts July 1. What is the situation now?

Mr. SCHULTZE. No, I mean in 1966. In 1965, there was $340 million.

Senator SPARKMAN. You are talking about fiscal 1965?

Mr. SCHULTZE. Fiscal 1965 there was $340 million allowed and made. In fiscal 1966, the budget provides for $355 million, a slight increase. How much is left for the remainder of the year, I honestly don't have the breakdown. I can get that for you.

For 1967 it goes up to $428 million.

(The following information was provided for the record:)

As of December 31, 1965, there was $151 million of section 7(a) small business loans in fiscal year 1966, and $204 million are estimated to be made in the second half of the year.

Senator SPARKMAN. Do you know what the situation is now? Have they resumed? Have they increased that $100,000?

Mr. SCHULTZE. They have not yet; no, sir.

Senator SPARKMAN. When will they?

Mr. SCHULTZE. That I do not know, Senator.

Senator SPARKMAN. Is anything provided in the supplemental budget that is being requested of Congress?

Mr. SCHULTZE. Not as far as I remember, sir.

Senator SPARKMAN. You mean we are going to continue on the $100,000 maximum? Weren't there some new funds becoming available the first of January? Wasn't there a $36 million——

Mr. SCHULTZE. There was a disaster fund.

Senator SPARKMAN. Well, they used up disaster funds. That is where available business funds have gone, isn't it? Into disaster loans?

Mr. SCHULTZE. The amount that is left over for business loans for the year as a whole provides $355 million. What I don't know, I am sorry to say, is how much of that is left over and when SBA can resume taking applications again.

This I honestly don't know. There are some funds left. That I do know, but how much and when they will be able to move, I don't know.

Senator SPARKMAN. I think there is a sizable amount which Congress has authorized that has not yet been appropriated.

Mr. SCHULTZE. This is the authorization part.

Senator SPARKMAN. Yes.

Senator PROXMIRE. Furthermore, if we provide the full authorization which apparently has been approved by the Bureau of the Budget, the testimony of the head of the SBA was that we would only be able to provide enough money so they would be able to make one loan out of three—or at least meet one dollar demand out of three—so they would still have to ration until July 1 at least.

I presume you will have a more generous attitude toward this program if we pass the participation legislation that is pending.

Mr. SCHULTZE. That will certainly help.

Senator PROXMIRE. That is one of the aspects that troubled me a great deal and I am sure troubled Senator Sparkman and other Members of Congress, that a policy of proceeding with small business loans in an economy in which small business needs loans so badly, is determined on the basis of what kind of a bookkeeping record the President can make on the budget rather than determined on the basis of the merits, and while I think the President is doing a marvelous job and he is under terrific stress, I do think that this particular administration attitude is very hard to justify.

Mr. SCHULTZE. Let me try to comment as frankly as I can as Budget Director.

I think in a period when the economy moves up rapidly—and quite apart from the Federal Reserve Board, in an economy moving up rapidly, credit does tighten up some—the demands on the Small Business Administration for funds tend to rise very sharply.

This puts the President and those working for him and his Budget Director in an obviously difficult situation as to what to do on this account.

You can't have a program, or at least I don't believe so—you gentlemen might disagree—in which almost any demand is financed. I think that is impossible.

I agree at the same time you do have a problem of being flexible to meet the situation at the time. How to balance off those two objectives is exceedingly difficult.

As I say, we have provided for a program with a slight increase in total volume of loans in 1966 even though so much of that went out in the early part of the year that it had to be cut down now and a further increase in 1967.

As I say, I realize that there can be disagreement over whether this was enough, but it isn't as if somebody decided we are really going to lean hard on the Small Business Administration.

This was not the case. This really is the case of the Small Business Administration having increased funding in a period in which demands are rising even more rapidly, and I think that is the kind of situation we are in.

Senator SPARKMAN. We are bound to expect that in an expanding economy, are we not?

Mr. SCHULTZE. Yes.

Senator SPARKMAN. Thank you, Mr. Chairman.

Senator PROXMIRE. I would like to get back very briefly to the initial point I made.

Let me ask you this: What assumption did you and the President make on the level of unemployment in 1967 in making your estimates in the budget on revenues?

The budget message was a little ambiguous on that.

Mr. SCHULTZE. We did not start out on employment assumptions. Rather, we started out with a projection of gross national product—obviously, you have to play these things back and forth: the budget effect on the gross national product and the gross national product effect on the budget—which essentially indicated a $722 billion figure which we used in both the Budget and Economic Report. This is the same dollar rate of expansion as we had in the prior year, but a slightly lower percentage rate.

Senator PROXMIRE. Is that the calendar year 1966?

Mr. SCHULTZE. Calendar year 1966.

Senator PROXMIRE. I am talking about the 1967 budget; your estimates here.

Mr. SCHULTZE. The 1967 budget revenues are primarily determined by calendar 1966 economic activity, so, essentially what we do is concentrate on making a projection of the calendar year 1966 economic situation.

Senator PROXMIRE. Then I assume from the estimate of the budget in brief you anticipate unemployment will go down to 3¾ percent this year. This is the basic assumption?

Mr. SCHULTZE. This is the basic assumption.

Senator PROXMIRE. You get the 3¾-percent unemployment target which is below the so-called 4-percent full employment position. This raises questions about whether or not you ought to revise that 4-percent level. You told both Senator Jordan and me, and Congressman Curtis, that this is a less restraining budget than it appears to be because rather than tax increases you have accelerated withholding—that was your answer to Senator Jordan—and then saying that sale of assets does not have the same restraining impact that reduction in spending has.

Now, we put those two things together and start with the argument that you have virtually a neutral budget. That is an assumption of one-half a billion dollar deficit in the national income accounts.

It seems to me you come down with the conclusion that this is at least a mildly expansionary budget.

Mr. SCHULTZE. Two points on that, Senator, before we start arguing semantics.

First, Mr. Chairman, I didn't say that this was a less restraining budget than it appears to be.

Senator PROXMIRE. Those are my words. It was my statement.

Mr. SCHULTZE. OK. I'm sorry. I think again that it is quite correct that the specific tax measures proposed don't have the same restraining effect—and were not intended to have the same restraining effect—as an equivalent amount raised through an increase in tax rates.

I mean this is not happenstance or trying to fool anybody. It was quite deliberate. We felt the situation required about this amount of restraint.

The second point is that the national income accounts budget does not reflect the acceleration of corporate tax payments nor does it reflect credit programs on either side, and this is the budget which has the half billion dollar deficit that we indicated.

I think the basic point, perhaps, is that you can't take a look at what is restraint or what is not restraint or what is stimulus solely in the context of the budget, but only in the context of the budget and all the actions that go into the budget and the rest of the economy.

I think the key point is that for the years 1962, 1963, 1964, and 1965, our basic economic policy has been one of stimulation—primarily, though not solely—through tax reductions.

Senator PROXMIRE. That was the trend, although the overall effect was more restraining than your current budget.

Mr. SCHULTZE. No, sir, I disagree.

Senator PROXMIRE. If you accept the full employment concept you certainly do.

Mr. SCHULTZE. What I am saying is that during that period, 1965 tax decreases were still coming into effect——

Senator PROXMIRE. That's correct, thank you.

Mr. SCHULTZE (continuing). Both excises and the impact of the 1964 income tax cuts, so that quite apart from how the final budget number came out, the thrust of economic policy was still towards stimulation by reducing taxes. The thrust of policy now is that this stimulation has stopped and that there is a restraining effect through the tax measures otherwise proposed.

This, essentially, is what I am saying.

Senator PROXMIRE. I won't argue with you. I think you make a good point but I am inclined to disagree.

Now, I would like to ask about some of the spending in this budget. You said you felt you could cut back some areas of construction. This has been a policy on the part of our Government at times when they wanted to restrain spending.

During World War II we virtually eliminated the public works spending. In the Korean war there were no new starts. Of course, this is a very popular program with Members of Congress.

