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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

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JANUARY 1966 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 9, 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 1202, New Senate Office Building, Representative Wright Patman presiding.

Present: Representatives Patman, Reuss, Mrs. Griffiths, and Widnall; and Senators Javits and Proxmire.

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.

We are informed that Mr. Reuther will not be able to appear as scheduled. I am sorry to learn that he has injured his hand in a household accident.

Mr. Reuther has sent in his absence his able research director, Mr. Nathaniel Goldfinger. Mr. Goldfinger, we are glad to have you with us, and I hope on behalf of the committee you will convey to Mr. Reuther our hope for a speedy recovery.

You have Mr. Reuther's statement. You suggested to me that you would probably like to put it in the record and make comments based on it; you may do so.

Mr. GOLDFINGER. Thank you, Mr. Chairman.

Chairman PATMAN. Without objection, the statement will be placed in the record at this point.

(Document referred to follows:)

PREPARED STATEMENT OF WALTER P. REUTHER, VICE PRESIDENT, AFL–CIO; CHAIRMAN OF THE AFL–CIO ECONOMIC POLICY COMMITTEE, AND PRESIDENT, UAW

I. THE EMPLOYMENT ACT AND THE REVOLUTION IN ECONOMIC THINKING

Two weeks from today the United States will observe the anniversary of the Employment Act of 1946, one of the great landmarks of our long journey out of darkness from the deepest depression the Nation ever experienced to the longest peacetime expansion in its entire history. The past 5 years of steady growth are a tribute to the forces responsible for the passage of that act and an even greater tribute to the forces which have given it meaning in this decade—the Kennedy and Johnson administrations, the Congress of the United States, and the majority of the American people who supported them.

The Employment Act was one of the most important legislative achievements of the postwar period. It imposed upon the American Government the obligation not simply of preventing a recurrence of the disastrous thirties, but the responsibility for promoting maximum employment, production, and purchasing power, as well. In addition, by establishing the Council of Economic Advisers and the Joint Economic Committee, it provided vital machinery for formulating the policies needed to realize the objectives of the act, for evaluating such policies and for raising the general level of economic literacy in America in the process.

However, the act was not self-effectuating. After 1953 this Nation suffered a decade of rising unemployment as a result of the failure of the Eisenhower administration to fulfill the commitment imposed by the act. Dominated by fears of inflation and by a driving compulsion to balance the budget, that administration allowed the economy to stagger from one recession to another while unemployment rose higher and higher and the rate of growth fell far behind its potentiality. In the course of this descent, it failed even to achieve the objectives to which it had accorded the greatest priority. Between 1955 and 1958, the Nation suffered the only serious inflation since World War II not related to war or its aftermath. And in 1959 it experienced the biggest budget deficit in peacetime history.

The record of the Eisenhower administration was a record of a Government constrained from taking effective action by the economic bogies and myths belonging to an era that had long since passed. With the advent of the Kennedy and Johnson administrations the process of jettisoning these myths and bringing American economic policy into the 20th century has begun. A revolution in economic thinking and policy has occurred. And as a result, the hope of the American people that their Government will meet the responsibilities imposed upon it by the Employment Act of 1946 has been revived. We now have a Government which recognizes that it has an obligation not only to prevent recessions but to help fill the gap between actual and potential production and that it has the power to do so without destroying individual freedom—a Government which is moving, as Walter Heller has said, "from an antirecession, shock-absorbing, fiscal policy to a gap-closing economic propulsion policy."

We now have a Government which recognizes that the antiquated policy of balancing its budget annually can not produce the maximum production, employment and purchasing power which the Employment Act calls for. We now have a Government which is aware that even when its spending and taxing policies remain unchanged during the course of an upswing, they may act as a brake upon the economy and prevent an expansion from moving ahead. And we now have a Government which has taken a step beyond the Employment Act by concerning itself with the quality as well as the quantity of our resources and the uses to which they are put.

This revolution in economic thinking and economic policy has already begun to pay dividends. Compared to the 2.4 percent annual rate of growth in real output during the years from 1953 to 1960 (measured from peak to peak of the business cycle), the economy has grown by 4.4 percent since the second quarter of 1960, and by more than 5 percent in each of the last 2 years. Unemployment has dropped to the lowest point since April of 1957. And even though we have had deficits in the Federal Government's cash budget in every quarter of the expansion except one, the public debt as a percentage of our gross national product will be more than 12 percentage points lower at the end of this fiscal year than it was at the end of the 1960 fiscal year.

Yet, in spite of our progress, the real test of our understanding and acceptance of 20th-century economic principles is yet to come. The real test is whether we can continue to move forward toward full realization of the goals of the Employment Act when the burden of defense expenditures has risen and the margin between actual and potential production has narrowed and the fear of doing too much begins to obscure the danger of not doing enough. The real test is whether the great unfinished tasks facing America, tasks which are as crucial to its future as the war in Vietnam, and which at best will require decades for their solution, will be shunted aside because of timidity, or attacked with the vigor, the foresight, the imagination and the economic resources which this Nation is capable of mobilizing.

II. THE OTHER WARS

With the stepup in defense expenditures there are those who will seek to persuade the American people that they must choose between providing adequately for defense or moving forward vigorously with programs to reduce unemployment, eliminate poverty, satisfy our public needs, and achieve other important social goals. The choice, however, is a misleading one. Posed as a "guns or butter" issue, it implies that nondefense programs are of secondary importance, that they are postponable and can be slowed down without serious consequences.

The fact is that we are not confronted by a choice between "guns and butter" in the terms referred to above. The fight for full employment and against poverty in all of its manifestations, public as well as private, foreign as well as domestic, is a fight which America cannot afford to lose or even to postpone. To choose between the two is to choose to fight one war rather than another of equal or even greater importance.

(*a*) *Unemployment*

In spite of increasing concern about labor shortages, this Nation still found itself considerably short of full employment at the end of last year. At 4.2 percent, the seasonally adjusted rate of unemployment during the final quarter of the year was still above even the interim goal established in 1962. And even this figure made no allowance for two sizable segments of unemployment.

In addition to the 3.2 million jobseekers represented by the official unemployment figure, there were almost 2 million people who were working approximately 20 hours per week on the average even though they wanted full-time jobs.

Still another group of workers was excluded from the official count of the unemployed because, while they had no jobs and were willing and able to work they were not actively seeking work. These were the coal miners in the stricken towns and villages of Appalachia, the older unemployed denied job opportunities by the arbitrary and unrealistic age requirements of many employers, or the young school dropouts who had never held a steady job and in some cases lacked the basic academic or vocational skills to obtain one. Estimated at 500,000 or more, they remained outside of the labor force because their search for jobs had proved fruitless in the past or because they had no reasonable expectation of finding a job.

Thus, even without taking into account the unknown number of workers trapped in occupations which failed to utilize their capacities fully, the actual amount of unemployment in the final quarter of 1965 averaged over 5½ percent of the labor force rather than 4.2 percent.

But even that figure conceals some of the most crucial aspects of the problem. During the final quarter of the year, the seasonally adjusted rate of unemployment for teenagers was more than 3 times the rate for the Nation as a whole; the rate for nonwhite adults was twice the rate for white adults; and the rate for nonwhite teenagers reached 27.1 percent, almost 2½ times the white teenage unemployment rate and higher than its annual average during 5 of the last 6 years.

Thus, despite the progress made in reducing the overall rate of unemployment last year, both teenage unemployment and Negro unemployment remained alarmingly high. Negroes still accounted for one-fifth of total unemployment in late 1965—twice their share of the labor force—with more than 1 out of every 4 Negro teenagers among them, living mostly in the slums of big cities, seeking but unable to find work.

In fact, for Negroes, the situation was even more frustrating than these figures reveal because they undoubtedly account for a disproportionate share of labor force dropouts as well as a disproportionate share of the underemployed, neither of whom show up in the official unemployment figures. Bureau of Labor Statistics data show that 72.6 percent of employed Negro males, many of whom had completed high school, were still concentrated in "unsteady, low-paying, unskilled jobs" in 1965 compared to only 39.5 percent of all white employed males.

It is true that in the past 2 years, under the stimulus of vigorous economic growth, the job situation of Negroes and teenagers has improved markedly. Unemployment among Negroes has fallen more rapidly than among whites. Unemployment among teenagers has remained high because of the unprecedented influx of additional young people into the jobseeking age groups. Yet between the last quarter of 1963 and the last quarter of 1965, the number of teenagers with jobs increased by 24.3 percent, compared with an increase of only 3.8 percent in all other age groups.

If the vigorous economic growth continues in 1966, Negroes and teenagers will undoubtedly continue to benefit. However, if we pull back on the reins of economic growth and slow down or stop the decline of unemployment, the major victims will be those who have been bypassed by prosperity so far.

When the economy is operating at a true unemployment rate of 5½ percent or more, when teenagers are pouring into the labor force in greater numbers than ever before, when the Negro people are desperately seeking a chance to share the benefits as well as the burdens of American life, when there is enough urgent unfinished business to occupy the labor force for years to come, it is unfortunate and tragic to find that there are those who are cautioning and warning about the dangers of reducing unemployment too rapidly rather than the danger of not reducing it rapidly enough. Yet, this unfortunately is precisely the stance that the Council of Economic Advisers appears to us to be taking.

In spite of its recognition that the economy can now operate efficiently at unemployment rates below 4 percent, the Council has failed to establish clear and precise goals for overall unemployment as well as for the unemployment of specific groups and to fix target dates for their achievement. Instead, it calls for "prudent * * * reduction in the unemployment rate to a level below 4 percent" and "a cautious move toward lower unemployment * * *."

We are not suggesting that the Council establish a final goal for the achievement of full employment. We are suggesting, however, that the time has now come to reduce the interim target to 3 percent, to set a specific target date for its achievement, and then to seek to lower it even further by eliminating any remaining unemployment which can be avoided by reasonable policies. European countries such as France, Germany, Sweden, and the United Kingdom have all set unemployment goals well below 3 percent in terms of American definitions; they have consistently achieved them; and there is no inherent reason why the United States cannot do the same.

In view of the Council's timidity on a matter of such overriding importance, it is necessary to repeat the appeal which we made to this committee last year:

"We hope this committee will remind the Council in the sharpest terms that it was created by, functions under, and is required by law to carry out the purpose of, the Employment Act. That act is not an anti-inflation or balance of payments act. If pursuit of the employment goal of the act should show signs of having adverse effects upon price stability or the balance of payments, there are methods that can be used to treat those ills directly. But the Employment Act—unless and until Congress legislates otherwise—specifically requires vigorous application of such therapy as may be needed to cure the disease of unemployment and restore full production."

(*b*) *Private poverty*

The effort to combat unemployment remains urgent because the fight against unemployment is part of a larger war, the war against poverty. Poverty has been permitted to reach such incredible proportions in this, the richest nation on earth, that even though we make progress in reducing it, as we have in the last few years, it continues to be a major threat to social stability in the United States.

Despite over 4 years of steady economic expansion, as of March of 1965 more than 34 million Americans, including 13.4 million children under 18, were still living on incomes below the level of the Social Security Administration's definition of poverty—a definition based on a food plan designed for "temporary or emergency use only." In addition to the 18 percent of the American people who fell within this definition, millions more continued to "hover around its edge."

When we analyze its composition we find that there is no mystery about the solution to poverty in America. In 1963 the heads of over half of all impoverished families and 1.8 million of the nearly 5 million poor who lived alone were either at work or looking for work. Among them were 2 million family heads and 500,000 unrelated individuals who worked all week every week during the year and still ended up with less than enough income to lift them out of poverty.

Obviously, what the working poor need is not a slowdown in the rate of economic growth but a continuation and even a speeding up of the rate of economic growth. During the years from 1957 to 1962, when jobs increased at the rate of less than 600,000 per year, the incidence of poverty inched downward at a rate of 0.6 percent per year. Between 1962 and 1964 jobs increased at an average annual rate of 1.3 million and the incidence of poverty declined by more than 1 percentage point a year—almost twice the rate of the previous 5-year period.

The tightening of the labor market in the last few years has been the primary escape route from poverty. It has resulted in a significant increase in jobs for the disadvantaged, the unskilled, the semiskilled, the Negroes and the long-term unemployed. It has provided opportunities for training and promotion which would not have been available otherwise. It has opened up new kinds of work opportunities for those in dead end jobs. And it has exerted upward pressure on substandard wages.

This major escape route from poverty must be kept open, expanded, and supplemented by other avenues of escape. In addition to fiscal and monetary policies designed to close the gap between actual and potential production, we need more public investment to help fill that gap and create the job opportunities needed by the millions of unemployed and underemployed still living in poverty.

The great problem in America is not lack of imagination in developing constructive ideas for public investment which can attack poverty and meet the need for public facilities and services simultaneously; it is the lack of boldness in implementing such ideas. The President has recently proposed an exciting program for the social and physical restoration of American cities. It is a program which can create a new environment for the poor and help eliminate urban decay and ugliness. As Mr. Johnson has said, it could transform the cities of the present into "the masterpieces of our civilization."

Clearly, this is an area which cries out for national action. The cities have the problems; the Federal Government has access to the money. Columnist Joseph Alsop declares: "A country as rich as the United States ought not to think twice about the remedy. The remedy—the only possible, the only practical remedy—is bold Federal action on a large scale." Yet, the spending the Congress has been requested to authorize for the first year of this new program is simply enough, as Walter Lippmann has said, "to plan how to plan." And even the expenditures contemplated for future years bear little relationship to the magnitude of the problem.

Another suggestion which holds forth promise both for the poor and the public in general is the proposal for an employment and training program conducted by public and private nonprofit institutions with major financial support by the Federal Government. This program, suggested by both the Full Employment Steering Committee of the Democratic Study Group, and the National Commission on Technology, Automation, and Economic Progress (the Automation Commission), would train and employ aids for nurses, physical therapists, dieticians, teachers, and recreation leaders. It would create jobs for homemakers and other home helpers. It would provide personnel to "enable us to open schools, libraries, museums, art galleries, and playgrounds in the evenings, on weekends and during summer" and it would open up opportunities for public service in other areas as well.

Many details of such a program remain to be worked out, including assurances that existing workers will not be replaced and that adequate wages will be paid. None, however, should prove insurmountable. Again, the only question is our willingness to devote sufficient resources to do a job from which all America will benefit.

Other measures to assist the working poor which also require immediate action are:

1. An extension of the Fair Labor Standards Act to the millions of low-wage workers on farms and in cities who are not presently covered and an increase in the minimum wage to $2 an hour as rapidly as possible. Economists and others have increasingly acknowledged the wisdom of guaranteeing an adequate income for all. Certainly, they should be ready to accept the justice of paying those who work all year round enough to live one notch about the level of poverty.

Approximately 20 million Americans currently receive less than $2 an hour—the amount which must be earned by a full-time worker in order to provide the Social Security Administration's "low-cost budget" for a nonfarm family of 4 (a budget requiring about $4,100 in terms of 1965 prices).

2. An improvement in the amount, the duration, and the coverage of unemployment insurance benefits. Pending the development of a national unemployment insurance system, such improvements should be achieved through the establishment of Federal standards. And, like the suggested improvements in the FLSA, they should be achieved now when unemployment has declined, profits have soared and the cost of making the necessary changes can be readily absorbed.

3. A truly national manpower policy to supplement the job-creating measures cited above. This is necessary not only to deal with the problem of poverty which we hope will be eradicated in time, but to deal with the problem of technological change which is a continuing and growing problem.

We have made considerable progress toward a manpower policy since 1961. However, we have yet to develop the kind of comprehensive and integrated programs we need to match the magnitude of the problems we face.

An effective manpower policy requires better coordination of the many different federally supported training programs which have been launched. Such coordination should be achieved through the Manpower Administration in the Department of Labor.