We get elected on it. But the President, instead of restraining it this time has increased it. Take a look at table F-1, in your Special Analyses booklet and it appears that civil public works—these are civil public works, not national defense—grants are up from $4½ billion in the 1966 estimate to $4.8 billion in 1967, and the Corps of Engineers' budget includes 25 starts for water resource projects.

(Table F-1, referred to above, appears below:)

TABLE F-1.—*Federal expenditures for public works, fiscal years 1958-67*

FROM BUDGET ACCOUNTS AND TRUST FUNDS

[In millions of dollars]

Year	Total, civil and defense public works	Civil public works				National defense public works
		Total	Federal construction	Grants	Loans (net)	
1958	5,070	3,106	1,254	1,735	117	1,964
1959	6,684	4,535	1,521	2,871	143	2,150
1960	6,846	5,011	1,643	3,211	156	1,835
1961	6,823	4,925	1,878	2,897	149	1,898
1962	6,938	5,310	2,085	3,018	207	1,627
1963	7,196	5,790	2,321	3,280	190	1,405
1964	8,346	6,999	2,691	4,167	142	1,347
1965	8,886	7,521	2,800	4,553	167	1,366
1966 estimate	9,167	7,697	2,961	4,528	209	1,470
1967 estimate	8,939	7,617	2,902	4,854	−139	1,322

NOTE.—In this and the following tables, nonconstruction costs are excluded; proposed legislation is included for the years 1966 and 1967. Details may not add because of rounding.

In view of the fact that many competent economists—including the man who just sat on the Council of Economic Advisers, Otto Eckstein, whom I consider as one of the outstanding experts in the country on water resources—have attacked the benefit-cost ratio system we use and have asked for 1½ to 1 instead of 1 to 1, because the basis of the present system is such a fake, it would seem to me the Budget Bureau and the President ought to give real consideration to restraint in this area.

It certainly would have a terrific economic impact because there is such an enormous amount of money involved and there are so many projects which are of very, very questionable value.

Some exceedingly competent and objective academic economists have pointed to a whole series of projects engaged in by Congress in the last few years that they say cannot possibly be justified, so why not consider restraint in this area?

Mr. SCHULTZE. I think I would have to answer that we not only considered restraint, but exercised restraint.

First, the particular number you referred to is, I am sure, heavily, though not solely, made up of the highway grant-in-aid program which is the trust fund, and the expenditures are essentially related to the revenues that come in on that.

Senator PROXMIRE. That is something that could be restrained, too, perhaps.

Representative CURTIS. Certainly. They have cost-benefit ratios, haven't they?

Mr. SCHULTZE. Let me move on. The second point is that our attitude, essentially, on these construction programs about fits the evaluation that we discussed earlier about the magnitude of this compared to Korea and certainly compared to World War II.

We did reduce new starts. We did not adopt a "no new start" policy. We did reduce new starts in the Corps of Engineers from 41 to 25. In the case of the small watershed program of the Department of Agriculture the reduction was from 80 to 35.

Senator PROXMIRE. You did increase the Corps of Engineers by $45 million.

Mr. SCHULTZE. The actual expenditures on Corps of Engineers projects are, of course, determined by contracts let, in many cases, as long as 5 or 6 years ago. What we did was go through, project by project, each of the construction programs that are ongoing and stretch them out as much as could be done without really being uneconomic or without pushing something past a new flood season.

In other words, once it is started—however much one may have argued about the particular cost-benefit ratio when the project started—you don't want to leave it half done.

Senator PROXMIRE. I would hope that you would argue a lot more on the cost-benefit ratio from now on. One turkey, we had last year was the Cross-Florida Barge Canal, with a 1.1-to-1 benefit ratio. The man who was mainly responsible for that in the Corps of Engineers retired and he wrote a devastating indictment of it. When you have a 1.1 to 1 and when you have a discount factor that is a way out of keeping with the present cost of money for the Federal Government, or the cost of money over the years for that matter, this adds up to the Congress approving, in the judgment of the excellent economists, project after project which is extraordinarily hard to justify——

Mr. SCHULTZE. My recollection is that we don't have any navigation projects which are analyzed over a 100-year period. They are all analyzed over 50 years. There was one project on a hundred year basis on which, if I recall it, we submitted a letter to the Congress indicating it should be evaluated over a 50-year period.

Senator PROXMIRE. That is good, because there were some.

Mr. SCHULTZE. There may have been. My recollection is that there are no navigation projections based on a hundred.

Senator PROXMIRE. Maybe this discount thing is something you ought to look at because you can do almost anything with that ratio.

The new budget, fiscal 1967, calls for an increase in subsidies for the aviation industry from $879 to $913 million. The aviation industry is currently enjoying one of the most profitable years it has ever had.

Almost all the airlines are making money. The manufacturers seem to be doing very well. I have been here in Washington since 1957 and have seen a quadrupling of the subsidies for the aviation industry. In 1957, this figure was $220 million.

Mr. SCHULTZE. There are three things involved in this, Senator. First, we are proposing to the Congress appropriate user charges to pay for these aids. The largest volume of this, of course, is for the navigational and other aids in our airways system which are, in an indirect sense, subsidies; but we are proposing user charges.

Second, we did—and are under significant criticism for it, but we did—propose a reduction in the airport grant-in-aid subsidy from $71 to $50 million. I think that is the right figure.

Third, this increase, I suspect—I would want to check it, perhaps, for the record—is primarily an increase due to the supersonic transport development program, not for the rest of the aviation program, so to summarize, we are sending up legislation to recapture from users——

Senator PROXMIRE. How much of this is for supersonic transport, because I think that is a tough one to justify, too.

Mr. SCHULTZE. The expenditures—and these are expenditure numbers you were looking at—for the supersonic transport, will raise from an estimate of $80 million in 1966 to $115 million in 1967, which I think more than accounts for this increase.

Senator PROXMIRE. Of course, this supersonic spending, the military says, is of no value to them.

My time is up.

Congressman Curtis?

Representative CURTIS. I want to direct attention to the budget of 1966, which is the crucial one, because we are in it now. Reading from your estimates of the "Budget in Brief" for fiscal year 1966, there is a statement:

> As a result the Federal deficit on a consolidated cash basis is expected to be $3.9 billion.

This is last year's budget, 1966, the one we are in now. In your present budget message this $3.9 billion deficit has now increased to $6.9 billion. Don't you agree that in this time of great economic activity jumping from a minus $3.9 billion to a minus $6.9 billion is highly inflationary?

Mr. SCHULTZE. No, sir.

Representative CURTIS. What do you think? What is your comment?

Mr. SCHULTZE. It seems to me you have to judge the budget, in the context of the entire economy. Let me make the following points on that if I may.

Representative CURTIS. You may say there are compensating factors, but with just considering the aggregate I don't see how you can even dispute the premise. But then you can go along and say, "But here are compensating factors." You disagree with the bare figures?

Mr. SCHULTZE. No, sir. I disagree with describing this as highly inflationary.

Representative CURTIS. Then let's say inflationary and we can argue on how much. Do you agree that it is inflationary?

Mr. SCHULTZE. No, sir.

Representative CURTIS. All right.

Mr. SCHULTZE. If I may, I would like to make some points with you.

Representative CURTIS. Certainly; you are entitled to because this needs a lot of words, I would say.

Mr. SCHULTZE. The key point on this is that in 1966 two things happened since the budget was orignially submitted:

First, the cost of Vietnam. That is No. 1.

Representative CURTIS. May I interrupt?

Mr. SCHULTZE. May I go on?

Representative CURTIS. But wait a second. I want you to be responsive. I agree there are reasons why we increase expenditures and I am perfectly willing to concede maybe we have to.

I don't say we can't have guns and butter or we don't have problems in the economy. That assumes we have expenditure increases, but how do you justify your statement that going from a $3.9 billion deficit to a $6.9 billion deficit is not inflationary? Direct it to that, not to reasons why we have to do this.

Mr. SCHULTZE. I was about to respond, Mr. Congressman, that there were a number of expenditure increases which did raise this deficit.

Representative CURTIS. That is true.

Mr. SCHULTZE. That recognizing that, we immediately move in the 1967 budget back from that $6.9 billion to a plus $.5 billion.

Representative CURTIS. We are talking about the 1966 budget, please.

Mr. SCHULTZE. Correct. I then wanted to indicate the economic context in which that $6.9 billion occurs. This was my point, that what happened is that in fiscal 1966, starting September, October, November, you began to see some of these coming out.

There were expenditure increases. We can discuss those in a moment. Recognizing those expenditure increases the administration moved to provide a turnaround in this so that by 1967 you are back down substantially.

Representative CURTIS. We are talking about 1966.

Mr. SCHULTZE. I just wanted to indicate that 1966 goes up and 1967 comes down.

Representative CURTIS. We are talking about 1966, please.

Mr. SCHULTZE. I want to indicate the context in which that occurs. In the first place, if we take a look at the actual price history in the last half of calendar 1965, during which some of these increases began to occur, you find that industrial prices are up only seven-tenths of 1 percent.

Representative CURTIS. But you find that the wholesale price index goes up considerably and so does consumer price index, does it not? The last 4 months you began your expenditure increases, in September 1965?

Mr. SCHULTZE. That is about what I was going to get into, Mr. Curtis, that the largest part of this increase is in farm products. This is not an inflationary phenomena. It is a cyclical——

Representative CURTIS. Oh, heavens!

Mr. SCHULTZE. Let me indicate one point.

Representative CURTIS. Go right ahead. We need more words than you are giving us.

Mr. SCHULTZE. The index for farm products in the wholesale price index has risen significantly. It is still below the prior peak, which was in the middle of 1958, a major recession. I am saying that this clearly is a cyclical phenomena, that one of the facts that indicates this is that the biggest recession we have had in the postwar period had the other prior peak in it.

Representative CURTIS. You are not talking to the subject. There is only one point before you. What happens when you go from a $3.9 billion to a $6.9 billion deficit?

Mr. SCHULTZE. I am saying that in the economy that we have, this is not inflationary. I am not saying that, if we did that in 1967, it wouldn't be inflationary.

Representative CURTIS. Let me ask you this question. There have been some developments of the Korean war type in relation to this situation. But the point I would make is that in the Korean war we started at a very low percent of plant capacity usage. Today you have already given us the figures approaching 90 percent.

In those particular industries which will be producing for war, the increase is even greater, so let's put it in context.

I started out by saying put it in the context of the economy that was in your own budget message and in the economic message, an economy that is, by your own definition, reaching its capacity of performance.

So, it is in that context that you come along and instead of balancing the budget, you increase the deficit by $3 billion. Then you say that in that context this is not inflationary.

Mr. SCHULTZE. I am saying in context of the timing both of the budget and in relationship of the economy to its potential, it is not inflationary; and I would like to go down some of the factors involved in this.

As I indicated earlier, the price increases we have had have been primarily in the area of food. These have been cyclical; and the fact that they are cyclical means that it is not an inflationary problem driving these up as is clearly indicated by the prior cyclical peak, which was 1958.

Representative CURTIS. Let's stop on this, because yesterday I got some of these answers from the Chairman of the Council of Economic Advisers. Then he said when we were on another subject, "But, they have been effective in holding down industrial prices" through these techniques used on the aluminum, copper, and steel industries, and he said there are a lot of other instances; those just got the publicity.

So what you have been doing is imposing a form of price control in the industrial area, but what are you reacting to? You are reacting to inflationary pressures. What else is there to react to?

Mr. SCHULTZE. They are reacting essentially to increases in prices which might have occurred in specific sectors of the economy.

Representative CURTIS. Exactly, and why are they occurring? The experience in the industrial area that you were just boasting about, is contrary to the movement of the wholesale price index and the consumer price index?

The Council of Economic Advisers said it wasn't just the threat of the use of stockpiles and their actual use in the copper and aluminum industries, and also in the steel industry. I would argue this corrupts defense procurement practice. The Federal Government moved in on steel and the Council of Economic Advisers said, "And these are only the publicized ones."

They have been able to do a lot of this hitting over the head, quietly. What is causing all of this?

Mr. SCHULTZE. Clearly, as the economy moves back closer to full employment, the problem of wage increases and price increases becomes greater.

There is no argument with that, compared to 1961. There is no question of that. What I am trying to say, Mr. Curtis, is that we did have these increases in expenditures in 1966 which are unavoidable, that we are moving immediately in 1967 to try to turn that around.

Representative CURTIS. I am trying to take this piecemeal so we can understand it. My first question referred to where we are now, which is the beginning of February 1966, and we are in fiscal 1966, and your last year projection gave us an expenditure level of $99——

Mr. SCHULTZE. $99.7 billion.

Representative CURTIS. $99.7 billion; and now you are giving us an expenditure level of $106——

Mr. SCHULTZE. $106.4 billion.

Representative CURTIS. $106.4 billion; and you have increased the deficit by $3 billion, and I am directing attention to that. The economy right now shows less than 4-percent unemployment and your capacity utilization is over 90 percent.

Mr. SCHULTZE. The capacity utilization is 89 percent at the last reading.

Representative CURTIS. At any rate, right near where people are saying—and in fact your own reports say—we are moving very close to, not above, what has been termed "full capacity."

Now, I am not considering what you are going to do in 1967, because we will get into that, and I happen to think that is the most questionable budget of all. But I am talking about what you are doing in fiscal 1966 and why we didn't move to curb expenditures in other areas in order to make way for what you argue is necessary in Vietnam.

I can't even get to that because you deny that increasing the deficit by $3 billion in this kind of economic climate is inflationary, so we can't even get to the discussion.

Mr. SCHULTZE. If this were an increased deficit which would continue to increase, I would agree with you. This is a temporary increase in the deficit in a period in the economy in which an increase of that size, I insist, is not inflationary.

It certainly would be next year, but it is not now. I tried to point to the fact that we do have plant capacity still some 3 percent below the desired rate, that in calendar 1966, manufacturers plan to expand their capacity by 6 percent.

Now, I think if we continued this and hadn't taken any actions as we did move up, you would be quite right, but we have taken actions.

The 1967 budget pushes this deficit way down.

Representative CURTIS. But yesterday you told Mr. Byrnes before the Ways and Means Committee that you didn't intend to ask for any price control.

You still want to do it, in a way that I would regard as illegal, through these techniques that you have used in aluminum, and copper, and steel, and all these other selective industries which have not been publicized. But you don't want to come in asking for controls.

You said that yesterday. Right?

Mr. SCHULTZE. That is correct. I don't believe the means are illegal.

Representative CURTIS. I must confess in light of your testimony here, the testimony of the Council of Economic Advisers, yesterday, and the context of the budget, my primary observation that President Johnson's statement that inflation is a serious problem facing us right now, not 1967, but fiscal year 1966, is almost meaningless.

I don't think that you have treated that statement seriously, to be honest with you.

Mr. SCHULTZE. To be honest with you, Mr. Curtis, I think we have. As I said, we did have these expenditure increases. They did temporarily increase the deficit. They did begin to occur in September, October, November.

We are moving from this kind of a situation through the end of 1966 into 1967 with a deficit which is decreasing.

Representative CURTIS. I guess we will have to wait for the future.

Chairman PATMAN. I will take my time now, if it is all right.

Mr. Schultze, I notice that the budget does not cut back on the poor people of this country. As the President said, we should not make them pay for the cost of the Vietnam struggle.

Can you give us an estimate of total Federal expenditures on behalf of the poor and indicate how much of an increase is recommended in this total for the coming fiscal year?

Mr. SCHULTZE. Yes, sir.