An effective manpower policy also requires greater attention to the need for upgrading workers already employed and to the need for training the unemployed for tasks which offer some hope rather than those which pay little and require skills which are relatively easy to acquire on the job.

It requires more adequate training allowances than are currently provided. U.S. training allowances, tied as they are to grossly inadequate unemployment benefits, are much lower in relation to normal earnings than the allowances provided by a number of European countries. Unless they are substantially improved, it will become more difficult to attract unemployed workers and to keep them from dropping out as employment increases—especially for courses requiring lengthy periods of training.

Also, if retraining is to bear fruit, particularly in depressed areas, we must go beyond pilot projects for relocating workers in communities in which jobs are available. We must develop a comprehensive program to meet in full the reasonable costs of moving unemployed workers and their families to such communities.

In addition, as the Automation Commission has pointed out, we need a completely federalized national employment service with sufficient resources to effectively match the supply and demand for labor throughout the country. To perform this function, we must have expanded testing and counseling facilities, employers must be required to list all job vacancies other than those to be filled by promotion, by recall or through special union-management arrangements: and we must have a truly national computerized system for matching available men and available jobs quickly and accurately.

We have a long way to go in this country to match the kind of integrated labor policies which the Europeans have developed. The closer we get to achieving the unemployment levels they have achieved, the more necessary it will be for us to eliminate that policy gap. As we move toward lower and lower levels of unemployment, we will need more intensive and imaginative programs to eliminate actual structural unemployment, to minimize frictional unemployment and to make the fullest possible use of the highest capacities of every individual willing and able to work.

The Automation Commission has recommended that study be given to a proposal which would enable management, labor and Government to cooperate in making technological progress possible without the sacrifice of human values. It involves use of the investment tax credit under the Internal Revenue Act to provide the incentive for employers to establish programs for the assistance of workers displaced by technological change.

In each year, one-half of the investment credit to which each firm is entitled would be paid to it directly and the other half would be placed in reserve in a Government trust fund where it would be held available for a period of 5 years to meet the needs resulting from technological displacement of the employees of that firm. At the end of 5 years any amount not so used would be returned to the firm.

The funds set aside for any particular firm could be used to supplement unemployment compensation or retraining allowances, to pay the costs of relocation or to pay for other benefits.

The moneys in the trust fund would be invested in Government bonds, in the same way as with the social security trust fund. The interest would be pooled, to pay the excess of the costs charged to any one company over the amount of investment credit reserved with respect to that company. If at any time the total sum of such excess costs was in excess of the amount of interest available, the difference would be made up by the Treasury out of general revenues.

The effect of this proposal would be to encourage firms to minimize dislocations resulting from technological change. The company would have a strong financial incentive to plan its changes so as to avoid dislocations, to find alternative jobs for workers disemployed, to train them for other jobs which it may have to offer and so on, since success in such efforts would increase the amount of reserved funds which would eventually be returnable to it. This encouragement to keep the costs attributable to technological change at a minimum would in turn minimize the possibility that there would be excess costs chargeable to the Treasury.

Mounted on a massive scale, the job creation, income protection, and manpower adjustment programs described above can eradicate the poverty attributable to unemployment or employment at substandard wage levels. However, other measures are necessary to aid the poor who are unable to work at all for one reason or another—a problem which in some respects has grown worse in recent years.

As the Council's Economic Report indicates, in the period between 1959 and 1964, the number of poor households headed by females (including women living alone) increased from 5.4 to 5.5 million. During the same period, the total number of poor unrelated individuals over 65 years of age increased from 2.5 million to 2.8 million. (An additional 2.6 million individuals living in families of 2 or more were 65 years or over.)

As the Council observes, "for the aged and for families headed by females, continued improvement of income maintenance programs remains the major route out of poverty, since most of them are not—and cannot—be active members of the labor force." For the former, the passage last year of medicare and the 7 percent increase in retirement benefits have been of tremendous assistance. However, even now, with average annual benefits of about $1,584 for an aged couple, $1,092 for a retired worker, $948 for a retired widow and no benefits at all for many other retired people, the social security system falls far short of providing a decent living for the aged poor. It is a contributory system, yet it provides married couples with less than Canada's noncontributory pension, to which contributory benefits have now been added.

The Canadian pension of $75 per person per month provides every retired couple with an income of $1,800 per year, now payable beginning at age 69, but legislation now on the books will lower the minimum age by stages to age 65 in 1970. The pension differential is even more striking when differences in living standards in the two countries are taken into account. Thus, the average U.S. pension for a retired couple represents only about 28 percent of the average wage in manufacturing, while the Canadian pension represents 37 percent of the average Canadian manufacturing wage.

The inadequacy of public assistance payments as a source of income maintenance for the poor has been clearly set forth in the Economic Report. Both in terms of coverage and benefits, such payments also fall shockingly short of any reasonable standard of adequacy.

Clearly, a substantial boost in social security payments is needed to help the aged poor out of poverty. In addition, they must be provided with low-cost housing and community facilities and a system of adequate benefits must be established for those who are not covered by social security during their working years.

For the poverty-stricken families headed by females, adequate public welfare payments or income maintenance allowances are essential, along with low-cost housing and day-care centers which would enable the heads of these impoverished families to find jobs if they are willing and able to work.

According to the Council of Economic Advisers less than $12 billion, if properly distributed, would have wiped poverty, as it is defined by the Social Security Administration, off the face of the land in 1964. However, much of that gap could have been eliminated if all those who were able to work had been provided with jobs at decent wages. Thus, considerably less than $12 billion—probably no more than 1 to 1½ percent of our total gross national product for that year, and less, undoubtedly, than will be spent in fighting the war in Vietnam during the coming fiscal year—would have been required to fill the gap for those unable to work. There is obviously no reason why this Nation cannot establish a floor under family incomes—a floor which would guarantee every man, woman and child in this, the richest and most productive country in the world, an income equal at least to the standard currently being used to define poverty in America.

While the administration's poverty program could never be regarded as the chief weapon in the war against poverty, we supported it with enthusiasm because we felt that it could be a useful adjunct to the job creation, manpower and income maintenance programs referred to previously and because it served to arouse the conscience of America. We still feel that the poverty program has an extremely important function to perform. We are, therefore, saddened and disappointed by the inadequate provisions for it in the new budget. To hold its expenditures to the figure which the President has set, the Office of Economic Opportunity will apparently have to reduce its goals and even cut back on some existing programs.

The dangers of cutting back on the poverty program and failing to move forward on other measures to assist the poor should be obvious. Such programs are the most crucial part of this Nation's effort to give meaning to the aspirations of a long-suffering portion of our population which was denied its basic freedom for centuries and is now being denied the opportunity to make full use of those freedoms. The hopes of the Negro people as well as the millions of whites who still live in poverty have been aroused. The fulfillment of these hopes must not be frustrated or postponed. We believe the war upon poverty is a war and that America is rich enough and powerful enough to fight the kind of two-front conflict which now appears to be necessary.

(c) *Public poverty*

The Nation faces still another task of gigantic proportions. As Edmund K. Faltermayer writes in an article entitled "The Half-Finished Society" in the March 1965 issue of Fortune:

"The United States has let its public environment run to overpowering disaster. * * * The whole place needs to be done over."

With an eloquence reflecting the depths of the feeling, others have expressed the same profound concern. One year ago, John K. Galbraith told this committee:

"We must continue to be wary of tax reduction at a time when so many public tasks of such urgency are awaiting attention.

"I am not quite sure what the advantage is in having a few more dollars to spend if the air is too dirty to breathe, the water is too polluted to drink, the commuters are losing out on the struggle to get in and out of the cities, the streets are filthy, and the schools are so bad that the young, perhaps wisely, stay away, and hoodlums roll citizens for some of the dollars they saved in taxes."

In the July 1965 issue of the Journal of Business, Walter Heller wrote:

"* * * The polluted air I breathe in many large cities, the polluted Lake Michigan and Puget Sound beaches where I swam as a boy, progressive urban decay, the blight of human poverty amidst plenty, the vanishing wilderness, the uneven struggle between beauty and ugliness in American life, the excessive incidence of illiteracy, crime, and delinquency—not to mention more mundane things like the flooding Minnesota and Mississippi rivers and the bumps and potholes in Minneapolis streets—all these reach out for a larger share of that $6 billion-plus annual dividend" [resulting from the normal growth of the economy].

Echoing the same theme, Walter Lippmann observed in his Washington Post column last month:

"The urgent need of the great cities is to be made habitable, and this can be done only by replanning and renewing them, which is a gigantic engineering and administrative task, and will require great sums of money which can be raised in no other way than through the Federal tax machinery.

"To overcome successfully the problems of urbanized America will require at least the work of a generation. This work is not postponable as being mere 'butter' which we can do without while we make the 'guns.' There are, as New York and Los Angeles have learned, explosive urban problems underneath our glittering affluence."

One can hardly accuse President Johnson of being unaware of the problem. Measures proposed by the administration and enacted by Congress, including those for the development of Appalachia and other depressed areas, assistance to elementary and secondary schools, the advancement of community and regional health services, the establishment of a Department of Housing and Urban Development, the beautification of highways, and the control of air and water pollution, all reflect a growing and commendable concern for the quality of American life.

However, the task is so monumental that the measures enacted thus far can only be regarded as a beginning. They go only a small part of the way toward meeting America's public service needs. The enormous extent of such needs is particularly apparent in housing, education, and health.

To meet our housing needs an average of 2.7 million dwelling units must be built each year for 15 years. By the end of 1980 we must provide 21 million homes to match population growth and to house families now doubled up in one home, and 20 million more to replace those that are now substantard, those that will have deteriorated by 1980 and those that will be destroyed by disaster or demolition—a total of 41 million for the entire period, or 2.7 million per year. By contrast, only 1.5 million new housing units per year have been started in recent years including a mere 38,000 low-cost public housing units.

In education, we have a backlog of close to 440,000 elementary and secondary classrooms which need to be replaced either because they are located in firetraps, in barracks and quonset huts, or in buildings which are obsolete. In addition we must take care of the excess pupils in overcrowded classrooms and we must provide for the more than 9 million additional pupils who will be enrolled between now and 1975.

Overall, we need to build 1,225,000 classrooms in elementary and secondary public schools between the fall of 1965 and the fall of 1975. In order to build the needed classrooms we will have to construct 122,500 new classrooms per year. By contrast, in recent years only about 70,000 classrooms have been built each year.

In higher education, the contrast between future needs and past performance is even more striking. With enrollment expected to double by 1970, $23 billion worth of new college and university facilities will be required—more than three times the value built during the preceding decade.

Finally, in 1964 the Federal Government estimated that we needed 1,109,000 additional civilian hospital beds to meet our needs. Yet since 1959, we have increased the number of acceptable beds by only 40,000 per year—little more than enough to keep with the growth in population.

As these and similar needs have multiplied, States and local governments have found themselves increasingly incapable of coping with the problem. For this, as well as other reasons, including the regressive nature of State and local tax systems, it has become apparent that only Federal leadership and Federal funds can establish the necessary programs on a sound and continuing basis.

The AFL–CIO urges the Federal Government to assume that leadership by developing and maintaining a national inventory of needs for housing, community facilities, and public services, based on present backlogs and future population growth. Such an inventory can then provide the foundation for programs undertaken directly by the Federal Government or by State and local governments with assistance in the form of Federal grants-in-aid and guaranteed loans. Target dates should be established for achieving specified objectives and the pace should be speeded up or slowed down, depending upon changes in defense requirements and the availability of manpower and productive capacity.

Such a program of public investment can remake America. It can dissolve explosive social pressures, improve the health of the Nation and make the cities of America habitable; it can increase our potential for economic growth; and it can create an enormous number of jobs for America's growing labor forces as well as for the future victims of technological change.

(*d*) *Wrong-way income distribution*

Deterioration in the public sector of the American economy has been accompanied by a disturbing trend in the private sector—a trend which has not been eliminated by the rapid growth and rising employment of recent years. The average American worker is being shortchanged. He has not been receiving a fair share of the gains of increasing productivity. The gap between what he produces in an hour and what he can buy for the money he earns in that hour has been steadily widening.

There would be no gap if the price-wage guideposts were strictly adhered to, even though the Council of Economic Advisers insists upon defining the wage guideline in current dollars. Prices would remain stable; average increases in real hourly compensation would equate with increases in nominal compensation, and both would correspond to increases in national output per manhour; and the relative shares of labor and nonlabor income in total output would remain unchanged. What has actually happened, however, is illustrated by the following tables based on figures in the Council's own report:

Annual percent changes in prices, productivity and compensation, 1960–65

Productivity total private economy[1]	3.6
Consumer price index[2]	1.3
Compensation per man-hour (current dollars):	
Total private economy[1]	4.2
Manufacturing[1]	3.6
Real compensation per man-hour[3]:	
Total private economy	2.9
Manufacturing	2.3
Shortfall in compensation per man-hour[4]:	
Total private economy	.7
Manufacturing	1.3

[1] Annual Report of the Council of Economic Advisers, p. 79.
[2] Bureau of Labor Statistics.
[3] Difference between compensation per man-hour in current dollars and CPI.
[4] Difference between productivity and real compensation per man-hour.

These figures show not a proportionate sharing of the gains of productivity but a significant shortfall in the share going to labor. Average increases in real hourly compensation did not correspond to increases in national output per man-hour. In the total private economy between 1960 and 1965, they fell short by an average of seven-tenths percent a year. The average worker, in other words, would have had to receive seven-tenths percent more in hourly compensation than he actually received—4.9 percent instead of 4.2 percent—in order to share proportionately in the national productivity gains of the period. And in manufacturing, the gap was even greater. There the average factory worker was shortchanged to the tune of 1.3 percent a year.

Actually, these figures fail to tell the full story. The data on compensation used by the Council includes not only wage and salary employees but millions of self-employed persons as well. Moreover, the gap between real compensation and real output per man-hour has been growing since 1956.

The losses sustained by workers as a result of the inequitable sharing of productivity gains have contributed mightily to the swelling tide of profits. Even before the recent revisions in national income data, businessmen themselves looked upon the phenomenal growth of profits with incredulous eyes. Then came the revisions and it was discovered that the unprecedented performance was more incredible than anyone had originally dreamed. According to the National Industrial Conference Board Record of October 1965:

"The most dramatic feature of the new look is that individuals, it turns out, have been providing a lot less of the Nation's aggregate saving than we used to think, and corporations have been providing a lot more. Most particularly of all, the rate of corporate profits, and of the undistributed portion of these profits, has undergone a spectacular revision.

"As late as last August, it was widely believed that corporate profits, before taxes, amounted to less than $58 billion in 1964; the new profits figure is close to $65 billion. Corporate tax liability, which had been supposed to be $25.8 billion, now appears to be $27.6 billion; and the profits after taxes of U.S. corporations have been revised upward from less than $32 billion to more than $37 billion.

"As a result * * * the share of corporate profits in national income has been revised strikingly upward, particularly in recent years. * * * On the new basis, profits as a component of the Nation's income flows have recovered to the level prevailing during much of the boom of the middle 1950's."

This remarkable performance occurred in spite of bookkeeping regulations which have had the effect of boosting depreciation allowances and understating reported profits in recent years. Taking this fact into account, we find the performance even more remarkable. According to preliminary figures provided by the Office of Business Economics, the total cash flow of all nonfinancial corporations (capital consumption allowances plus profits after taxes) as a percentage of the gross product originating in all such corporations was greater in 1965 than at any time since the extremely abnormal Korean war year of 1950.