The total, including the part of the trust fund which goes to the poor in 1967, is $21.4 billion, an increase of approximately $3.7 billion over the prior year.

Chairman PATMAN. Can you give us the total interest expenditures of the Federal Government for the current year and the estimates for the next year.

Mr. SCHULTZE. Yes, sir; $12.1 billion for this year, $12.9 billion for 1967.

Chairman PATMAN. $800 million more?

Mr. SCHULTZE. Yes; $750 million. These are round figures.

Chairman PATMAN. Is that due solely to the increased cost of interest?

Mr. SCHULTZE. Almost, but not quite, solely. In other words, the Federal debt will rise very slightly in fiscal 1967, but the major cost is higher interest rates.

Chairman PATMAN. Practically all of it?

Mr. SCHULTZE. Practically all of it. I don't have an exact amount.

Chairman PATMAN. That is due to the December 6, 1965, increase by the Federal Reserve?

Mr. SCHULTZE. No, sir; I wouldn't say it can quite be put to that. Interest costs have risen.

Chairman PATMAN. I know, but the Fed, you know, has charge of the interest cost.

Mr. SCHULTZE. My only point, Mr. Chairman, was that I wouldn't put the whole responsibility on that specific action, but I agree it clearly had a role.

Chairman PATMAN. You would at least say that a 37½-percent increase is a rather big jump, wouldn't you, in interest rates at one time?

Mr. SCHULTZE. Yes, sir; I agree.

Chairman PATMAN. That is clearly outside of every guidepost and every guideline, isn't it?

Mr. SCHULTZE. Well, I had never thought of it in that context, Mr. Chairman.

Chairman PATMAN. Yes, sir. Can you give us an estimate of how much interest rate increases in the cost of Federal Government interest payments were during the past 15 years? Could you ascertain that?

Mr. SCHULTZE. I am not sure I could. I think quite probably the Treasury Department would be more able to furnish that particular number than I could.

Chairman PATMAN. I want to agree with you about price controls. I went through that in World War II here as a Member of Congress and as a member of the committee that had to do with price and wage controls.

There were 8 million prices and wages fixed at that time. It would probably be about 16 million this time. And we have never had problems and we will never have problems in the future that will compare to the problems you have in trying to fix prices and wages and dealing with the black market all at the same time, so I urge you to establish controls only as the last resort and make sure that you have the sentiment of the people behind you almost 100 percent.

Otherwise, it cannot be a success.

Senator Douglas?

Senator DOUGLAS. Thank you, Mr. Chairman.

The level of prices depends, does it not, on the ratio between the quantity of monetary purchasing power and the rapidity of circulation on the one hand and, the quantity of goods and services to be exchanged on the other?

Mr. SCHULTZE. Senator, I guess in one sense it is. I am not sure I would want to subscribe to that unequivocably.

I agree that arithmetically that is true. As a causal point, I might want to quarrel with that a little bit.

Senator DOUGLAS. Let me ask you this question: During this last year the quantity of goods and services produced has increased very markedly, has it not?

Mr. SCHULTZE. Correct, sir.

Senator DOUGLAS. Eliminating increases in price levels, the increase has been about 5 percent.

Mr. SCHULTZE. A little over 5, I believe that is right.

Senator DOUGLAS. So that you could have an increase in the quantity of purchasing power assuming rapidity of circulation remained the same of about 5 percent, with no increase in prices, isn't that true?

Mr. SCHULTZE. Correct, sir.

Senator DOUGLAS. And only to the degree that the Government deficit contributed to this increase in the quantity of purchasing power through an increase in bank credit would it have a price effect. The deficit might lead to diversion in the economy but if the total increase in quantity of bank credit or money does not exceed, say, 5 percent—that is, the increase in goods and services—the price level would be relatively constant, would it not?

Mr. SCHULTZE. That is correct, so long as we underline if the velocity of circulation remained the same.

Senator DOUGLAS. I understand.

I wish my friend from Missouri were still here. He is barking up the wrong tree, isn't he? He is assuming that any governmental deficit necessarily results in inflation. We have inflation only when the sum total of newly created bank money is greater in proportion than the increase in quantity of goods and services; isn't that true?

Mr. SCHULTZE. I agree, sir. The main point that I was trying to make was that you have to put the deficit in the context of the economic situation, that if we had not taken steps to change it——

Senator DOUGLAS. I wanted to put it in an arithmetical context.

Mr. SCHULTZE. I appreciate that, Senator.

Senator DOUGLAS. Now, may I ask you whether you see any soft spots in the budget? Do you think we should spend approximately $5 billion a year to put a man on the moon by 1970?

What is the use in getting to the moon before another country for prestige reasons when there is no advantage to either country getting to the moon?

Mr. SCHULTZE. Well, if all we were doing with this program was getting to the moon and it had no side benefits, your question would disturb me.

Senator DOUGLAS. I have talked to scientists and the scientists tell me there are no scientific advantages in getting to the moon. I think there are no military advantages in getting to the moon.

You can hit any spot on earth from the earth just as well as you can from the heavens, and, besides, you can do your photographic work at 186 miles up; you don't have to go 240,000 miles up.

Mr. SCHULTZE. I think that the additional factor to be put in here, however, is that this effort has generated tremendous advances in technology—in industrial management and the like—which admittedly can't easily be quantified or identified. But in evaluating—however one comes out—the merits of this program, this has to be taken into account.

Senator DOUGLAS. Taking a chance on failure.

Mr. SCHULTZE. No, sir, I don't really think so. I recently, for the first time, had a chance to visit all these installations, and I must say I was tremendously impressed.

Senator DOUGLAS. Oh, yes, one is overawed by them, but what is the need or use? I have seen a marvelous blind chess player—marvelous fellow—playing 12 games at once, but what is the advantage of that?

Mr. SCHULTZE. I am not sure, Senator, I don't want to be facetious, but I suspect that the first fellow who put the wheel together probably had a neighbor who said: "What are you going to use that darn thing for?"

I admit that you can't really put your finger on this. I admit that reasonable men can differ about how many dollars should go into the effort.

Senator DOUGLAS. Is it not really romance and prestige that is behind the drive for putting a man on the moon—simply romance and prestige?

Wouldn't it be better to improve the conditions of people on Earth than to put a man on the Moon or go to the other planet or planets? Shouldn't we consider the human conditions of mankind and not merely general prestige? That is one question.

Mr. SCHULTZE. I just want to point out in this context, Senator, that we do have some $21 billion going toward the direct improvement of the poor, one way or the other.

Senator DOUGLAS. I know, but as you will very carefully say, part of that is from the trust fund, as I understand it. While there is an increase in the fiscal year, since most of the poverty program started late in fiscal year 1965, there is a slowing down of the momentum which has been accumulated in the last 6 months.

Mr. SCHULTZE. Two points to that, Senator. First, there is clearly a slowing down in the rate of acceleration.

Senator DOUGLAS. A slowing down in the total, isn't it?

Mr. SCHULTZE. No, sir.

Senator DOUGLAS. So far as the last 6 months are concerned?

Mr. SCHULTZE. Of this year?

Senator DOUGLAS. Of the last 3 or 4 months.

Mr. SCHULTZE. No, sir; I don't think so. In fact, I looked only recently at their rate of obligations in the first 6 months compared to what their rate will be in the last 6 months, and—this is obligations—it will be higher in the last 6 months.

Senator DOUGLAS. Very little higher, if any, and in some programs a slowing down.

Mr. SCHULTZE. There are a few, that is correct; but in the bigger ones, there is not a slowing down.

Senator DOUGLAS. May I ask about a point that I heard my friend and colleague, Senator Proxmire, inquiring about when I came in, the supersonic air transport. How much is that going to cost?

Mr. SCHULTZE. The expenditures that we have in the budget for the supersonic air transport are $115 million, I believe.

Senator DOUGLAS. Yes, but what is beyond that, in future years? What is the ultimate total cost of developing supersonic air transportation?

Mr. SCHULTZE. The experts and the people in charge of the program are still working out the details on this and I don't have a final figure, sir.

Senator DOUGLAS. I have heard figures; $1 billion, $2 billion.

Mr. SCHULTZE. It is in that general range, I think, but I am not that close as to a specific estimate.

Senator DOUGLAS. What were the results of the Oklahoma City experiment?

Mr. SCHULTZE. I can't answer that, Senator.

Senator DOUGLAS. The chairman comes from the borderline of Oklahoma, Arkansas, and Texas, but my information is it knocked out all kinds of windows and created all kinds of disturbances. What speed will the supersonic have?

Mr. SCHULTZE. Mach 2.5 or 2.6, which is two and a half times 700 miles an hour. It gets up in the neighborhood of 1,800 to 2,000 miles an hour.

Senator DOUGLAS. I want to ask what is the use of going 2,000 miles an hour when you can go 750 miles an hour; considering all the incidental disadvantages, vibration, and shock?

Mr. SCHULTZE. Senator, you are asking me for a reasoned analysis and exposition of the SST program for which, at the moment, I am not prepared.

It seems to me that a reduction in the time from here to London, let's say by roughly half—which I think is what would be involved—is over a period of years a significant saving in time.

Senator DOUGLAS. That is flying time.

Mr. SCHULTZE. This is block time.

Senator DOUGLAS. But it is not a commensurate reduction in total time because of the time getting to the airport and getting on.

Mr. SCHULTZE. It is about 3 hours.

Senator DOUGLAS. That would be a reduction of only about 20 percent so far as that is concerned. It will take more time to get to an airport than to fly across the Atlantic. I want to say that one can get mesmerized by these new developments.

Mr. SCHULTZE. As I say, and as I answered in the case of the space program, there are very substantial intangible benefits; and I don't mean just the benefits that come out of this in terms of science, technology, and the whole industry. I can't give you the dollar cost-benefit relationship—one tangible, one intangible—obviously, but I think it is an important advance.

Senator DOUGLAS. I remember when this man-to-the-moon business first came up I asked Mr. Bell, who was your predecessor, how much it would cost. He said a minimum of $20 billion. And I questioned whether it was worthwhile. One of my colleagues said: "Well, people questioned the expenditure to finance the experiments by Alexander Graham Bell and the telegraph." I replied: "That cost $40,000, and there is quite a difference between $40,000 and $20 billion."

My time is up. Now I simply want to say that a little critical judgment is needed on these measures. The public, the business community, the political world, is just carried away with the fascination of these subjects, and yet we ignore the human beings who live here in the United States of America, 20 million of whom live in abject poverty and 35 to 40 million living in poverty.

You can easily shift your sense of values from the human value to the spectacular mechanical value.

What profits a civilization if it has 20 million people in abject poverty and sends one man to the moon?

Thank you.

Chairman PATMAN. Mr. Reuss?

Mr. REUSS. Because of the time, I would just like to ask three questions and have you answer them for the record.

Mr. SCHULTZE. Yes, sir.

Mr. REUSS. The first question proceeds from Senator Douglas' line of inquiry about the moonshot and the supersonic transport plane, for both of which there are multi-billion-dollar items in the budget.

Using the new techniques of systems analysis and cost-benefit studies which are so much in your mind, would you file, for the record, the application of that technique to the direct benefits and side benefits of the moonshot and the direct benefits and the side benefits of SST, quantifying this to the limits of your ability and the new science of systems analysis.

Mr. SCHULTZE. May I interject, please, Mr. Reuss?

Mr. REUSS. Yes.

Mr. SCHULTZE. You may recall that this is a new system which is just going into effect and which we hope, by this summer and next fall, will have a number of results for us.

Whether we can clearly supply for the record a statement of how this would be applied, we clearly can't give you some nice, quantifiable results.

Mr. REUSS. Do the best you can, because we are embarked upon these multibillion-dollar programs and I certainly don't want to address myself to them without the benefits of new science of cost effect and systems analysis.

In that connection, does your analysis of the SST take into account what Senator Douglas said about the difficulties of getting from the airport to the center of the city once you have flown across the Atlantic in 3 hours? And would you comment, also, on the fact that in this budget there is not one penny for research into new methods of within-city urban transportation?

Mr. SCHULTZE. That last part is not correct. I don't know the number. I will furnish it for the record. We do have such research in this. It is small compared to the SST, I realize.

(The material which follows was subsequently supplied as promised:)

Systems Analysis and the Manned Lunar Landing

No cost-benefit analysis of the manned lunar landing program was done because, at the time it was made, the decision to undertake the program was not susceptible to effective systems analysis. Too many intangibles were involved. The kind of factors considered in arriving at the decision to undertake the program included but was not limited to those cited below. The difficulty of quantifying most of them is apparent.

(1) The effect on domestic public opinion of conceding the unique capability of manned space operations to a Communist world power.

(2) The effect of such a concession on the opinion of the public and the leaders of the uncommitted countries.

(3) The possibility that manned space operating capability could be used at some future date for purposes of military offense or defense.

(4) The contribution to science by the experiments conducted.

(5) The contribution to the advancement of technology by the research and development effort involved.

(6) The effect of different target dates on the total cost and on the annual cost of the project.

I would like to add that although the basic decision on whether or not to have a manned moon program at all necessarily had to be decided on the basis of many intangible and unquantifiable factors, once that decision was made there was, and is, great scope for systems analysis on the specific programs for getting there.

ANALYSIS OF THE SUPERSONIC TRANSPORT DEVELOPMENT PROGRAM

The program to develop a safe and profitable supersonic aircraft was formally proposed to the Congress by President Kennedy in 1963. Prior to that time extensive research conducted by the industry with some Government support had established that this major advance in air transportation was feasible and potentially profitable to manufacturers and the airlines. In his letter to the Congress of June 14, 1963, President Kennedy stated that—

"Our determination that the national interest requires such a program is based on a number of factors of varying weight and importance:

> "A successful supersonic transport can be an efficient productive commercial vehicle which provides swift travel for the passenger and shows promise of developing a market which will prove profitable to the manufacturer and operator.
>
> "It will advance the frontiers of technical knowledge—not as a byproduct of military procurement, but in the pursuit of commercial objectives.
>
> "It will maintain the historic U.S. leadership in aircraft development.
>
> "It will enable this country to demonstrate the technological accomplishments which can be achieved under a democratic, free enterprise system.
>
> "Its manufacture and operation will expand our international trade.
>
> "It will strengthen the U.S. aircraft manufacturing industry—a valuable national asset—and provide employment to thousands of Americans."

President Johnson has carried forward the program for essentially these same reasons. As he noted in his budget message, significant progress has been made by the engine and airframe manufacturers in solving the difficult technical problems involved in producing an SST. Moreover, studies by the manufacturers, the Federal Aviation Agency, and the Department of Commerce have indicated that there is a high probability that the plane can be commercially profitable. Admittedly, there are many problems yet to be overcome, and we will not know with certainty whether the project will be a success until the plane flies. But balancing the very substantial tangible and intangible benefits to the Nation of an SST against these uncertainties, the President, with the full concurrence of his advisers, decided that the program should proceed.

Both Presidents Kennedy and Johnson have made it clear that the SST program must be and is essentially a commercial undertaking. The ultimate test of its success will be in the marketplace. Federal participation can only be justified because of the unique benefits the aircraft will bring to the Nation as a whole and because the substantial costs involved are well beyond the capacity of the industry to finance. For these reasons, the SST program is without any real precedent, and cannot be compared with other major Government investment or research and development programs. The Federal Government fully intends to recoup its investment in making possible this major advance in air transportation.