The most outstanding example of our superprofitability is, of course, General Motors Corp., which last year became the first business enterprise in history to earn over $4 billion in profits before taxes and over $2 billion after taxes in the course of a single year. The corporation's after-tax profit represented an extortionate 28-percent return on the stockholders investment—sufficient to double the value of that investment every 1,300 days. It exceeded the combined amount of the U.S. Government's current administrative budget expenditures for manpower development and training, vocational rehabilitation, all the programs of the Office of Economic Opportunity, and health services for the aged.

If General Motors had been satisfied with a 13.1-percent annual rate of return after taxes in 1965, the rate enjoyed by the average U.S. manufacturing corporation in the first 9 months of 1965, it would have had sufficient funds left over to have raised the wages and salaries of every one of its employees everywhere in the world by $2,960, or to have cut the wholesale price of every car and truck it sold in the world by $299, permitting a substantially greater cut in the retail price.

Yet, General Motors is only one of many superprofitable corporations whose profits in these years of expansion have been growing at unbelievable speeds. The 25 largest corporations in the country, as ranked by Fortune, increased their after-tax profits in the first 9 months of 1965 by an average of 30 percent over the same period of 1963. Among those at the very top were Bethlehem Steel Corp. with an increase of 83 percent, International Business Machines with an increase of 70 percent, United States Steel with an increase of 51 percent, and Ford Motor Co. which for the full year of 1965 earned 39 percent more profit than in 1963.

This enormous rise in nonlabor income, along with the lag in wages and an increasingly regressive tax structure, has produced a wrong-way income distribution trend. Office of Business Economics figures show that in the decade between 1952 and 1962 the share of personal income received by the bottom two-fifths of all consumer units dropped from 17.4 to 16.4 percent while the share going to the highest fifth increased from 42.4 to 43.7 percent.

These figures do not take into account the capital gains resulting from the increase in the value of stocks and other forms of capital which are held chiefly by the rich. Nor do they reflect the enormous expansion of expense account living, a form of income in disguise enjoyed primarily by those in upper income brackets.

Furthermore, although the Office of Business Economics has not published income distribution figures for the years after 1962, the disparity has evidently grown greater since then. In 1965, the compensation of employees, the form of income upon which low- and moderate-income groups depend primarily, was no higher as a percentage of national income than it had been in 1962 (despite the continuing shift from self-employment into wage and salary employment). On the other hand, during the same period, corporate profits as a percentage of national income rose by one full percentage point.

Aside from the matter of equity, the continued flow of cash into corporate treasuries at such a pace poses serious economic problems. Excessive profits breed recession and economic stagnation. They lead to excessive savings, to savings which are not sufficiently offset by investment, causing a gap in total demand, a loss of billions of dollars in goods and services, and unemployment for millions.

It is true that business investment has shown surprising strength in recent years. Nonresidential fixed investment rose to 10½ percent of GNP in late 1965 and is expected to be slightly higher this year. "Yet," as the Council points out, "it is obvious that business fixed investment cannot continuously grow twice as fast as GNP, as it did in 1964–65, and that it cannot always be a propelling sector of demand."

In fact, in 1963 one of the members of the present Council, Arthur Okun, presented a paper to a meeting of the American Statistical Association in which he concluded: "Over the long run we may optimistically hope to do better than the implied 9.8 percent (of GNP) as our investment ratio at full employment. But at this point, such a view is better supported by hope than conviction."

The economic consequences of inflated profits plus accelerated depreciation allowances are illustrated by the Federal Reserve Board's data on the sources and uses of funds by nonfarm and nonfinancial corporations. In every one of the past 8 years these corporations, in spite of paying record dividends, received more in undistributed profits and depreciation allowances than they were able to invest in new plant and equipment. For 1965, the excess was $7.8 billion. Since 1959, when the process began, this excess of retained cash flow has totaled $40.9 billion.

Although plant and equipment do not represent the only investment outlet for corporate funds, the point is that traditionally such investments have exceeded the volume of funds available from internal sources, and additional funds for this purpose have been sought from the public, thus providing investment opportunities for noncorporate savings. The reversal of this trend contributes to the overall deflationary danger which exists whenever the decisions of corporations and individuals to save outrun their opportunities to invest.

If present investment levels cannot be sustained, as many economists fear, and if, therefore, private corporations take more purchasing power out of the economy in profits and depreciation allowances than they put back in through investment spending, only the willingness of Government to incur deficits and the willingness of consumers to spend can provide the stimulus to achieve and sustain full employment. While a massive attack by Government on poverty in both the private and public sectors is essential, the Government cannot be expected to carry the entire burden of promoting rapid economic growth. In our economy, consumer expenditures are the chief source of support for expanding markets and we expect them to remain so.

Therefore, economic necessity, as well as considerations of equity, makes the adoption of a positive wage policy designed to provide workers with greater purchasing power and to establish a more balanced distribution of national income a matter of compelling importance. This is especially true when the economy is operating at less than full employment, as it currently is, in spite of recent improvements. Yet, the wage policy proposed by the Council of Economic Advisers is extremely negative and grossly unfair.

The Economic Report itself provides a host of reasons for avoiding panic about wage pressures. It declares that "wage movements of recent years must clearly be characterized as moderate"; that increases in hourly compensation have been "consistent with relative stability of average unit labor costs throughout the economy"; that "unit labor costs in manufacturing decreased by 0.8 percent last year" (and, it might well have added, they have been declining almost steadily since 1958); that "because of the relatively light calendar of expiring contracts, the basic pattern of wages for most key industries has already been set for 1966." It notes that profits have risen astronomically, a fact which would indicate that there has been no general wage-cost-price squeeze. And it calls attention to the substantial improvement in our balance of payments. Despite all of this, the Council, with a callous disregard for fairness, revised its method of calculating the guideposts in an attempt to repress wages.

There was clearly no justification for the Council's action. The guideposts implied by earlier Economic Reports, ranging from 3 to 3.2 percent, have been lower than the actual increase in productivity in 3 out of the last 4 years. What is more, the increases in real hourly compensation which workers have actually received have lagged far behind the gains in productivity for almost a decade.

Furthermore, if the Council is right in assuming that the true productivity trend is 3.0 to 3.3 percent per year (and there is absolutely no conclusive evidence that it is), the 5-year moving average method which it had been using would have yielded a guidepost figure of approximately that size within 2 years. During those 2 years, the enormous profits which corporations have enjoyed in the current expansion, partly at workers' expense, and the profits which they are likely to continue to enjoy, would have enabled them to absorb wage increases exceeding productivity gains without raising prices.

Yet, instead of insisting that management "take the bad with the good," the Council is once again asking workers to bear the burden of fighting inflation—just as it has done in the past by defining the wage guideposts in terms of current dollars rather than dollars of real purchasing power.

We would like to remind the Council that a wage policy which is concerned only with compensation as a cost is an inadequate and even dangerous policy. At the very least, instead of asserting that in the absence of price pressures "Public policy is and should remain neutral with respect to wage and price decisions that attempt to change the distribution of industry's income * * *," the Council should have reaffirmed the position it took 3 years ago when it said:

"The proportions in which labor and nonlabor incomes share the product of industry have not been immutable throughout American history, nor can they be expected to stand forever where they are today. *It is desirable that labor and management should bargain explicitly about the distribution of the income of particular firms or industries.* It is, however, undesirable that they should bargain implicitly about the general price level." (Emphasis added.)

(*e*) *Foreign aid*

U.S. foreign aid programs along with those of other nations have helped improve economic and social conditions throughout the free world. Nevertheless, the gap between the rich and the poor has grown wider. AID data show that between 1957–58 and 1963–64, the per capita income of the developed nations rose at an average annual rate of 3.1 percent while that of the less-developed nations increased at a rate of only 2.3 percent. During this period, the average per capita income of the latter rose to $160. If it continues to increase at the same rate as in the past, it will reach $370 by the end of this century. In 1963–64, the average per capita income in the United States was $3,083.

As seen by C. P. Snow in his book, "The Two Cultures and the Scientific Revolution," this is what such figures mean:

"This disparity between the rich and the poor has been noticed. It has been noticed, most acutely and not unnaturally, by the poor. Just because they have noticed it, it won't last for long. Whatever else in the world we know survives to the year 2000, that won't. Once the trick of getting rich is known, as it now is, the world can't survive half rich and half poor. It's just not on."

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"In the poor countries * * * Men * * * are no longer prepared to wait for periods longer than one person's lifetime."

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"Since the gap between the rich countries and the poor can be removed it will be. If we are shortsighted, inept, incapable either of goodwill or enlightened self-interest, then it may be removed to the accompaniment of war and starvation; but removed it will be. The questions are, how, and by whom."

* * * * * * *

"Though I don't know how we can do what we need to do, or whether we shall do anything at all, I do know this: that, if we don't do it, the Communist countries will in time. They will do it at great cost to themselves and others, but they will do it. If that is how it turns out, we shall have failed, both practically and morally."

Whatever else needs to be done, obviously two things are necessary. The poor countries need capital and they need technical assistance. However, since 1961, the long-term capital supplied by developed countries, while remaining constant in absolute terms, has declined both in terms of their own GNP and in per capita terms, based on the rapidly growing populations of the developing countries.

In view of this and in view of the estimate made by the World Bank that the less developed countries have the capacity to effectively absorb $3 to $4 billion more per year than they are currently receiving, it is disturbing to find our own country proposing to reduce its expenditures for development loans and for technical assistance as well during the coming fiscal year.

Overall, the economic and military aid program which has been proposed for fiscal year 1967, consisting mainly of stopgap crisis aid, amounts to $3.4 billion. This represents less than one-half of 1 percent of our anticipated GNP for the year and less than one-half of the 1 percent of GNP contributions called for by UN and OECD resolutions.

As a matter of self-interest as well as humanitarian concern, this process must be reversed. Rather than reducing the proportion of our GNP which we devote to foreign aid, we should be increasing it for years to come. If by our example we could persuade the other developed countries to follow a similar course, the total amount of aid available to the developing countries would be multiplied many times, and would then begin to approach the dimensions of their need. With such aid, we would have a far better chance than we now have of developing viable economies which would eventually take their rightful place alongside the developed countries in a peaceful and stable world.

One other need of the underdeveloped countries should engage the immediate attention of America in particular. That is their need for food. This is an immediate need. Provision of capital and technical assistance are more or less long-term programs. But we live in a world in which two-thirds of the people still go to bed hungry every night. They need food now. Tens of millions of them will starve to death if they do not get it.

What is equally important, their existing malnutrition stands in the way of their doing those things which they could do for themselves to overcome it. As Josue d'Castro, former Chairman of the Executive Council of the United Nations Food and Agriculture Organization, pointed out some years ago in his book, "The Geography of Hunger," persistent malnutrition is primarily responsible for the torpid lethargy and complete lack of ambition which afflict whole populations and hold back self-development in so many areas of the world, as well as for the susceptibility to tuberculosis and other debilitating diseases which render hundreds of millions physically unable to work.

Yet, in these days of worldwide hunger and slow starvation, we in America have an immeasurable reserve of food-producing capacity which we have not dared to touch. So rapid has been the growth of productivity in agriculture that for a decade we have had to pay American farmers not to produce lest they overwhelm us in a glut of food and fiber. What could be more illogical? Indeed, what could be more immoral? Let us take the wraps off American agriculture. Let us start planning now so that every ounce of food we can produce which is surplus to our own needs and the requirements of our present foreign markets will be made available to help reduce the hunger of the world.

Such arrangements, of course, will have to include protections against the disruption of our own market or those of other countries. But that is simply a matter of establishing the necessary international mechanism. The important thing is that we make up our mind to release the productive genius of American agriculture and put an end once and for all to the idiocy which demands restraint on food production while hundred of millions starve.

III. FULL EMPLOYMENT AND STABLE PRICES

Clearly, in spite of the increased military effort this is no time for America to call a halt to social and economic progress at home and abroad.

At the end of last year, manufacturers were operating at approximately 89 percent of capacity. In other words, they were producing some 11 percent less than they were capable of producing to meet the needs of the American people and there was little evidence of any strain in order backlogs.

What is more, manufacturers have been adding to their capacity at a phenomenal rate. The year 1966 may well be the third straight year in which investment in new plant and equipment has risen by more than 14 percent. In the process, manufacturing capacity will rise by another 7 percent or so. This, as the Council says, "should keep the average operating rate essentially unchanged for 1965."

Also, existing employment is still far from full employment. Early last month Arthur Ross, Commissioner of the Bureau of Labor Statistics, noted that aside from "stringency in some areas and occupations and in a few industries * * * there is little clear evidence that production schedules are being delayed by manpower shortages."

Obviously, existing productive capacity, further growth in such capacity, and current levels of unemployment all leave ample room for very substantial increases in demand this year. In fact, our estimates show that with an unemployment rate of 3 percent in 1966 we could produce in the neighborhood of $740 billion worth of goods and services during the year—some $18 billion more than the Council of Economic Advisers has actually projected. Based on a 2-percent rate of unemployment, we estimate that the gap would be about $25 billion.

Even though GNP is still well below its potential, and is likely to remain below it through the year, prices have begun to creep up at a slightly faster pace. The Consumer Price Index rose 1.7 percent in 1965 compared to only 1.2 percent per year in the previous 6 years.

A 1.7-percent increase, as Secretary of the Treasury Fowler recently said, is not a desirable increase but it is a "tolerable increase." It is far less than the 3.8-percent average annual rise for the postwar period as a whole; it is less than the annual rise of 2.6 percent between 1913 and 1945; it is less than the 2½-percent annual increase in the 16 years of "peace of prosperity" from 1897 to 1913; and it is far less than recent rates of increase in most other industrial countries.

Rise in consumer prices

[Changes over 12 months ending September 1965]

	1964	1965
Japan	3.3	8.7
Denmark	3.9	8.6
Sweden	4.0	5.5
Canada	1.6	2.6
Germany	3.0	3.8
United Kingdom	4.3	4.8
United States	1.2	1.7
France	2.5	2.4
Netherlands	6.7	5.6
Italy	6.5	4.1
Norway	8.2	2.9

Source: OECD Observer, November 1965.

Obviously, recent U.S. price increases have not been violent. In fact, such increases have been a very small price to pay for the 5½-percent growth in output during 1965 and the drop of almost 600,000 in employment between December of 1964 and December of 1965. They do not justify a reduction in expenditures, a tightening of credit, an increase in taxes, or any other negative response which sacrifices the unemployed and the poor on the altar of absolute price stability.

The jobs that can be generated now by a continuation of rapid economic growth are too crucial to permit any slamming of the economic brakes at this time. As Economist Robert M. Solow says in the Christian Science Monitor of January 11, 1966:

"Those last few jobs matter particularly because they will go in large part to the people who need them most: the Negro, the teenager, the unskilled manual worker, the dropout or 55-year-old without a high school diploma.

"It is precisely when the labor market tightens, when the skilled, the educated, the experienced all have jobs, that it becomes the turn of the disadvantaged. To relax now, to give up on the problem of full employment without inflation, is to condemn thousands of our citizens to more or less permanent unemployment.

"That last few billions of dollars worth of production is important because it will satisfy important needs. If it is not produced, the war on poverty will suffer, not the Defense Department. There will be fewer school buildings, not fewer color television sets."

While it opposes efforts to curb price increases by calling a halt to economic growth, the American labor movement firmly believes that we can and should make full employment and even the approach to full employment compatible with reasonable price stability.

One positive answer to the problem lies in making optimum use of our labor force. The manpower programs suggested earlier can do much to increase the productive capacity of the economy. Additional investment in human resources, in their health, their education and their physical environment, can do more. Along with vigorous enforcement of the Nation's equal rights legislation, such programs could tap the enormous productive potential of the Negro people. Raising Negro employment and productivity rates to the white level, this year's annual report estimates, would increase our GNP by 4 percent or $27 billion.