URBAN TRANSPORTATION RESEARCH

It is not possible to fully separate demonstration and research expenditures on urban transportation problems, because both types of activities are intermingled. However, the following amounts are included in the 1967 budget for this area of research and demonstration:

Program	New obligational authority (in millions)
Department of Commerce:	
High speed ground transportation research	$24.0
Highway research	8.1
Department of Housing and Urban Development: Urban transportation demonstration grants	10.0
Total	42.1

Mr. REUSS. Yes. Make sure, however, that the $5 million or so tagged for research isn't, in fact, being spent on demonstration grants for the same old subway cars and the same old buses and trolleys as we now have.

My second question has to do with the price-wage field and a bill that I have introduced, which I know is on your desk. It would let the Joint Economic Committee and the Congress in on both reviewing the guideposts and, at the behest of the Council of Economic Advisers, holding hearings on breaches of the guideposts, once adopted, which would threaten the national economic security.

I would like your position on that, whether you are for it or against it with your reasons.

And, thirdly, I would like your views on the following propositions. Would it not be good sense, in view of the inevitable time that it takes Congress to pass a tax bill and in view of the possibility of inflationary situations developing within the months and year to come, for the administration to forward to Congress and the Congress to enact tentatively a tax increase bill of an anti-inflationary nature with its effective date to be delayed until such time as Congress by joint resolution directs that it be put into effect? The idea is that this would avoid the months of detailed hearings that the money committees of the two Houses of Congress would have to go through.

Thank you very much.

(The following comments were subsequently supplied by the Bureau of the Budget:)

COMMENT ON BY CONGRESSMAN REUSS' BILL ON WAGE-PRICE GUIDEPOSTS

The administration has been very gratified by the general and voluntary compliance of business and labor with the informal wage and price guideposts. Responsible action of workers and management consistent with these guideposts has contributed significantly to the unprecedented record of price stability we have enjoyed over the past 5 years.

The administration feels that continued voluntary compliance with these guideposts would provide adequate restraint against possible inflationary pressures in the current economic situation. Considerable investigation and discussion of alternative measures for the guideposts was given before reaching the policy recommended for 1966 in the Annual Report of the Council of Economic Advisers. The administration feels more experience with the present formula must be accumulated before there can be serious consideration of any legislation to make one or another approach formal. Such legislation is not now necessary and might well jeopardize the record of responsible restraint we have experienced up to now.

One of the major values of wage-price guideposts is to provide a basis for evaluating proposed wage agreements and price changes. In fact, the guideposts have been used several times in the past year to modify wage settlements and price changes which would have breached the guideposts. Congressional hearings on breaches in the guideposts, therefore, would take place only after they had already occurred.

As has been indicated in both the Economic Report and in testimony before this committee, it would be difficult to create a simple formula, which accurately reflects all the factors influencing changes in productivity. It is still too early to predict, for example, whether the productivity gains of the past few years will be sustainable, or to tell precisely how the benefits from such gains should be distributed.

Comment on Proposal for Preenactment of Tax Increase

The administration's fiscal policy program this year proposes that certain excise tax reductions be reinstituted and that other tax measures be adopted which will raise tax revenues by $1.2 billion and $4.8 billion in fiscal 1966 and 1967, respectively. Under present economic conditions and given the current uncertainties concerning the cost of our Vietnam defense commitment, these revenue-raising proposals are deemed to be adequate both for the achievement of steady economic growth and for the avoidance of inflationary price rises.

There is more than the usual amount of uncertainty in the economic outlook this year. However, the President has stated that he will not hesitate to ask for further taxes if these are required. It might well be desirable for the staffs and members of the relevant committees of the Congress to consider alternative tax measures which might be proposed and quickly enacted should economic or budget conditions warrant it, and the criteria that govern the choices among the alternatives. It would, however, be premature for the administration to propose or for the Congress to enact at this time specific standby tax measures which might turn out to be inappropriate or ineffective for the economic circumstances as they develop.

Chairman Patman. Let's see what the pleasure of the committee is. Both the House and the Senate are in session. Do you have further questions?

Senator Proxmire. Yes, I do. There is one program I would like to inquire about.

Chairman Patman. If it is not too troublesome will you preside?

Senator Proxmire. Yes, sir.

Chairman Patman. Tomorrow morning we have Secretary Fowler here at 10 o'clock. We will recess when you have finished for today until 10 o'clock tomorrow morning in this same room.

Senator Proxmire (presiding). First, Mr. Schultze, I wholeheartedly agree with your emphasis in your statement on the importance of education in terms of increasing productivity and I would like to ask you if it isn't true that this antipoverty program and the money we are spending in the antipoverty program, the money we are spending on manpower training, and so forth, is the very thing that can forestall inflation in 1967, 1968, and so forth. One bottleneck that can increase the cost of living is the shortage of skilled labor and trained labor and is exactly what the antipoverty program, and manpower training, tries to overcome in various ways.

Mr. Schultze. I fully agree, Senator.

Senator Proxmire. So that rather than inflationary action by spending in this area, we are creating a situation in which inflation is less likely.

Mr. Schultze. It helps to make the interim target of 4 percent too high—helps, essentially, to get to a situation in which unemployment can be lower.

Senator Proxmire. And the experience we have had in the last year tends to confirm that in the final instance many people thought we couldn't get down 4 percent without rampant inflation.

Mr. SCHULTZE. That is right; exactly.

Senator PROXMIRE. You had a new element that I hadn't recognized—on health. But the expenditures for health, you argue, by prolonging life and by eliminating illness and so forth, or at least shortening the period of illness, has also increased our productivity.

Mr. SCHULTZE. Correct, by a substantial amount.

Senator PROXMIRE. At the same time, it would seem to me that in view of the great emphasis on longevity, and people living beyond the age of 65 and the very large increase in numbers of people in that classification, that they would tend to have a greater effect on demand, inasmuch as the retired people by and large are consumers and not producers, and we are doing our best to give them an income so they can be satisfactory consumers and lead a satisfactory life.

Mr. SCHULTZE. You are quite right. The older your population is on the average—other things being equal—the lower the saving rate will tend to be and the higher the consumption rate.

The other side of this is that to the extent that you can make these people healthy, you may reduce the demand for medical services. I mean this thing can work back on itself so that you don't need the highly skilled medical services in the same proportion.

Senator PROXMIRE. Then the other point I wanted to ask about briefly before I go into the school milk program was what has happened in terms of approaching the optimum factory capacity?

Now you were saying we are 89 percent. The Council has a very excellent analysis of the machinery industry. They point out that the machinery industry not only is approaching their preferred operation, now at 87 percent of capacity compared to 90 percent preferred, but they are going to add this year another 8 percent to their capacity.

Mr. SCHULTZE. Right.

Senator PROXMIRE. This means that rather than there being only 2 percent away from it now, if they are going to have the preferred level of operation they are going to have to expand their production by some 10 or 12 percent.

Mr. SCHULTZE. That is right. In manufacturing as a whole, for example, next year we will add about 6 percent to capacity, which certainly will help on the inflationary side.

Senator PROXMIRE. One of the most puzzling decisions to me that the administration has made in recent years is their decision not only to refuse to permit the school milk program to go ahead on the basis that Congress decided it should when they appropriated $103 million, but their decision to virtually kill the program in coming years.

This is a conservative program, a well-established program, an accepted program, not criticized by the NAM, the chamber of commerce, or other groups.

It is a program that makes all the sense in the world because you have a surplus product here that is otherwise going to be stored away under price support programs. The Government is going to save very little by cutting back on this program because they are just going to have to turn around under the 75-percent price-support situation and buy the milk and store it and waste it.

I just can't understand the reasoning behind this.

Mr. SCHULTZE. I hesitate to get myself in a position of arguing with someone who knows so much about it, but let me try at least some of the reasons that went into it. Let me assure you that it was not done until a good bit of careful consideration went into it—much of which you may disagree with, but it was carefully considered.

First, as you, of course, are aware, the whole emphasis in this reduction is to leave school milk in two situations: No. 1, where there is no school lunch program in a school. As you undoubtedly know, the school lunch program provides for a mandatory half pint oı milk for the school lunch program to qualify. So that in cases where there is a school lunch program, pulling out the special milk program will still leave milk.