There are other approaches to the problem of price stability. President Johnson, like President Kennedy, has taken vigorous action against the abuse of administered price power by large corporations with virtually monopolistic pricing authority and he has succeeded in preventing the worst excesses from occurring. In steel, in aluminum, in copper, in wheat, proposed price increases have either been prevented or at least limited. The President's use of Government stockpiles and Government contracts have represented an imaginative and, in some industries, an effective method of substituting Government market power for the competitive market forces which are no longer effective.

However, such methods are far from satisfactory as a permanent means of maintaining price stability. They suffer from three major defects.

First, they can be brought into play only after a price increase has been announced. Complaints have been made in Washington that it is highly irresponsible for corporations in key industries to announce price increases without a word of advance notice to the Government. But irresponsibility of this kind is a built-in characteristic of the modern U.S. corporation. The answer is not appeals to responsibility, but legislation requiring such corporations to give their Government advance notice of decision which can affect the whole economy.

A second weakness in the present method of direct presidential intervention is that it puts the whole prestige of the President on the line each time. One failure would do inestimable damage to the position of the President, and would probably make any similar future action on his part impossible. Obviously, this is a weapon that can be used only on special occasions, when the need is great and the President's position unassailable. It cannot be used, for example, to combat creeping or "bologna slicing" inflation—the repeated increase of one price by a little bit here, and another by a little bit there—which slowly but surely raises the level of all prices.

The third weakness in the present method is that it has absolutely no effect in bringing about price cuts in industries with greater than average rates of productivity advance, where prices should be falling. As the Council of Economic Advisers has repeatly pointed out, there are some industries in which productivity advances at a pace slower than the national average. Most of the service industries are in this category; for example, no one has yet figured out how to automate a haircut. If wages of the workers in these industries are to keep pace with the national average, prices cannot help but rise. If we are to have a stable overall price level, these price increases in industries with lower than average rates of productivity advance have to be offset by price cuts in industries with greater than average productivity increases—such as the auto industry, for example. Yet, although the auto industry could make very substantial price cuts and still earn better than average profits, it has refused to lower prices by any significant amount.

In order to deal with this problem the AFL-CIO, at its last convention, declared:

"To curb the potential danger from the pricing policies of the major corporations in key administered-price industries, the spotlight of public attention is needed. Only the Federal Government—Federal agencies, congressional committees, or both—can adequately focus public attention on the facts of the cost-price-profit-investment policies of these corporations, in an attempt to curtail administered-price abuses."

My own union, the UAW has proposed that a new force be applied in industries in which the forces of price competition no longer exist—that of a fully informed public opinion. For that purpose we urge the establishment of an administered prices board and a consumer counsel.

Under legislation establishing the Board, any corporation holding a dominant position in a key industry—for example, controlling 25 percent or more of the industry's sales—would have to give at least 60 days' notice to the Administered Prices Board of any intended price increase. If the Board thought necessary, it would have authority to call the company before it for a public hearing.

At such a hearing the Board would have the power to dig out all the pertinent facts and publish them following the hearing. The Board would not be empowered to make any ruling on the proposed increase; once the Board's report was out, the corporation would be free to put the increase into effect if it saw fit. But if the facts and figures made it clear that the price increase was not justified, it is highly doubtful that the corporation would attempt it. Indeed, just the knowledge that such an investigation was probable would deter most large corporations from even proposing price increases unless they could be fully justified.

There are probably no more than 100 corporations that would be subject to such hearings procedures, for it would need to apply only to the one dominant company in each industry. If that company were restrained from raising its prices, the smaller ones would have to follow suit.

Opponents of this proposal have argued that it would make corporations reluctant to reduce a price because of the difficulties in the way of restoring the price cut if it should become necessary. And in any case, a procedure that could be triggered only by a threatened price increase would fail to meet the problem posed by high-productivity industries which refuse to grant the price cuts they could well afford.

Both of these objections can be met by the establishment of an Office of Consumer Counsel. This office would represent the interest of consumers in all hearings before the Board, and it would have the power to initiate hearings when sufficient evidence was available to suggest that prices of any corporation subject to the procedure were already too high.

Unions would also be subject to the hearings procedure when appropriate. Whenever a corporation subject to the procedure claimed that it would have to raise prices if it gave in to a union demand, the union as well as the corporation would then be required to produce the relevant facts. The Council of Economic Advisers has pointed out that in some circumstances a wage increase is justified even if it does require a price increase. If this were the situation in a given industry, the hearing would reveal it. But if the union's demands were exorbitant, that would be revealed. If, on the other hand, the company could well afford to grant them and absorb the cost, that fact would be made apparent. Both sides would then go back to the bargaining table with the knowledge that the public had the facts, and was prepared to pass an informed judgment on the result of their negotiations.

If and when inflation poses a really serious problem requiring further measures, there is still no justification for solving it solely or primarily at the expense of the unemployed and the poor, or even the average worker who has already borne more than his share of the burden of maintaining price stability. For almost a decade the average American worker has received less than his fair share of the Nation's productivity gains. He has been the chief victim of an increasingly regressive tax structure. He has borne the brunt of the negative and misguided efforts to control inflation during the Eisenhower administration. And, more recently, he has been hit unnecessarily and with unequal impact, by higher interest rates which have raised the costs of cars and houses and other things which he must buy on credit and deterred investment in schools and other public facilities which he and his family are dependent upon.

If and when the demand for goods and services really threatens to exceed the limits of our capacity, the measures which deserve the greatest priority, both on economic grounds and as a matter of elementary fairness, are a repeal of the recent corporate tax cut, in part or in whole, and revocation of the investment tax credit. In the latter case, however, an exception might be made for investment in depressed areas.

Both of these measures would generate substantial sums without imposing undue hardship on anyone. A 2-percent increase in corporate taxes would produce about $1½ billion in revenue; the complete elimination of the investment tax credit would produce approximately as much. Both actions could even make it possible to bring an end to the utterly shameful collection of $100 million in Federal income taxes from impoverished families with incomes of less than $3,000 a year.

Since business and upper-income groups have been the greatest beneficiaries of the tax changes made in recent years, these suggestions are eminently equitable. Since recent investment rates appear to be unsustainable, they are economically sound, as well. If profits and depreciation allowances are permitted to pile up while investment tapers off, the record expansion of the past 5 years could well come to an end.

If overall stabilization measures are necessary as a result of a national emergency, the labor movement will support such measures wholeheartedly. However as President Meany has declared:

"* * * That would mean every economic factor—all costs, prices, profits, corporate executive salaries, dividends, and wages—being equally restrained. All America, then, would be sharing equally the costs and the sacrifices of a national problem."

IV. NEW TOOLS FOR ECONOMIC POLICYMAKING

America's impressive economic growth in recent years has been accompanied by an almost equally impressive growth in economic understanding. New concepts have been developed and new institutions created which have made the 5 years of steady expansion possible and brought the Nation within sight, at least, of fulfillment of the commitments made under the Employment Act. Now we must go on to forge the new tools for economic policymaking which are necessary to carry the Nation all the way to full employment and keep it there.

One vital prerequisite for further progress is pointed up by the failure of this year's annual report to provide the specific information which the Nation needs to fully judge the aims of the administration and its proposals for achieving those aims. Filling this information gap will help eliminate future gaps in employment and production. We, therefore, urge the Council of Economic Advisers to provide the following data each year:

(*a*) Employment targets for the labor force as a whole and for the major occupational groups within the labor force;

(*b*) An estimate of the level of GNP required to achieve those targets, as well as estimates of the magnitude of the major components of that GNP required for long-run growth and equilibrium;

(*c*) An estimate of the GNP likely to be obtained in the absence of further changes in Government policy and programs; and

(*d*) The policies proposed by the administration to compensate for any imbalance between the latter projection and the level of GNP required for full employment.

In addition, early each year the President should call a conference of leaders of the major groups in the economy to discuss the estimates made by the

Council of Economic Advisers. The opportunity for such discussion and exchange of viewpoints could provide business, labor, and Government with a more informed basis for making the numerous decisions necessary in a free economy.

Another new economic tool which we badly need, as the uncertainty of our current situation indicates, is a device which will make changes in fiscal policy possible without interminable delay. As Walter Heller points out:

"We have yet to gear both our tax legislative process and our executive spending process (including, in part, our social security system) to the swift actions and shifts that may be needed to deal with surprises in an imperfect economic world—and, in particular, to forestall recessions or nip them in the bud." (Journal of Business, July 1965, p. 236.)

It has been suggested that Congress adopt advance legislation directing tax and expenditure changes which could be held in reserve. In case of need, the legislation could be recommended by the President and approved simply by a joint resolution of Congress. (The increases in public expenditures could be effectively tied to the inventory or shelf of public works suggested earlier.) We urge serious consideration for this and other proposals designed to achieve the same goal.

In addition to more flexibility, the Nation needs far better coordination of its economic policies. We had a striking demonstration of this need last December when the Federal Reserve Board raised discount rates prematurely.

The power of the Board to seriously undermine the economic policies of the national administration is an anachronism. It has no proper place in a 20th century economic system. We, therefore, recommend that the Federal Reserve System be made more responsive to the needs of the American economy by: (*a*) changing the term of office of the Chairman of the Board of Governors to coincide with that of the President of the United States; and (*b*) opening up membership on the governing authorities of the system—which are dominated by bankers, big businessmen and monetary experts—to people from other sectors of the American economy, including trade unions.

Finally, to bring the arsenal of weapons which we have suggested and the many worthwhile measures proposed by others into a systematic and effective relationship with each other and with existing programs requires still another tool of coordination. We need an overall democratic planning mechanism which can prevent the effort and resources devoted to restoring and developing the economy from being frittered away in uncoordinated and conflicting projects. As we pointed out last year, it is a curious anomaly that while lower levels of Government are required to plan as a condition of receiving Federal assistance, there is no national plan into which the programs themselves can be integrated.

Recognizing that national planning is essential to the solution of the major problems facing the Nation, a resolution adopted at the last convention of the AFL-CIO called for a massive, coordinated national effort to meet our needs for housing, community facilities and public services, and concluded:

"* * * To maximize the effectiveness of these urgently required expenditures for achieving full employment such outlays must be coordinated with other economic policies and programs through a national planning agency."

CONCLUSION

The past 5 years have provided America with a taste of the enormous progress this Nation is capable of achieving once it discards the fears and the myths of a bygone era. These 5 years of expansion have demonstrated the ability of a democratic government to consciously work toward the achievement of maximum employment, production, and purchasing power, to begin the job of social reconstruction which America so badly needs, and to raise the quality of American life to a new and higher plane.

However, the last 5 years have also left a number of unfinished tasks. The commitment made 20 years ago at the time of the adoption of the Employment Act has been only partially fulfilled; at least one-fifth of our people have been bypassed by prosperity; our urban areas, in which 70 percent of all Americans live, need a total rehabilitation and rebirth; imbalances in the private sector of our economy threaten the continuation of the present expansion; and a vast, hungry, and unstable world beyond our own shores cries out for help and assistance.

Obviously, this is no time to call a halt to the progress of recent years. It makes no sense to allow resources to remain idle while urgent private and public needs go unsatisfied. Nor would it make much sense, even if the Nation's resources were fully employed, to curb vital social programs while demanding no sacrifices of the affluent.

We believe that the American people have the intellectual and material resources to meet our commitments abroad and continue the programs of social and economic reconstruction begun at home. Furthermore, if and when sacrifices are necessary, we believe they have the moral resources as well to give priority to the unfinished tasks of American life.

TESTIMONY OF NATHANIEL GOLDFINGER, DIRECTOR OF RESEARCH, AFL-CIO

Mr. GOLDFINGER. Thank you, Mr. Chairman.

My name is Nathaniel Goldfinger; I am director of the research department of the AFL-CIO.

At the outset I wish to express Mr. Reuther's regrets at not being able to be here. As you know, he had a little accident last week and is compelled to be close to home under medical attention.

We in organized labor, Mr. Chairman, are glad to see the welcome improvements in economic policy and also in economic trends in the past 2 years. We certainly have welcomed the substantial change in fiscal policy, the improvements in manpower policy and the developments in the antipoverty programs which cut the unemployment rate from 5.7 percent of the labor force in 1963 to about 4.6 percent or so in the middle of 1965.

As we see it, last summer, when the Vietnam situation worsened and military expenditures began to rise modestly, and the draft was stepped up, expectations generally began to rise also. There was a further rise of planned business investment outlays with a result that the unemployment rate continued to move down to 4.1 percent in December, and at long last, to the administration's interim goal of 4 percent in January.

As we see it, however, our economy is still some distance from full employment. We in the organized labor movement never accepted the 4-percent interim goal of the administration as full employment. We never did in the past and we don't today, and we are convinced that we are still some distance from full employment and from full operation of productive capacity.

It is our suggestion at this time that the administration establish a new interim goal of a 3-percent unemployment rate, which should be set now, and which we should move toward as rapidly as possible.

Despite the improvements in economic policy formulation and also in economic trends, there still are a number of questions that remain and the primary one is, as I see it: Can we as a nation sustain the improved economic performance after the economic stimulus of the Vietnam situation levels off or declines?

Can we maintain the forward momentum that has brought the unemployment rate down to 4 percent and which, in our opinion, should continue to bring the unemployment rate down to 3 percent and lower?

In terms of the short-run outlook, in relation to present trends, the size of the Federal budget, and the anticipated rise of business investment, it seems to me that the Council of Economic Advisers' $722 billion gross national product forecast seems rather reasonable, although possibly on the low side.

We are then talking, as I see it, of a 1966 rise in GNP of about $50 billion, a rise of approximately 7.4 percent in current dollars, and about 5.2 percent, more or less, in constant dollars.

It seems to me that such a rise in economic activities is perfectly feasible without general economy-wide inflationary shortages. And here I think it important to call attention to the fact, which has undoubtedly been called to the attention of the committee before, that the level of defense expenditures at present and the level anticipated on the basis of current trends, the level anticipated for the rest of 1966, is something like about 8 percent of GNP.

This is in contrast to the situation in 1952–53, during the Korean war, when national defense expenditures accounted for approximately 13 percent of GNP. The unfortunate circumstances of the Vietnam conflict and the necessity in recent months to increase our military expenditures, nevertheless, does not equal in any sense whatsoever—in terms of economic stimulus and economic impact of the Korean war—either in terms of dollar expenditures and, more particularly, the impact of the dollar expenditures on the economy. Our economy today is considerably bigger than it was in 1952–53.

As I said, it seems to me that the anticipated rise in economic activities is perfectly feasible without general economy-wide inflationary shortages for the following reasons:

First, we are not at present at full employment. There is some slack in the economy; there is some distance to go before the achievement of full employment.

With a 4 percent unemployment rate, there are some 3 million jobless. In addition, there are about 1.8 million compelled to work part time because full-time jobs are not available. There are some 500,000 or more people who are not in the labor force. That is, they are not actively seeking work, but probably would be back in the labor force either at work or seeking work, if jobs in their skills and occupations were available in their communities.

In addition, there are several hundred thousand people in the Neighborhood Youth Corps programs, the Job Corps programs, the Manpower Development and Training Act and related programs who could and undoubtedly will be brought into the active labor market, actively seeking work in the months to come, if and when the job opportunities are available.

With the additional step-up of on-the-job training by private industry, as economic activities continue to improve, the potential growth of the labor force—in terms of the existing slack and the existing potential, plus the normal growth of the labor force—should be somewhere in the area of about 1.6 million in 1966. This should provide sufficient increases in labor force expansion to absorb a rise of real GNP of about 5.2 percent.

In addition to the existing slack and the growth of the labor force, the potential that exists within the labor force area, in addition to that, there is the rise in productivity which is taking place. The rise in productivity in recent years has been at a fairly rapid rate.