Second, it will also continue to go to needy school districts on a formula that either hasn't been fully worked out or, if it has, I am not yet quite aware of it.

What this essentially does is to reduce the Government's contribution in paying for milk for those who can well afford it.

That is point No. 1.

Point No. 2, on the basis of estimates of the Department of Agriculture only about one-fifth—I think I am right on that—there would be a reduction of about one-fifth in the amount of milk consumed in participating schools, and in most cases the reduction will not affect needy districts.

It is not being taken out of areas where there is no school lunch program. Purchases and consumption of milk will continue.

In turn, since the Government will have to pick up that one-fifth——

Senator PROXMIRE. Is there any documentation at all to that conclusion?

Mr. SCHULTZE. I am sure the Department of Agriculture is prepared to provide that documentation in their presentation to the Appropriations Committee.

This is essentially the analysis they give us.

Senator PROXMIRE. The Department told me last night what they intend to do is just leave it to the school administrator to decide which children are poor and which children are not poor.

How would you like to be a school administrator under those circumstances, to say this child's parents are poor? They can't afford to buy milk. In the first place, that requires a means test. We have never had a means test for children before.

We opposed a means test for adults for the medicare program and as one of our principal points of opposition. Now we are going to apply it to children and we are going to make the school administrator separate his flock in this way.

It seems to me he will be unpopular with both sets of parents—those who are not going to qualify because they are able to pay for it, and those who qualify because they are labeled poverty stricken—can't even pay a nickel a day for Johnny's milk.

What is going to happen under this program—on the basis of everything I have seen, and I have all kinds of letters from administrators all over the country—is that the administrators are going to say, "We don't want the school milk program." They will argue, "The school milk program is divisive and very bad for morale, and even though milk is important, it is just not that important."

Mr. SCHULTZE. Senator Proxmire, as I said earlier, I must confess I don't know the specific administrative details which will be followed. I know that the objective of the cut was to continue to make milk available to children who need it, but not to have the Federal Government making contributions where they are not needed.

I know from earlier childhood experience that this kind of thing can be done without embarrassment to children because I was in a school where a similar thing was done.

It wasn't for milk. It was for other contributions. I know it can be done that way. We never knew who paid or who didn't pay. It was a parochial school where you paid, and it was so worked out that those who weren't going to pay got tokens and nobody ever knew the difference. So I know it can be worked out.

I must confess, I can't guarantee that this will work perfectly. I don't know all the specific administrative arrangements, but this was the objective of the reduction.

Senator PROXMIRE. Who do you eliminate? People in the Department of Agriculture tell me, "You don't want Rockefeller's children to have free milk, do you?" Well, of course, this is the kind of argument that is ridiculous. The fact is that the great majority of people with children in grade school are at the toughest parts of their lives. They started their family formation a few years before, of course.

They are usually in debt. The wife has had to stop working because she has the child at home. They are people whose budgets are strained; and in view of the fact there is no opposition to the program, in view of the fact that you use up the surplus commodity, in view of the fact that it provides a very desirable and necessary element in the child's diet, it is very, very hard for me to understand it.

You say that the schools that have a school lunch program are the only ones who are going to be directly affected by it. Of course, there are many, many schools that don't have a school lunch program now and that don't qualify as needy schools.

It is my understanding that this would only be used in areas where either you have, as you said, a situation where most of the children come from needy families.

Mr. SCHULTZE. Right.

Senator PROXMIRE. Or a situation in which you have the administrator apply some kind of a test or some kind of a judgment on his part.

Mr. SCHULTZE. But, my understanding was that the primary way this would be done would be by school districts rather than by individual children, although, as I say, I am not sure of the exact specifics.

Senator PROXMIRE. It is perfectly obvious there is going to have to be a lot of discrimination. In almost every school district, including Montgomery County, the richest county in the country, there are many thousands of families whose incomes are extraordinarily low, and in each school district—you bring it down on the school districts—with few exceptions you find that in almost every school district, even though many of the families are well-to-do, there are other families that are not.

Mr. SCHULTZE. But I would ask you to look at it in two lights. First, we have turned down many programs and we have cut many programs, and there isn't one of them that doesn't have some benefit.

This is a question of putting this into the context of a very difficult budgetary year, looking across the board at relative priorities and looking at benefits compared to costs. This is not to say that milk to needy children doesn't have a high priority.

Senator PROXMIRE. Milk to children; period.

Mr. SCHULTZE. The other kids will get the milk.

Senator PROXMIRE. Well, I am not so sure.

Mr. SCHULTZE. They will get the milk.

Senator PROXMIRE. You admitted yourself that the Department of Agriculture's own estimate is that a fifth to a sixth of this milk isn't going to be consumed.

Mr. SCHULTZE. But that is a relatively small proportion, Senator.

Senator PROXMIRE. Maybe a small proportion, but if you have 4 million children involved that is 800,000 who aren't going to get it.

Mr. SCHULTZE. That won't get the same amount. This is an estimate of total consumption at home and in the school. In many cases, it can continue in the school, but with full contribution.

In other cases, it will be gotten at home. I would be the first to admit that there is no administrative arrangement we have for helping the needy which doesn't give problems.

There is no question about that. I would be frank to admit it. But, again, we can't—it seems to me—make budgetary decisions on the basis that only when we can get 100 percent perfect administration can we take a step.

It would be impossible. So, I realize your great interest in this program. I know you disagree vigorously with what we did, but I I did want to indicate that we didn't do it arbitrarily.

We didn't do it simply on the basis of finding something to slash. We did give this a lot of consideration.

Senator PROXMIRE. If this program were fully funded it would be at a level of about $120 million and we have pretty much gone along with that in the Senate.

The House has refused to go along because they have some people who have a little personal matter involved, but, at any rate, the Congress did appropriate $103 million this year.

It is a very rare situation in which you decide you will not spend the amount that Congres appropriated, isn't that correct? You have done it at times, I know. You have done it in various areas, and I think you have the right to do it.

Mr. SCHULTZE. We did in a number of other areas this year.

Senator PROXMIRE. But in this situation you cause a great deal of disruption. I am not talking about the big cut we were talking about before. I am talking about the fact that the administrators have made plans for the year.

They had counted on this by the Federal Government. They were going to need a certain amount of funding. Now they find they are going to have to cut back their program another 5 percent and they say that the administrative difficulties are very, very great, plus they think that there are very bad equity effects.

Mr. SCHULTZE. I guess I would have to agree, Senator, that if we had been able, we should have made this decision a little earlier than we did.

Now, for a number of reasons it did come along a little late, but we did find it necessary, as much as we could, to try to keep down the level of expenditures this year.

Again, I realize $3 million is not a lot of money to a Federal budget; but conversely, it is not that much money in the program, either.

Senator PROXMIRE. Can you answer this: I don't know whether you feel you can or not. If subsequent legislation implementing this new approach that you have suggested is not passed, does the Bureau feel the program should be supported at the previous levels?

Mr. SCHULTZE. I don't know whether I could answer that.

Senator PROXMIRE. What I am really asking is, is the $3 million cut part of the decision to virtually eliminate the school milk program on the basis of the past?

Mr. SCHULTZE. I wouldn't say change it from its past basis. My feeling was—and you probably know the answer—that I didn't think legislation was needed to do this. I could be mistaken on this. I thought this essentially could be done through a combination of appropriation reduction and administrative arrangements.

You may be right that it requires legislation. I didn't think so. I am perfectly willing to check that, but I didn't think it did.

Senator PROXMIRE. Thank you, very, very much and I apologize for detaining you. You have done your usual extremely impressive and competent job.

I think you have an excellent start on meeting the needs of the country and doing so with restraint and wisdom.

Mr. SCHULTZE. Thank you.