Last year it was something like 2.8 percent, and perhaps when the estimates are cleared up, it will turn out to be somewhat greater than that amount.

The estimated increase of output per man-hour in the private economy in 1966 is in the neighborhood of 3 percent, which provides an additional potential for growth in demand.

Thirdly, on the basis of the capital goods boom of the past 2 years and the continuing rise of business investment in fixed plant and equipment, it is anticipated that the new installations of the most modern, newest laborsaving plant equipment will increase industry's productive capacity by about 7 percent this year.

Therefore, it is my opinion that we can absorb the kind of increase in the demand for goods and services, which is now anticipated. As far as organized labor goes, that means that we can absorb the continued progress of social and economic measures, such as in the areas of Federal aid to education, the antipoverty programs, and so on.

Moreover, it is the opinion of the AFL–CIO that it would be dangerous not to do so; that it would be dangerous to cut back or to freeze the current level of expenditures for those essential programs which, in our opinion, are of the utmost importance in strengthening the fabric of America's society and in reducing the kinds of social tensions that festered and grew during the years of neglect, during the 1950's when unemployment and underemployment were in a rising trend.

If there should be, in the months ahead, a significant rise of military expenditures then I think we would be in a somewhat different ballpark. If such a rise of military expenditures of a substantial nature does occur, then I think that we, as a nation, should consider some kind of economic policy to restrain the rate of increase in the demand for goods and services through the elimination of the 7-percent investment credit, for example, and/or an excess profits tax and/or a rise of the corporate tax rate, which is now 48 percent, back to 50 percent or perhaps to 52 percent.

Moreover, under such circumstances of a rise of military expenditures, perhaps we should also consider, under those circumstances, selective credit controls of various types. Certainly, in my opinion, we should even now be considering increases in the margins on the stock market and under the conditions of a significant or substantial rise in military expenditures, beyond what is now anticipated, we should be looking into margin requirements on the commodity exchanges as well.

However, except in an extreme emergency, we of organized labor do not believe that we should cut back or freeze the level of expenditures for social and economic programs because those programs—such as the aid to education programs, both to elementary and secondary schools, higher education, vocational education, the programs of training and retraining under the Manpower Development and Training Act, and the programs under the antipoverty measure—those programs, as we see it, are of great value, in and of themselves, to strengthen the fabric of American society and to increase the investment in human resources.

And as we see it, it is utterly necessary at this point in time—with radical changes in technology, changes in race relations, and very rapid urban growth—to move ahead as fast as possible in the rebuilding of our cities, in the renewal of our urban areas, in the development of mass transit systems, in the improvement and expansion of public services, in the areas of health, education, welfare, vocational training, and so on.

As we look at it, it is perfectly feasible at present under present anticipations, to absorb this expansion and progress in these programs and to absorb the kind of increase of real GNP in the area of about 5¼ percent, which is indicated in the President's Economic Report and which is implied in the President's budget.

However, as I said, should military expenditures rise substantially and should the ballpark change, then I think that we should consider a tax increase in the form of elimination of the 7-percent investment credit and/or an excess profits tax and/or a rise of the corporate tax rate, plus consideration of some kind of selected credit controls.

However, except in an extreme emergency, it is our judgment that we should not cut back or freeze social and economic programs because of the danger to society of cutting back or freezing the progress that we have begun to make in the area of investment in human resources.

Despite the outlook, as I see it, and the outlook which the administration has more or less presented in these terms to the public and to the Congress—in terms of the demand side of the picture—there is increasing talk of wage pressures and increasing talk of wage restraint.

At the present time, as we look at this picture, we see no sign at all of general wage pressures on the price level. The President's Economic Report states that unit labor costs in the national economy as a whole have barely moved as increases in productivity have largely offset moderate increases in hourly labor costs.

In the economy as a whole, there is no sign at all at present, there was no sign last year and there is no sign now, of a general upward pressure from unit labor costs. Moreover, in the key manufacturing sector of the economy, labor costs per item have been in a declining trend since the 1960's and according to the President's Economic Report unit labor costs of industrial goods actually declined by eight-tenths of 1 percent last year. With this picture of declining unit labor costs in the key manufacturing sector of the economy, and with relative stability of unit labor costs in the economy as a whole, I fail to see the foundation for the talk, and to some extent perhaps a hysteria among some people, of wage pressures on the general price level.

Within this context, the Council of Economic Advisers, in the Economic Report, chopped down the wage guideline figure from where it should be, on the basis of the Council of Economic Advisers own arithmetic and own method of calculating the guideline, it has cut that guideline down from 3.6 percent where it should have been for 1966 and kept it at 3.2 percent where it has been in recent years.

Now, this it seems to us is simply changing the rules in the middle of the game.

One might describe this as an attempt to short change workers, in an attempt to maintain a so-called magic number of 3.2 percent, which is supposed to solve all problems.

Well this action by the Council of Economic Advisers, in trying to cut down the wage guideline figure to maintain it at 3.2 percent, is but an additional reason for organized labor's opposition to the wage guideline.

In the first place, there is a built-in restraint on wages which does not exist in prices and in most other forms of income. Wages are not determined unilaterally by the union. In unorganized plants, wages are determined by the employer and to some extent by market forces, but not by the employees and certainly not by a union, which in that case would be nonexistent. Even in organized industries, where unions exist, there is likewise a built-in restraint, because wages are determined, in those cases, jointly between the union and the employer. On the wage side of the picture, there is an inherent built-in restraint, which does not exist on the price side and which does not exist on the profit side or on some of the other forms of income.

Moreover, in 3 of the past 4 years of the administration's wage guideline, the actual rise of productivity in the total private economy was substantially greater than the guideline for wages.

In 1962 when the administration's guideline was 3 percent, the actual rise of output per man-hour in the private economy was 4.6 percent. In 1963, when the guideline was 3 percent, the actual rise of output per man-hour in the private economy was 3.5 percent, and in 1964, when the guideline was 3.2 percent, the actual rise of output per man-hour in the private economy was 3.6 percent.

I do not recall in those 3 years, the Council of Economic Advisers indicating any displeasure at the inequity of the guideline being considerably below the actual rise of productivity. Yet, in those 3 of the past 4 years of the administration's wage guideline policy, the guideline was considerably less than the actual rise of productivity in the private economy.

Fair treatment, it seems to me, would surely have permitted the guideline figure to rise to 3.6 percent in 1966, as the Council of Economic Advisers' arithmetic itself requires, merely to partly offset the years from 1962 through 1964, when the wage guideline was substantially less than the rise of productivity.

To leave the guideline figure at 3.2 percent, as the Council of Economic Advisers has now done, is simply an attempt to shortchange workers.

In addition, as I indicated before, there is no evidence, at all, of general wage-cost pressures on the price level. As indicated, unit labor costs for the economy as a whole have remained relatively stable over the past 4 to 5 years. In the key manufacturing sector, there has been a declining trend of unit labor costs since 1960. For production and maintenance workers—the group that is largely represented by union organizations—in manufacturing industries, the unit labor cost of production and maintenance workers in manufacturing have been in a declining trend ever since 1957.

Despite this record of general stability of unit labor costs in the private economy as a whole in recent years, and the declining costs of labor per unit in the manufacturing sector, the level of consumer prices has risen over 1 percent per year during the recent years of the administration's guideline. The rise in the cost of living, as measured by the Consumer Price Index, has been eroding part of the value of wage and salary gains. However, the administration's wage guideline takes no account whatsoever of the rise in living costs, an economic fact of life that is vitally important to workers.

As a result, the administration's wage guideline is considerably less than 3.2 percent, in terms of buying power, because to the extent that the cost of living continues to go up, it erodes the buying power value of the money wage increase. The 3.2 percent in real terms, in the terms of buying power, is perhaps 2½ percent or less.

During the past decade, the buying power of wages has risen at a much slower pace than the economy's productivity. For example, from 1960 to 1965, when output per man-hour in the total private economy rose at an average yearly rate of 3.6 percent, the buying power of employee compensation—wages, salaries, and fringe benefits in the private economy per hour of work—increased, according to our figures, only 2.9 percent per year.

I notice in this morning's paper that Secretary Wirtz indicated that it rose 3 percent, and I am willing to buy his estimate of 3 percent. There was a rise in the buying power of employee compensation in the private economy of about 3 percent a year as against a 3.6 percent average annual increase of output per man-hour in the private economy.

This lag of employee buying power behind productivity indicates a continuing shift of income distribution and this shift has been taking place ever since 1956. It indicates a continuing shift of income away from wage and salary earners in the private economy to other groups in our society. One example of this shift in income distribution can be seen in the soaring rise of business profits and dividends from one record peak to another, at a considerably faster pace than employee compensation.

From 1961 to 1965 corporate profits after taxes rose about 64 percent. Now it can be argued, and correctly so in part at least, that the 1961 level of corporate profits was somewhat depressed, as a result of 1961 being a recession year. However, corporate profits did not only rise sharply in 1962, they have risen sharply in every year since 1961. For example, last year, 1965, corporate profits before taxes rose 15 percent, and 20 percent after taxes—more than twice as fast as total wage and salary payments in the economy.

However, there are no administration guidelines for profits. There are no administration guidelines on dividends. As far as we can see, from our vantage point, if there is an inflationary trend in the economy it exists now and has in recent years in the stock market. But there is no administration guideline for stock market prices and the margin requirements on the stock market have remained the same. In addition to what the Council of Economic Advisers did in changing the rules in the middle of the ball game, in shifting the method of calculating the wage guideline simply in an attempt to cut it down, these are some of the facts that account for organized labor's opposition to the wage guideline.

Moreover, we do not believe that the rigid application of any so-called magic number—3.2 percent or any number, 3.6 percent or 4.6 percent—that any kind of rigid application of any number or the rigid application of any single factor such as productivity, is a workable or equitable means of wage determination in an economy in which there are many costs of production, in addition to wages, and in an economy of continental size such as the United States, where there are thousands of different markets, industries, and occupations.

However, AFL–CIO President George Meany indicated in a statement on January 28 that if there is a substantial change in the economic situation, as a result of a worsening of the Vietnam conflict, he stated:

> If the President concludes there is such a national emergency to require extradordinary overall stabilization measures, he will have the complete, wholehearted support of the labor movement. That would mean every economic factor—all costs, prices, profits, corporate executive salaries, dividends and wages—being equally restrained. All America, then, would be sharing equally the costs and the sacrifices of a national problem. There are a multitude of factors that go into prices and into the cost of living. Wages are not the only cost factor, but they are the only income factor for most Americans.

And Mr. Meany went on to state:

> We are prepared to sacrifice—as much as anyone else for as long as anyone else—so long as there is equality of sacrifice. But rigid guidelines, based on shifting methods, are not the way to do it.

There is more to this wage policy issue than simply the issue of the guidelines. The fact that real wages, the buying power of wages, have lagged behind the rise in productivity for a full decade, and seems to be continuing to lag behind the rise in productivity, indicates clearly a shift in income distribution away from wage and salary earners to other groups in the economy. This indicates to us, at least, a continuing and developing lack of balance within the economy, which poses some problems—not at the moment because of the rise in demand in the economy that is partly related to the impact of the tax cut of 1964 and more recently to the stimulus of the rise in military expenditures due to the Vietnam conflict. But it does raise in our minds, and I know from reading the business press that it raises in the minds of many business economists as well, the question as to whether the current sharp increases of business investment in new plant and equipment are sustainable. It raises the question as to where the economy will go 6 months, 12 months, or 18 months from now, when the expenditures in relation to the military situation begin to level off or decline.

At that point, where will the stimulus to the economy come from, in a situation where the buying power of wages and salaries has continued to lag behind productivity and where the emphasis in the economy has been on business investment?

Business investment has risen at an average yearly rate of 15 percent a year in the past 2 years, and the anticipated rise of business investment this year is once again about 15 percent. This rise in business investment is now running twice as fast as the rise in the gross national product. The share of GNP going to private fixed business investment in plant and equipment has increased to 10½ percent in 1965 and an estimated close to 11 percent in 1966.

As we see it, these levels of business investment and this share of business investment as a share of the GNP are not sustainable. The lack of balance in the private economy which partly reflects the lag of buying power behind productivity is something which can cause trouble 6 months, 12 months, 2 years down the road, when military expenditures ease off or decline.

This is something which I call to the attention of the committee, because I think that our problems are not only those of the moment but we should be looking ahead to see where we will be going; because, as I stated at the outset, I do not believe we have achieved full employment as yet, we are still some distance from full employment, and we have not demonstrated, to my mind and to the mind of organized labor, that we have yet solved them and developed the methods and the techniques of achieving and sustaining full employment under ordinary, peacetime conditions. Social and economic balance—balance within our society and balance within our economy—to us is essential, not only in terms of the moral and ethical issues involved, but also in terms of the sustainability of a high rate of economic growth and of a high rate of employment and the low levels of unemployment, which are essential for the strengthening of American society.

Once again, I want to emphasize our strong feeling that the social and economic programs—such as aid to education, urban redevelopment, the housing programs, the attempts to rehabilitate and rebuild our cities, and the antipoverty programs—these measures, in our opinion, should move ahead. They should not be cut back and they should not be frozen because of their essential worth in terms of investment in human resources and in the strengthening of American society.

In terms of the tests to come when the level of military expenditures level off, I would suggest strongly that we have to think in terms of a positive wage policy which takes into account not only the Council of Economic Advisers sole emphasis, almost monomania, on productivity as the only factor of any importance, but that we must take into consideration the increase in the cost of living, the changes in the Consumer Price Index, as an essential factor, and other factors such as wage inequities. A positive wage policy to expand consumer markets is essential as we move ahead, not only through the current period of the next several months but also as we move ahead into the next several years, without sharp declines in economic activities and sharp increases in unemployment.

I do not believe that American society can afford another period such as we had during the latter 1950's, of frequently recurring recessions and sharply rising unemployment and underemployment. These are tests which are yet to come and these tests, under the Employment Act, are on the achievement of full employment and sustainability of the improved economic performance and improved economic trends of the past couple of years.

Thank you, Mr. Chairman.

Representative REUSS (presiding). Thank you, Mr. Goldfinger, for introducing an important whole new dimension to our deliberations here. Speaking personally, I think if there is one area in which the largely admirable Council of Economic Advisers' report this year has been unsatisfactory, it is in this whole question of the division of income in this country and the relative shares of varying segments of our society.

It certainly will not do as a long-term proposition to have a situation in which labor's share lags and then the Government makes it up more or less to labor by ever-increasing tax cuts. If you do that you not only neglect the public sector, but you create an excess of paper assets in this country which could stir up problems for the future. So I think you would probably be the first to agree you have not said the last word on this subject.

I am glad you have said one of the first words on it.

Mr. GOLDFINGER. I agree with you fully, Mr. Chairman, but to extend your comments just a bit further, I think that the trend within the economy, in terms of the shifts in income distribution and a lag of real wages and salaries behind the rise in productivity, places an increasing burden on fiscal policy. It makes it more and more difficult to achieve and sustain full employment, so that the burden on fiscal policy, to offset the imbalance within the private economy, becomes greater and greater and the political feasibility of achieving the required fiscal policy offsets becomes difficult. This worries me, because it means that perhaps it may not be possible to achieve and sustain full employment, because of the increasing difficulty of obtaining the kind of Federal budget deficits that are required to offset the increasing imbalance within the private economy.

Representative REUSS. Chairman Martin of the Fed a few months ago made a widely publicized speech in which he pointed out certain alleged parallels between the situation today and the situation in the 1920's. Would you agree that it would have been a better speech had he included some references to the parallel between income distribution or maldistribution now and that in the 1920's?

Mr. GOLDFINGER. Well, my vantage point is considerably different from that of Chairman Martin. I certainly agree with you that there are some unfortunate parallel trends in terms of income distribution—parallel to those that occurred in the 1920's, when real wages lagged considerably behind the rise in productivity.

Representative REUSS. Now let me get down to brass tacks on a proposition that has interested me and many of my colleagues very much, the price-wage guidelines.

As you know, I have introduced legislation and identical bills have been introduced in the Senate, which would do two things with respect to the price-wage guideposts.

One, it would require, before the guideposts go into effect that this committee, the Joint Economic Committee, receive them from the Council of Economic Advisers, and hold public hearings upon them at which labor, management and all other groups would have a chance to comment on their efficacy and equity. Then they either would go into effect or, if the Joint Economic Committee wished to deliver to the House and the Senate proposals for changing them, then Congress could act on them.

They would still have simply their advisory effect, but they would have the benefit of public hearings and of the judgment of Congress.

Secondly, once those guideposts were established, the bill directs that the Council of Economic Advisers notify the Joint Economic Committee when wage-price behavior inconsistent with the national economic interest was imminent or occurring. The Joint Economic Committee would then, in its discretion, hold hearings on that proposed wage-price behavior, make findings and, if desirable, issue recommendations to the parties concerned and to the President.

That, in a nutshell, is what my bill proposes, and I would like your views on it. From the statement you included in your report of Mr. Meany's view, in which he recognizes the importance of some congressional responsibility in the matter, I should think that you might be sympathetic.

Mr. GOLDFINGER. Well, Mr. Chairman, the AFL–CIO does not have as yet a policy view and we have not adopted a policy on your bill. However, it has been our policy over many years now, that the focus of public attention should be placed on the cost-price-profit-investment policies of the dominant corporations in key industries, in an attempt to inhibit the price increases that come from our big oligopolies where much of the problem comes from. In that sense I think that we would view—at least parts of your bill—with a good deal of sympathy—certainly the first part of it. We have no fear at all of a public discussion and public debate on the issue of wage policy and the wage guidelines.

Representative REUSS. In that connection you have said that in 3 of the 4 past years the wage guideposts invoked by the Council of Economic Advisers have actually lagged, in some cases, considerably behind the actual productivity in that year.

Mr. GOLDFINGER. That is right.

Representative REUSS. Does it not occur to you that if you had had an opportunity when those guideposts were being formulated each year to present your point of view, you could have at least gotten this committee and Congress to knit their brows over how the guideposts were arrived at, and whether they really were the most sensible way of achieving full employment without inflation?

Mr. GOLDFINGER. I agree with you, sir, that that would would be a virtue. It would provide us with the opportunity of publicly indicating what some of the problems are with these guideposts, such as the problem that I indicated before, and that is that the administration's guideposts take no account at all of the change in living costs so that the 3.2 percent figure, in terms of buying power, is considerably less than 3.2 percent.

Representative REUSS. Would it be fair, then, to say that overall, on the legislative proposition I have put to you, you are generally sympathetic? If you have objections to any part of it I would like to have you state them.

Mr. GOLDFINGER. I am not prepared at this point, Mr. Chairman, to get into that. Personally, I would look with favor on your proposition as a whole. There are perhaps some things that we would like to see changed. However, in relation to the AFL–CIO's official views of the importance of placing the focus of public attention on these issues, merely the presentation of your bill as well as the general outline of your bill does offer and would offer in the future, the opportunity to place the focus of public attention on these issues.

But we think that the focus of public attention is important.

Representative REUSS. Getting back to the guidelines. I have heard your complaint that the Government is changing the rules on wages in the middle of the game. Certainly that portion of its Economic Report did require a lot of explaining by the Council of Economic Advisers.

Let me ask you this. Whatever the rights and wrongs of the present proposed guideline—3.2 percent for 1966—would not an aggressive program by the administration, of enforcing that part of its price guideline which says that above average productivity industries ought to reduce prices, be a needed component of a proper antiinflationary program for the period to come? Some prices are going to go up, and unless you have other prices which can go down—actually go down—you are going to have spiraling prices.

If the wage earner did get gypped in the last 4 years you cannot rewrite history and undo that. But would it not be a fair partial recompense, at least, if some emphasis were placed upon price reductions where they are possible?

Mr. GOLDFINGER. I agree with you, Mr. Chairman. Even in terms of the Council of Economic Advisers the wage guidelines would make sense—theoretically, at least—only if what you described were to take place; only if we were to get price reductions in those industries and those sectors of the economy in which productivity is rising rapidly and in which profits are high. But we have not gotten those kinds of price reductions.

As a result of this, the cost of living as measured by the Consumer Price Index has risen over 1 percent a year during the period of the guidelines and last year rose 1.7 percent. Yet the Council of Economic Advisers guideline only considers money wages. It imposes the so-called magic number of 3.2 percent, based upon productivity. Now, productivity is measured in real terms, of real output per man-hour. But the wage guideline is not real, it is money wages. To the extent that the cost of living rises, real wages increase less, so that the 3.2 percent figure of the wage guideline is actually somewhere about 2 percent or 2½ percent, so that the issue is that—to use your words of workers being gypped—workers are being gypped by comparing the guideline to the rise in productivity, because it is real wages that should be measured against real output per man-hour.

Representative REUSS. My time is up. But I would comment that there, sir, you make the kind of argument which I would like to hear made—and also its rebuttal to the extent that there is one—before this committee in an orderly manner in our reviewing the guideposts. I believe somebody in our Government has to perform this function, and it is now not being performed.

My time is up, but I am going to ask you to do the same thing which I asked our Council of Economic Advisers to do. That is to file with this committee for the record a list as complete as you can make it of those industries, including individual companies within those industries, which you believe are eligible for price decreases within the President's guidelines which say that industries or concerns having a larger than average productivity increase should be decreasing prices. Would you, to the best of your ability, make available such a listing?

Mr. GOLDFINGER. I will try to do it. Our resources are far less than those of the Council of Economic Advisers and of the Federal Government.

(At the time of printing this information had not been received.)

Representative REUSS. Your statement indicates that you know something about General Motors, for example?

Mr. GOLDFINGER. Well, General Motors is certainly a candidate for what you are talking about. With after-tax profits of over $2 billion in 1965 and a rate of return of 25 percent or more on investment capital, it seems to me that here is a clear-cut example of a corporation which could easily afford to cut its prices and to offset the increases in prices that occur in the services, medical costs, et cetera, so that the cost of living could be relatively stable.

Representative REUSS. Thank you. Senator Javits?

Senator JAVITS. Thank you very much, Mr. Goldfinger. Would you be good enough to express to Mr. Reuther my personal solicitude and concern over his accident or whatever problem he has physically?

Mr. GOLDFINGER. I will, Senator Javits.

Senator JAVITS. I came especially to hear him, I have great respect for his views. Would you consider it appropriate if I would raise a few questions to which I would like answers in writing from Mr. Reuther? I am sure you will agree that his answers in terms of policy would be authoritative as stating a labor position which I think would get wide interest, if not wide support. You need not write them down because the reporter will give them to you.

Mr. Chairman, I ask unanimous consent that Mr. Reuther may, at his convenience, furnish answers for the record to the following questions:

Representative REUSS. Without objection it is so ordered.

Senator JAVITS. In Mr. Reuther's statement, he has some views as to why direct Presidential intervention in price increase situations is not desirable, and he supports instead a board which I think he recommended publicly some time ago. He supports an administrative price board and consumer council, the board being the main point.

One of the arguments he makes is that the President cannot put his prestige on the line every time there is a threatened price increase situation which the President thinks threatens inflation. Now, would not the same argument apply to Presidential intervention in major labor disputes where the President also puts his reputation on the line every time he intervenes or seeks to intervene or bring about a settlement as he did in the 1965 steel situation? That is question No. 1.

The second question: Does Mr. Reuther favor the guidelines proposition? This was not raised by Congressman Reuss, but I think it is a very important point as labor has protested only very recently the failure to escalate the guidelines in accordance with the criteria which were used to establish them in the first place. Labor claims that the original criteria would now make the guideline 3.6 percent instead of 3.2 percent. So, does Mr. Reuther favor the guidelines principle at all—wage and price guidelines to be established by government?

The third point: Would Mr. Reuther be willing to amend his idea for an administrative price board to be more analogous to Congressman Reuss' idea which deals with those problems which arise outside the guidelines rather than within them, and thus gives a certain liberty of action to American business and to American labor within what seems to be the judgment of our authorities as to the best policy for the Nation?

The next question I would like to ask is: Does Mr. Reuther believe that the problem of national interest in strikes like those on the railroads, those on the docks—or strikes or lockouts affecting some important segment of the Nation so as to be national interest strikes, like the New York City transit strike—requires improved mechanisms for achieving settlements without the tremendous public dangers, even to the public's health and safety, which adhere in such strikes or lockouts? And could Mr. Reuther spell out for us precisely his prescription for handling such matters?

I recall that he raised the question of the national interest in strikes in respect of this administered price board idea with a view toward having some public forum in which recommendations could be made for settlement. But I do not think that anybody has ever been able to quite pinpoint what he is suggesting as the prescription for dealing with national interest strikes insofar as the Government's role is concerned.

Finally, if Mr. Reuther chooses—and this is entirely his option—to make any comment on my own bill, S. 2797, dealing with national interest strikes or lockouts I would be grateful for his expertise, which is very great in this field.

Mr. Chairman, if the witness desires to make any comment I have no objection, but I do think, with all respect, that it would be more helpful to us to have an authoritative statement from the witness who is such an illustrious American personality.

Mr. GOLDFINGER. As you well know, I cannot presume to give Mr. Reuther's answers. I will transmit the questions to Mr. Reuther and I am sure that you will get the answers for the record, sir.

Senator JAVITS. Thank you very much, Mr. Goldfinger.

I have asked the chairman of our committee, and suggested to one of our most distinguished members, Congressman Reuss, the idea of the Joint Economic Committee's holding hearings on the whole price-wage guidelines concept, and I am very pleased to see some of the reasons developed in Mr. Reuther's statement. The questioning would seem to indicate that we really urgently need and ought to deal with this question.

I might say for my colleagues that if the idea of setting price-wage guidelines through Government's suggestion is to be really sound then I think that the Congress ought to have a role in what is the Government's suggestion. I do not think the Executive standing alone really ought to try to fill that bill and that was the reason for my suggestion, Mr. Chairman.

Mr. GOLDFINGER. Well, sir, we would certainly be glad to express our views on this subject at greater length than I have done this morning. We believe that our case on this subject is very strong, and we would like to go into it in great detail.

Senator JAVITS. Thank you very much.

(See appendix, p. 552, this volume, for material relating to foregoing.)

Representative REUSS. Mrs. Griffiths?

Representative GRIFFITHS. Thank you, Mr. Chairman.

May I ask you what would be the effect of a $2 minimum wage for farmworkers? Would you not actually have a situation where the worker in most instances drew more than the farmer?

Mr. GOLDFINGER. Where most workers drew——

Representative GRIFFITHS. The farmworker drew more than the farmer? A minimum wage of $2 an hour in a year's time, if my figures are correct, would give a farmworker $4,160. In fact, a greater income than the average farmer?

Mr. GOLDFINGER. In the first place, I am not aware of any suggestion up before the Congress for a $2 minimum wage for farmworkers.

Representative GRIFFITHS. Oh, you suggest that farmworkers be left out?

Mr. GOLDFINGER. No, ma'am. The suggestion is the following:

First, that the Fair Labor Standards Act be extended to cover the bulk of farmworkers—certainly those farmworkers who work on large commercial farms. Secondly, the suggestion that came from the House Labor Committee was that the minimum wage be increaesd in steps up to, I believe, $1.25 an hour.

Representative GRIFFITHS. For farmworkers?

Mr. GOLDFINGER. Right.

Representative GRIFFITHS. Why are you behind the suggestion of 3.9 percent as the target goal? Does not the experience of Europe show that they had tremendous price increases in those countries?

Mr. GOLDFINGER. Well, in the first place—unfortunately we do not have in this country any good studies, with the exception of one brief study that was made for this committee back in 1959 or 1960—we do not have any good studies available which would indicate what full employment would mean, within the context of the American labor market, American society, and American social mores.

I think it would be important for us to develop that. My own hunch, based on the study that was made by Mr. Zeisel of the Labor Department for this committee back in 1959 or 1960, is that full employment, within the context of the American labor market and the American society, would be somewhere in the area of about a 2-percent unemployment rate or a 2.5-percent unemployment rate.

I suggest, now, that we have at long last reached an unemployment rate of 4 percent, that we move to a new interim goal of a 3-percent unemployment rate and seek to achieve a 3-percent unemployment rate as rapidly as possible and then move down from the 3-percent unemployment rate.

You have raised the issue of the price level. The price level to me is a secondary issue. Our prime objective should be full employment or as close to full employment as we reasonably can get.

In terms of the European experience, the Western European countries have achieved and sustained unemployment rates of 1 to 2 percent. It is true that their price level has risen at a faster pace than ours; their economies are also different from ours. Their dependence on exports is different, the sizes of their countries are different.

Price issues can be handled and should be handled separately from the employment and full employment goal. At some point, to use the term of the economists, there may well have to be a trade-off between the full employment goal and the price stability goal, but that decision is a political decision and it should be made, not at a 4-percent unemployment rate or a 5-percent unemployment rate.

We do not know at what level of unemployment we would have widespread inflationary shortages in the economy. I recall only a year or two ago, some prominent economists and spokesmen for the business community indicated that to move below a 5 percent unemployment rate would produce raging inflation.

Well, this has not occurred. We have moved down to a 4-percent unemployment rate, without any sharp rise in the price level. We just do not know.

Furthermore, we can develop tools, we can develop mechanisms to get at the price problem. Why should we pay the price of high unemployment in an attempt to maintain something like stability of the price level? I think that this is a price that is an unfair one, particularly when it is Negroes and teenagers who pay the largest part of the price. And, I think that in——

Representative GRIFFITHS. And women?

Mr. GOLDFINGER. And women. I think that in those terms that this is an unfair, inequitable kind of imposition on the economy as a whole and on special disadvantaged groups in American society. As far as I am concerned and as far as the organized labor movement is concerned, our top priority objective should be to achieve and sustain full employment.

Representative GRIFFITHS. How many women have the AFL–CIO organized?

Mr. GOLDFINGER. Frankly, ma'am, I don't know what the figure is.

Representative GRIFFITHS. How many contracts do you have now where women are paid at one rate and men at another?

Mr. GOLDFINGER. As far as I know, there are none on the basis of sex discrimination. Now, there may be some firms——

Representative GRIFFITHS. Now, wait a minute. You organized the retail clerks, did you not?

Mr. GOLDFINGER. Yes.

Representative GRIFFITHS. You have many retail clerks contracts that list women and men and pay them from 17 cents to $2.55 difference in a day, right?

Mr. GOLDFINGER. Well, I do not know the facts here. You may well be right about that, but I was going to say that in those cases, there may well be different occupations which traditionally have been described as women's occupations and as male occupations. One would have to look into those facts.

Furthermore, my understanding of the equal pay law and title 7 of the Civil Rights Act would make those kinds of provisions violations of the law.

Representative GRIFFITHS. Are you checking to see if they are violated in plants and industries that you organize?

Mr. GOLDFINGER. We are checking on that, and our office has sent information on this to the various affiliated unions of the AFL–CIO. If you know of any complaints, of any specific complaints, please let us know and we will check into it.

Representative GRIFFITHS. I have already given you two real good ones, and one of the answers came back that the woman would have to lift too much weight.