Senator PROXMIRE. The committee will meet tomorrow morning at 10 o'clock here in this room. We will hear the Secretary of the Treasury, Secretary Fowler.

(Whereupon, at 12:20 p.m., the hearing was recessed to reconvene at 10 on Thursday, February 3, 1966.)

(The following material was submitted for the record by the Bureau of the Budget:)

QUESTIONS AND ANSWERS: SENATOR JAVITS TO CHARLES L. SCHULTZE, DIRECTOR, BUREAU OF THE BUDGET

1. Question. On January 28 I introduced a concurrent resolution expressing the sense of the Congress that there is a need to improve economic policy coordination between administration economic policymakers and the Federal Reserve Board. The resolution indicates several areas where coordination may be improved. Would you comment on the resolution and the problem of economic policy coordination in the Federal Government in general?

Answer. The proposed concurrent resolution introduced by Senator Javits is designed to improve economic policy coordination and communication among Government agencies primarily responsible for fiscal and monetary policy. The provisions of that resolution, however, would merely formalize a coordinating and communicating mechanism which already exists among the principal fiscal and monetary authorities and which has been working generally satisfactorily.

Periodic meetings have been taking place whenever necessary with the Chairman of the Federal Reserve Board, the Chairman of the Council of Economic Advisers, the Secretary of the Treasury, and the Director of the Bureau of the Budget. This "quadriad" of agencies met seven times during 1965—more than the number of meetings stipulated in the proposed resolution. A formal stipulation as to the frequency of such meetings would introduce an unwarranted and undesirable rigidity into the more flexible and less formal current arrangements. These arrangements have evolved over the past 5 years, and in my opinion their flexibility tends to encourage freer exchanges of views than would occur under a formal system.

As for the second and third points of the resolution—providing information to the Chairman and other members of the Board or to the members of the Federal Open Market Committee—data on Federal expenditures and other relevant information are provided to the Chairman whenever appropriate, including exchange of information at quadriad meetings. It would be my position, however, that the process of communications within the Federal Reserve Board itself is a matter within the purview and responsibility of the Chairman and the Board. For this reason, I have no comment on this aspect of the resolution.

As to the fourth point of the proposed resolution, the existing communication channels have in the past provided an adequate medium for the Chairman of the Federal Reserve Board to notify senior Administration officials concerning monetary and credit policy actions under consideration by the Board. Such information has, in fact, been exchanged and there appears little need to adopt a formal resolution to that effect.

2. Question. Would you tell the committee how, specifically, economic policy coordination was achieved between the administration and the Federal Reserve Board at the time the Fed raised the discount rate last December 3?

Answer. In early October, the members of the quadriad held one of their periodic meetings with the President. At that time they were informed of the inclination of some members of the Board to look favorably upon an increase in the discount rate. By late November, an increase in the discount rate appeared more imminent. The position of the administration was to counsel against such action by the Board until more was known regarding the 1967 budget outlook and the fiscal policy recommendations which the administration would make. The administration also urged a discussion of the economic and budget outlook as then viewed at a meeting of the quadriad with the President on December 6.

A majority of the Board of Governors apparently felt the need to act prior to this meeting on requests from directors at two Federal Reserve banks to raise the discount rate at those banks. Therefore, on December 3 the Board met and approved the requested increase in the discount rate and released this announcement to the press on Sunday, December 5.

Admittedly, in this instance the monetary and fiscal policy coordination procedures did not work successfully.

3. Question. Is it your practice and that of the other members of the quadriad to circulate high-level policy papers with members of the Federal Reserve Board?

Answer. Members of the quadriad often exchange high-level policy papers they may prepare on matters of mutual concern. Internal distribution within each of the agencies involved is determined by each member of the quadriad.

4. Question. To what extent was the Federal Reserve Board informed of the administration's plans for the fiscal year 1967 budget and its estimate of the Nation's economic outlook on December 3, 1965?

Answer. On December 3, the specific budget plans for fiscal year 1967 were still in a relatively early stage of formulation and review. For example, during the preparation of the 1967 budget, agency requests were reduced by more than $20 billion. In late November and early December this process was still far from complete.

With respect to the 1966 budget, the administration had prepared a review of the budget and the economic outlook early in November covering the balance of fiscal 1966. Information on the outlook, including prospects for Federal purchases of goods and services, was discussed with Federal Reserve officials at this time. Shortly thereafter a new review of this outlook was undertaken, based on the developing situation.

In view of the great uncertainty at that time, regarding the outlook for defense and civilian agency expenditures as well as business investment, continued consultation among the quadriad members on fiscal and monetary policy was considered desirable as additional information became available and budgetary decisions with respect to both revenues and expenditures were made throughout December and into early January. Had the Federal Reserve Board awaited these decisions, it would have had better knowledge of the President's fiscal program, including proposed tax and expenditure programs, in determining its actions on discount rates.

5. Question. Would you say that when the Federal Reserve Board decided to raise the discount rate it acted without full knowledge of the administration's plans?

If so, what specifically was it unaware of? What then was the purpose of your regular consultations with Chairman Martin? (Chairman Martin stated that he did not consider knowing the fiscal year 1967 budget a major factor in the Board's decision.)

Answer. The action by the Board last December to raise the discount rate from 4 to 4.5 percent took place about 1 week after the latest available information about the Government's fiscal year 1966 budget outlook had been released. The figures then issued were characterized as rough and preliminary, and were given in terms of a range of estimates. It turned out, for example, that the January budget document carried a fiscal 1966 revenue figure substantially higher than the preliminary November estimate, which was a conservative figure, based on early information, and which excluded the effect of the administration's tax proposals.

A further review and refinement of the fiscal 1966 estimates was underway at that time and there was the possibility of new tax decisions which could affect fiscal 1966. Moreover, the entire budgetary situation was still under review and specific decisions continued to be made over the following 4 to 6 weeks. Judgment as to the economic outlook and any necessary tax measures were also not determined at the time of the Board's action. The budget proposals for fiscal 1967 were settled by early January and would have provided a more informative basis for consideration by the Board of the need for any restrictive monetary policy action, particularly since such actions often have economic effects stretching over a long period of time

Frequent consultations between the members of the quadriad are held to keep each participant abreast of the current knowledge and viewpoints concerning the status of the economy. These consultations and meetings are not limited simply to a discussion of the Federal budget but necessarily cover the broad range of fiscal and monetary policy problems, including prospects for the private economy, price levels, employment, the balance of payments, and other matters.

6. Question. In what way do you think economic policy coordination mechanism could be improved? How do you think, for example, the Fed's decision would have been affected by waiting another 4 to 6 weeks? What decisions did the administration make in that period which would have affected that decision?

Answer. The current mechanisms for economic policy coordination have generally been adequate and should be continued.

It must, of course, be recognized that even with good coordination, judgments as to the proper policies will differ. However, I hope that with continued regular contact and exchange of views we can achieve better coordination in the timing of policy decisions in the future.

It would be mere conjecture for me to offer a personal opinion as to whether the decision of the Federal Reserve Board to raise the discount rate would have differed with the passing of another 4 to 6 weeks. During those weeks, a great many decisions were made involving the size and composition of Federal expenditures and taxes. Postponement of the decision by the Board until the budget issues were settled would have permitted better timing and coordination of fiscal and monetary policy decisions.

7. Question. How much staff support is made available in advance of the regular meetings of the quadriad? Would you favor the establishment of a small secretariat for this purpose?

Answer. The amount of staff support made available in advance of the quadriad meetings depends on the purpose of the meeting. The arrangements are flexible, the meetings are informal, and the discussions can be based on either oral or written briefings, depending upon the purpose of the meeting. Moreover, the most useful staff support for members of the quadriad comes from their own staffs who are constantly involved in the matters under discussion. A separate secretariat would be less useful to quadriad members than the current staff arrangements. Under the circumstances, there does not seem to be much to be gained by the establishment of a formal, even if small, secretariat. It would be best to leave preparation for each meeting up to the participants.

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