Now, I checked with a few negotiators and they assure me that there is not a man in the State of Michigan in a union plant lifting more than 30 pounds; that under such circumstances two men lift the weight. They use forklift trucks, they use other things; no union will permit a man to do that.

So, what I am interested in is how long are you going to let management get away with this?

Mr. GOLDFINGER. Well, I will check into this. I do not know, but I suggest that the question you are posing is not simply a question of sex discrimination, but it also involves traditional patterns of occupations and wages, where the wages are related to the occupation and traditional patterns of male occupations and female occupations in American industry.

And it may be that these issues are intermixed and intertwined. I will check into this. You refer to retail clerks in the State of Michigan?

Representative GRIFFITHS. No, this is not the one. This is an industry that I gave you. I referred to the retail clerks in Idaho.

Now, I would like to look at page 12 where you say for the poverty-stricken families headed by females, adequate public welfare payments or income maintenance allowances are essential, along with low-cost housing and day-care centers.

You know, if you don't go any further, that looks like minimum wage for men and welfare for women.

Mr. GOLDFINGER. Oh, no, ma'am.

Representative GRIFFITHS. But you go further, and this is what you say, which would enable the heads of these impoverished families to find jobs, if they are willing and able to work. Why willing?

Mr. GOLDFINGER. Well, because in many such cases it seems to me that in many such cases the woman head of the family may not be able to work because of the burden of many children.

Representative GRIFFITHS. Then "able" would be the real answer; if you will check your Bureau of Labor Statistics, you will find the world has changed since 1930, and since the unions were organized. In fact, women are working——

Mr. GOLDFINGER. Of course, they are.

Representative GRIFFITHS. You would solve most of your problem of the aged poor if the social security treated workers as families or gave to every worker exactly the same rights to draw.

The difficulty of the aged poor under social security is that social security is schizophrenic. Just by giving families the right amount, you would add $1.8 billion per year.

If you actually gave to a woman worker the same rights that a man worker has, you would add infinitely more.

My time is up.

Mr. GOLDFINGER. I feel I must I must explain the term "willing and able." The issue is a semantic issue and not a substantive issue. The reason for using this term "willing and able" is that it is the term that is used by the U.S. Department of Labor in its definition of the labor force, willing and able and actively seeking work. The use of the term "willing" does not have any kind of connotation against women, believe me. There was no such connotation.

Representative GRIFFITHS. I do think that the AFL–CIO should begin to look at workers as workers.

Mr. GOLDFINGER. Well, we do.

Representative GRIFFITHS. And try to see to it that they get the same wages, the same benefits and they should be the first to promote laws that treat them exactly the same.

Mr. GOLDFINGER. Well, we have been making a strong effort along these lines for many years. I believe that despite our lack of perfection, and we are far from perfect in this regard as in other regards, I think you will find that the record of pay for women in this country, in contrast to the pay for men for similar occupations, is considerably better than what it is in Western Europe.

Now, this is not good enough——

Representative GRIFFITHS. That's not good enough. You cannot be excused because you are not as bad as they are.

Mr. GOLDFINGER. I am not seeking excuses, but I do think our record here has been at least a fair one, if not a very good and certainly not a perfect one.

Representative GRIFFITH. It is not very good.

Thank you, Mr. Chairman.

Representative REUSS. Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

In your statement you have mentioned the capital gains resulting from the increase in the value of stocks and other forms of capital which are held chiefly by the rich.

Mr. GOLDFINGER. Yes.

Representative WIDNALL. Is it not a fact that our great educational institutions in this country, many of our churches, labor unions, and others own these stocks?

Mr. GOLDFINGER. Well, to some extent that it is true, but the bulk of privately held stock is held by wealthy families. This is what the statistics have shown.

Representative WIDNALL. And many of those funds are in foundations such as the Kennedy Foundation, the Rockefeller Foundation, the Ford Foundation, and the income from that is used for great benefit to the people of our country?

Mr. GOLDFINGER. Well, to the extent that those foundations do gain from the benefits of capital gains, they have been used for the benefit of society. However, sir, the capital gains issue is a basic tax issue and as far as we are concerned, it is a basic inequity in our tax structure.

It provides a much lower tax rate on capital gains than on other forms of income, and the way the economy has been going in recent years, with sharp rises in prices of stock and with substantial capital gains going to wealthy families, the capital gains inequity in the tax structure provides one of the basic foundations for this shift in income distribution that I suggest has been going on. We think that this change in income distribution is bad in economic terms, because it provides an imbalance in the private economy and, furthermore, we think that it is socially wrong.

Representative WIDNALL. Do you have any figures on the amount of stockholdings and capital holdings of the unions of America today?

Mr. GOLDFINGER. No; I do not, sir. But this should not be too hard to find. I think that we can get that. The Bureau of Labor Management Reports of the U.S. Department of Labor probably has that.

Representative WIDNALL. Is it not true that the workers in many, many industries today have the ability to buy stock and to buy it favorably and accumulate stock and have done so, so that they own stock in the corporations?

Mr. GOLDFINGER. Well, of course, this has been happening to some extent, but I suggest that the studies that have been made by various people over recent years—studies made at Harvard University and detailed studies that have been made over a perior of years for the Federal Reserve Board—clearly indicate that the bulk of privately held stock in this country is held by wealthy families and that there is a very sharp concentration of stock ownership in this country.

One study after another shows this; in fact, I know of no studies, sir, which even throw any doubt into the issue of the very high degree of concentration of stock ownership among wealthy families.

In fact, as I remember, the studies that have been made for the Federal Reserve Board by the Survey Research Center at Ann Arbor, Mich., indicate very little stock ownership among families with incomes below $7,500 a year, and the great bulk of stock is owned among families with incomes above $25,000 a year.

Representative WIDNALL. Following up Mrs. Griffiths' remarks, further studies show that the women hold most of that stock rather than the men. They have inherited these large holdings and control a great many of the corporations today in the United States.

Mr. GOLDFINGER. Well, this is because of the peculiar quirk of fate, where women tend to live longer than men and the women in wealthy families live longer than the men in wealthy families. I think this accounts for a good deal of that.

Representative WIDNALL. You also spoke about the enormous expansion of expense-account living, a form of income in disguise enjoyed primarily by those in upper-income brackets.

Mr. GOLDFINGER. Yes.

Representative WIDNALL. I think that is undoubtedly a true statement. I would like to know the impact on organized labor if expense accounts were stopped; how many jobs would be lost in the American economy in building airplanes for private use, in building yachts for private use, in the operation of clubs where there are restaurant workers and the like, and where musicians are employed? There would be a tremendous change in the economy effected by cracking down more on expense accounts, is that not so?

Mr. GOLDFINGER. Perhaps, but I doubt it, because what we are suggesting is a more equitable distribution of the fruits of industrial progress in this country and to the extent that you build up middle-income markets and make it possible for low-income families and poor families to move up the ladder in terms of income, they, too, can go to night clubs and to recreational clubs; and they, too, can buy boats.

The big market in the United States, the strength of our economy, is precisely that: The development of mass markets. Our economy has not been based on the privileged positions and incomes of a few. It has been based on mass markets.

What we are suggesting is a more equitable distribution and we think that the tax structure, in part, has provided the basis for this inequitable shift of income distribution in recent years.

Representative WIDNALL. The thought just occurred to me that as I understand it, the mortgages on most of the big Miami hotels are held by some labor unions, and if there was not expense-account living, the mortgages would be defaulted, I think, in the Miami area.

The people would not have the money to go down and fill those hotels.

Mr. GOLDFINGER. I do not know whether it is true that unions own the mortgages of any large number of the Miami hotels. But, I assume that the base of the hotel and restaurant business and night club business in Miami and in other recreational resorts is not so much founded upon expense account living as it is upon the increased incomes in the middle-income range.

So, that what I am suggesting again is that the improvement of living standards generally and the building up of mass markets are the key to prosperity generally, rather than the privileged position of a few top-income families.

I do not think that you can account for the large numbers of people traveling abroad or for the large number of people enjoying vacations unless you take account of the collective bargaining gains which have been made by unions in the form of paid vacations for workers and of the collective bargaining gains in terms of wage increases.

I think it is a good thing for the country that working people in many cases can now enjoy the sun of Florida or of southern California, and I think this is the trend that has been developing and this is the trend that we would like to see extended.

Representative WIDNALL. I would agree with your statement about the advantages that they have now that they did not have before and the work that the unions have done in making this possible, but I deeply regret what is going on right now, especially with the emphasis on the $3,000 level as the minimum level of living for people in our country.

We are once again building up class consciousness here in the United States where it need have no place. We used to hear all about the class struggle and it seems to me we are now going right back into that older era, which was an unhealthy period, I think, in the United States. And I regret to see—and this is my objection to your statement, because I have seen this many times in statements by the AFL-CIO—only a slap at the rich. Who are the rich? What are the rich?

They are all supposed to be bad because they supposedly get so much income automatically. I remember seeing in a labor newspaper in New Jersey a number of years ago something about Congressman Kean—Bob Kean—at that time who was a wealthy man, and he had inherited $17,500 from somebody, and there was an article on this. They felt this was newsworthy, that it was too bad when he was already so and so. This was in the AFL-CIO paper.

What was that put in there for except to create a class consciousness? I think this is a very unhealthy thing in America. I appreciate the very sound judgment the unions have in many areas and the tremendous contributions that they have made to alleviate conditions for the working people, and to improve the general lot of the people of the United States, but I do hope that we do not get into this too much and continue to emphasize things which I think are done to try to make people think that the unions only represent the poor.

There are a lot of wealthy people in unions today. There are a lot of people in unions who are getting very, very fine incomes today. In the building trades, places like that, they are getting very fine incomes. They are not getting minimum wages or anything like that.

Mr. GOLDFINGER. We are proud of those achievements, sir, and furthermore, the American labor movement never accepted Marxism and to the extent that the issue of Marxism was posed within the American labor movement, it was rejected.

Marxism is repugnant to the American labor movement; we have rejected it consistently ever since the foundation of the present labor movement in the early 1880's. We do not accept any kind of Marxist ideology, in terms of analysis and certainly not in terms of programs.

Representative WIDNALL. I think this is very much to your credit and the American people are grateful for that when you say they did not accept Marxism.

I would like to ask one more question: What would be the employment effects of a rise in the minimum wage to $2 an hour?

Mr. GOLDFINGER. We think that the increase in the minimum wage to $2 an hour as rapidly as possible is essential. We have not suggested $2 an hour right now, this year. But we believe that a rise in the minimum wage to $2 an hour as rapidly as possible, such as within 3 to 5 years, is feasible in terms of the American economy's ability to absorb that kind of increase in minimum wage among low-income and low-wage workers. Furthermore, there would be a boost to the economy and a boost to employment, as a result of lifting the income levels of low-income families and making them more of an integral part of the American economic system, so that they could participate not only as producers, but also as buyers of the products that we produce.

Representative WIDNALL. Economists suggest a difficulty of confusing value judgments with economics itself. Would it not be more efficient to pay labor the value of its marginal product in providing additional income subsidy not confused with the wages paid?

Mr. GOLDFINGER. Well, that is the theory that appears in the textbooks, sir, but I have no idea whatsoever as to what this means in practical terms. Furthermore, if you extend the theory, as some do—some people, let us say, from the NAM or the Chamber of Commerce—to suggest that lower wage rates would do the job, I believe that lower wage rates would cut into the market for American goods and services. They would cut into employment. A lower level of wages in this economy would be bad for the economy as a whole and also for employers and wealthy people, and by the way, we do not slap the rich.

What we are arguing for is an equitable, balanced society and an equitable, balanced economy, and what concerns us is that the economy today, as we see it, has been moving out of balance.

Representative WIDNALL. Is it not true that the hard core of unemployment is 1.5 million people?

Mr. GOLDFINGER. Well, I do not know what the number is; I guess you are speaking of the long-term unemployed?

Representative WIDNALL. That's right.

Mr. GOLDFINGER. It is probably in that area, sir; yes.

Representative WIDNALL. And that is three-quarters of 1 percent, roughly, of our population?

Mr. GOLDFINGER. That may be.

Representative WIDNALL. And the balance of the unemployed are the floating pool, sort of like flotsam and jetsam. Some of them are in and out of it and some of them come into it very temporarily, so our problem is really dealing with that hard core, whether it be the elderly, women, the teenagers, or the Negroes?

Mr. GOLDFINGER. Yes.

Representative WIDNALL. And we have a lot of programs addressed to that right now, particularly in the educational field.

Mr. GOLDFINGER. Yes. It is for that reason, sir, that Mr. Reuther in his statement, and I in my oral statement, have suggested that now at long last, when we have achieved the 4 percent interim unemployment target of the administration, let us now establish a new interim goal of a 3-percent unemployment and move to that rate as rapidly as possible and then move down lower. But aside from that, the unemployment situation even today is worse than the figures.

In addition to those people who are counted as unemployed by the U.S. Department of Labor, there are, people who are working part time for economic reasons, who are compelled to work part time because they cannot find full-time job opportunities.

The Labor Department's estimates are that there are more than 1.5 million of such people. In addition to that——

Representative WIDNALL. Could I interrupt you for just a minute?

Mr. GOLDFINGER. Surely.

Representative WIDNALL. Does that include some of those who are receiving social security and have part-time employment, who would like to have more full-time employment, but they would lose their social security if they had it?

Mr. GOLDFINGER. It may include a few such individuals, but no large number of them, because the Labor Department's definition is fairly clear. This includes people who are working part time and would like full-time work—that is people who cannot find full-time work and would like full-time work. The bulk of these people are people who are compelled to work part time because of economic conditions.

In addition to that, there are some 500,000 or more, and we do not know the exact number, but there are a considerable number of people in various spots in the country, who have given up the active search for work, because they have not been able to find jobs at their skill levels and their occupations in their communities. The true unemployment rate today is not 4 percent but probably in the neighborhood of 5.5 percent or somewhat more, by our count.

Representative WIDNALL. I want to correct a statement I made of 1.5 million. I have in front of me the economic situation, 1966, which was a statement of Arthur Ross, Bureau of Labor Statistics, under long-term unemployed, the average number of persons unemployed for 15 weeks or longer was down to 675,000 in the last quarter of 1965, accounting for one-fifth of the total unemployment.

One further question: How many members of organized labor organizations are unemployed today?

Mr. GOLDFINGER. We have not been running our own unemployment figures among trade union members, so that I do not know the answer to that.

Representative WIDNALL. Is there any large group anywhere that is unemployed?

Mr. GOLDFINGER. Any large——

Representative WIDNALL. Group of organized labor members unemployed today in any industry?

Mr. GOLDFINGER. Well, I would think there still is a considerable degree of unemployment among miners in the coal mining areas; there have been reports that we have received of fairly large-scale unemployment among building trades workers in some parts of the country, such as the New York City area and there are other pockets of unemployment today, as indicated by the figures, by the Labor Department's report of over 3 million unemployed people.

Representative WIDNALL. Thank you, Mr. Chairman.

Senator PROXMIRE (presiding). Mr. Goldfinger, I want to congratulate you on an excellent statement. I think it is mighty welcome and very, very impressive. I am particularly impressed by the fact that the AFL–CIO, which represents organized labor, in your concluding statement you indicate that the AFL–CIO is deeply concerned with people by and large who are not members of your organization. This is most unusual and I think most welcome.

You say, for example, in your second paragraph in your conclusion, at least one-fifth of our people have been bypassed by prosperity. Now, while, of course, everybody would like to see the members of their organization do better, the members of the AFL–CIO would not fall generally into that category.

Then you talk about imbalances in the private sector of the economy threatening the continuation of present expansion and a vast, hungry, and unstable world beyond our own shores crying out for help and assistance.

Of course, these people are not members of the AFL–CIO; they are overseas. So this is a remarkably selfless document in that sense and I think it is a real contribution in every way.

Mr. GOLDFINGER. Thank you, sir.

Senator PROXMIRE. I would like to pursue the questioning which Mr. Widnall finished a little bit further and in a little different direction.

The Chairman of the Council of Economic Advisers, Mr. Ackley, indicated—and Mr. Wirtz also seemed to indicate, as did Secretary Fowler—that the goal is still 4-percent unemployment.

Although Mr. Wirtz announced yesterday to this committee that we had achieved that goal, he did imply that they were estimating in the coming year an average unemployment of 3.75 percent, with a December 1966 prediction of 3.5 percent.

As an economist, what effect would you say the insistence by the administration that their "high employment" goal remain at 4-percent unemployment, will have on fiscal policy? We have been told that the so-called full employment surplus or high employment surplus for years has been calculated on 4-percent unemployment. On this basis we calculate what the fiscal drag of a particular budget is.

If we continue to calculate it on a 4-percent unemployment basis, it is clear that you might get a budget in balance or neutral as far as the economy is concerned at 4 percent, whereas if you calculate it on your proposed 3-percent level, you would get a substantial drag in the economy. Therefore, is it not very important if we are going to have a progressive expansion of our economy for the administration to give very searching consideration to the notion of reducing the goal to 3 percent?

On this basis, then, our monetary policy, the Federal Reserve Board, our fiscal policy for both the executive agencies and the Congress could recognize what these policies are doing to achieve a desirable target by having an adequate fiscal and monetary policy in terms of a realistic goal of 3 percent?

Mr. GOLDFINGER. I agree with the implications of your question completely, sir. We never accepted the 4-percent goal as a definition of full employment. We never did in the past and we do not today. Mr. Reuther suggested in his statement, and I suggested orally, that now that we have achieved the 4-percent unemployment level at long last, I think we should establish a new interim target of a 3-percent unemployment rate—to achieve a 3-percent unemployment rate as rapidly as possible, and then to try to move down below that.

Now, in terms of fiscal policy and of monetary policy, the implications of your question are clear. It would be wrong, I think, from an economic point of view, to seek to achieve a budget balance and/or a surplus at a 4-percent unemployment rate, because with such a balance and/or surplus, as you indicated, the stimulus to the economy would be gone. We would then enter an area of fiscal neutrality or of pulling down the pace of advance, a drag on the economy, at a level of 4-percent unemployment.

This, I think, is wrong. I think that one of the things that is altogether too bad in the Council of Economic Advisers report is that it does not indicate an unemployment target below 4 percent. It does not indicate where we should go from here. It does indicate that, perhaps on the basis of current trends, the unemployment rate may be reduced below 4 percent. But this is not presented as a target or as a goal, and, therefore, it is not presented in the terms of your question in relation to the fiscal policy stimulus even after we have reached a 4-percent unemployment rate. It is my feeling, in response to your question, that we are still in need of a fiscal policy stimulus.

Unfortunately, we are getting that stimulus from the Vietnam conflict. However, as I indicated a little while ago, I do not believe that we have proven, at all, our ability to achieve and sustain full employment, which would be an unemployment rate below 3 percent, or we have not even proven our ability to achieve and maintain even the 4-percent unemployment rate at reasonably normal peacetime conditions.

Senator PROXMIRE. In view of the fact that you have suggested 3 percent as a goal——

Mr. GOLDFINGER. At least as an interim target.

Senator PROXMIRE. Interim target, I should say, and in view of your acknowledged competence as an economist, I think it would be helpful for the record when you get a chance, preferably when you are correcting your remarks, would you give us your estimate of how much of a drag the present budget constitutes?

Now the President said that on the basis of the cash budget, we will have a surplus of $500 million; on the basis of the national income accounts, a deficit of $500 million. This means, in effect, that the present budget at 4-percent unemployment, or 3.75-percent unemployment is neutral.

But at 3-percent unemployment, if that is our interim target, it is clear there is a real fiscal drag, regardless of the Vietnam war, or anything else. The Vietnam war is included in this, and with pessimistic escalated assumptions and, therefore, I would think it would be helpful if you could make your own study, at least a tentative study, that would indicate how much drag there is at 3 percent.

Mr. Goldfinger. I will attempt to do that, sir; but I would indicate now that in 1963 when the unemployment rate was 5.7 percent, it took a very strong dose of aggressive expansionary fiscal policy to bring the unemployment rate down to about 4.6, 4.7 percent in the middle of last year, at which point the step-up in the Vietnam conflict, military expenditures and expectations all changed the picture and added to the stimulus.

However, as the unemployment rate moves down, the mix of economic policy also should change somewhat, so that the degree of expansionary fiscal policy at a 4-percent unemployment rate need not be as great as at 5.7 percent. At a 4-percent unemployment rate, I would suggest, sir, we need a continuing moderately expansionary fiscal policy, with the additional mixture of an emphasis on manpower training and labor mobility, so that——

Senator Proxmire. Is this not why the economists tended to calculate the impact of a budget in terms of a so-called surplus, you automatically could get that corrective factor?

In other words, if you figure that a particular budget is neutral at 4 percent, at 5.7 percent you would be running a big deficit; at 3 percent there would be a substantial surplus.

Mr. Goldfinger. Frankly, I do not believe that the budget should be neutral at 4 percent. I believe it should be moderately expansionary at 4 percent and aggressively expansionary at 5 percent.

Senator Proxmire. To get into another area, you indicate that the minimum wage should be $2 and you say we should try to get that over a period of a few years. How many years?

Mr. Goldfinger. Well, our estimates are something like 3 to 5 years. There are different groups of people involved. For those who are now covered by the Fair Labor Standards Act, we think that those workers who are now at $1.25 could be brought up to a minimum wage of $2 an hour within a period of 3 years in steps, and we think that this is feasible.

Now for those workers——

Senator Proxmire. That means an increase running as high as 20 percent in a single year—$1.25, $1.50, $1.75, and $2?

Mr. Goldfinger. Yes, sir: steps in that level. And for those workers who are not now covered by the Fair Labor Standards Act, many of whose wages are below $1.25, we believe in a large scale extension of coverage to bring those workers into coverage under the Fair Labor

Standards Act. It may be necessary to extend the time period and to increase the number of steps maybe to 5 years.

Senator PROXMIRE. What does this do to the concept which I understand you accept only in part that wage increases should be geared to productivity increases? Obviously if you increase your minimum wage by 25 cents a year for 3 successive years this is an increase ranging from 15 to 20 percent each year; if productivity increases 3 to 4 or 5 percent is this not likely to have some inflationary effect in some areas, particularly in view of the fact that so many of these people are in retail selling and there might be an easy tendency for retailers to simply pass on the increased wage costs to the public in higher retail prices?

Mr. GOLDFINGER. Well, on an overall basis it is our considered judgment that the economy can absorb that kind of increase in the minimum wage. Fortunately the numbers of people involved are not that great. I mean, this would not involve half the labor force, it involves relatively small groups.

Senator PROXMIRE. Earlier, you said 20 million are under $2 an hour.

Mr. GOLDFINGER. Right. Now we think that the rise in productivity and the high and rising level of profits does make it possible for the economy as a whole to adjust to this kind of increase in the minimum. However, there may be cases such as you indicated, where some price increases could be justified. I think that this is a small price to pay for the most effective way of eliminating poverty.

I think that we are kidding ourselves if we talk about wiping out poverty and not do anything substantial at the level of the minimum wage. The studies of the Social Security Administration indicate that the heads of over half the poor families in the United States are in the labor force. Furthermore, the studies of the Social Security Administration indicate that the heads of something like 25 to 30 percent of all poor families work full time the year around which means clearly that the root cause of poverty for over half of the poor in the United States is employment conditions—either unemployment, part-time work, and low wages—and very clearly for something like 25 to 30 percent of the poor, the root cause of their poverty is low wages. The organized labor movement is utterly convinced that the single, strongest step that can be taken to wipe out poverty in this country would be extension of coverage and an increase in the minimum wage.

Senator PROXMIRE. Every time I talk to a businessman about this he argues that the people who are paid less than $1.25 by and large, with many exceptions but by and large, are teenagers and women who work part time and are less skilled; and they claim that if they have to increase the minimum wage that much they simply will not hire these people.

Mr. GOLDFINGER. Well, you know, we have heard this charged time and again——

Senator PROXMIRE. Let's—let me just finish by saying yesterday I asked Secretary Wirtz about a proposal which had been made and reported in the Washington Post that there be a split minimum wage. In other words, one minimum wage level of the kind you suggest for those who are adults and a lower minimum wage for teenagers. The feeling was that a lot of the teenagers only want part-time work, they want to help pay for their education, and that they can do this for $1 an hour, $1.25 an hour, at least for less than $2 an hour, and that no matter how the coverage is extended, and I agree we are going to extend it and should extend it, no matter how you extend this, the fact is many, many people will be left out of it because they will not be in interstate commerce.

Mr. GOLDFINGER. Yes.

Senator PROXMIRE. And for that practical fact recognizing that so many of the teenagers work in this area, would it not make sense for very logical reasons to apply the minimum wage on a lesser basis for teenagers and a more strict—a more stringent basis for adults?

Mr. GOLDFINGER. No; I do not think so, Senator, because the existing minimum wage in covered industries—and unfortunately coverage is relatively small in terms of sectors of the economy—but the existing law does provide for learner permits and does provide for some orderly procedure for lower rates of pay for a period of time for students. The Secretary of Labor is permitted to grant these learner and student permits, so that there is some flexibility in the Fair Labor Standards Act.

Senator PROXMIRE. How broad is this? How much does this involve? Five percent, ten percent of the teenagers or a substantial number?

Mr. GOLDFINGER. I do not know; but it could be applicable to a fair-sized number of industries and they could apply for these learner permits.

The second thing is, and this is basic, a lot of people have charged that the existing minimum wage had a rather deleterious effect upon youth employment and youth employment opportunities.

It is my utter conviction, that this is sheer prejudice. It has never been proven. The Fair Labor Standards Act today does not cover large areas of the economy. Teenage employment frequently is involved in small retail establishments, small service establishments, which are not covered by the Fair Labor Standards Act now and may well not be covered by the Fair Labor Standards Act improvements, even under the bill that came from the House Labor Committee.

Moreover, I would suggest that we need some studies here. I offer this as a challenge to the opponents of the extension of minimum wage coverage. Take the city of New York in the State of New York, where the State of New York has greater coverage under its State minimum wage law than the Federal law; whereas in the State of Illinois there is less coverage under the State law than under the Federal law.

Now, can anyone prove to me or to anyone that there is relatively more teenage unemployment in New York State than there is in the State of Illinois?

This has never been demonstrated.

Senator PROXMIRE. That is a good question, but I think it is the kind of thing that would be relatively easy to determine. I know when they get unemployment statistics they have to get them on a national basis, I know that any smaller sample would be not as accurate, if of course, but both Illinois and New York are very big States and I should think this is the kind of study that could be made.

I think it would be very helpful.

Mr. GOLDFINGER. To my knowledge this has never been one, sir, and what we have gotten are a lot of blanket charges, but without any kind of significant proof. I get back to the point that the area of teenage employment, of first job opportunities for the kinds of young people that you are talking about, by and large are in small establishments, frequently the kind of "Mom and Pop" establishments that are not covered by the Fair Labor Standards Act now and probably would not be covered by the Fair Labor Standards Act even under the bill that was proposed by the House Labor Committee. But in addition to that, sir, if the idea of a twofold minimum wage were established, I fear we would be pitting one section of the population against another.

We would be pitting young workers against old workers and employers very often would take advantage of the lower minimum wage for teenagers and use teenagers to displace jobs for adult workers. This, I think, would not only be wrong in an economic sense, but I think socially it would be dangerous.

Senator PROXMIRE. I understand that you feel that the wage price guidelines should not be made effective until the price situation deteriorates more than it has. To what extent would you think the Consumer Price Index would have to rise before you think price-wage guideposts should be used? I was not here when you made the assertion, I did not find it in your statement.

Mr. GOLDFINGER. Let me restate, sir, if I may, what I was trying to get across. I think that the way the wage guideline works—aside from what the Council of Economic Advisers did on the arithmetic of the guideline—the concept of the guideline is not feasible. We do not get price cuts in the highly profitable, highly productive industries, to offset the price increases in low profit, low productive industries, with the result that we get increases in the cost of living and the increases in the cost of living erode part of the wage gain, so that the 3.2 percent wage guideline is less than 3.2 percent, in terms of buying power.

Senator PROXMIRE. We are certainly not going to get it by abandoning the whole concept, are we?

Mr. GOLDFINGER. But if we are going to do anything like that, sir, let us do it on an equitable and fair basis.

Senator PROXMIRE. This is the concept that the council has certainly in mind, a lot of people do not understand it, but the fact is that nevertheless in the automated, efficient industry, where you have a productivity increase that exceeds the wage-price guidelines, you should have price reduction. I agree that more attention should be called in some way to these industries.

This is certainly the concept at any rate, the idea. We have had some examples in some areas of price reductions, we have had a relatively good record of price stability since 1960.

Mr. GOLDFINGER. That is right, compared to other countries in the world the record of our price level has been excellent. When we speak of price stability, we have had a very high degree of price stability, of wholesale prices, which are costs to employers. We have not had——

Senator PROXMIRE. And also their price to employers—employers also sell at wholesale.

Mr. GOLDFINGER. Correct. However, the cost of living as measured by the Consumer Price Index rose at an average yearly rate of 1.3 percent in 1960 to 1965. This raise in the cost of living eroded part of the wage gains and the rise in the cost of living erodes the wage guideline. The Council of Economic Advisers wage guideline of 3.2 percent, in that sense, is a phony. It is not real, the buying power of that wage guideline is about 2 percent, or 2½ percent. It is not 3.2 percent.

Now regardless of the theory, and I agree with you that the Council of Economic Advisers has presented the theory of the guidelines as you did—it would require price cuts in the highly profitable, highly productive industries. But the fact of the matter is, sir, that we have not received those price cuts. We did not get price cuts in the highly productive industries and highly profitable industries to offset the price increases in the services—medical care and so on—so that the cost of living, as measured by the Consumer Price Index, has continued to move up. The record shows clearly that real wages have increased at a much slower rate than the rise in productivity for the past 10 years.

We have had a record of 10 years now where real employee compensation per man-hour has lagged behind the rise of productivity. In the past 5 years, from 1960 to 1965, real compensation per man-hour for all employees in the private economy—wages, salaries, and fringe benefits—have increased about 2.9 percent or 3 percent a year, whereas productivity in the total private economy has increased 3.6 percent per year.

Senator PROXMIRE. I wonder what these figures really mean, the fact is that people who are on fixed incomes suffer more than workers who—more than workers by and large.

No. 2, farmers whose productivity has increased far more than the rest of the economy, I do not find much reference here to the farmers, although they are one of the groups outside of the organized labor movement, farmers have really been on the bottom of the totem pole, they have had a marvelous increase in efficiency, no question about it, but their income has not begun to keep pace either with their productivity or the general increase in income in the economy as a whole.

Small proprietors on the basis of the best evidence I can get, small business, I am chairman of the Small Business Committee of the Banking and Currency Committee, we have been studying this quite closely, they have not had a chance to keep pace with rising prices. Landlords, as measured by returns on rent, have not kept pace either.

Now workers have kept ahead of many groups in the society, and then when you come to members of the AFL-CIO, particularly the construction trades and UAW, you have a very vigorous and very efficient bargaining operation, then you find a consistent and substantial increase in income.

Mr. GOLDFINGER. But the UAW, for example, has a cost-of-living escalator. The UAW has such provisions written into its collective-bargaining agreements. Most other groups of workers do not. I believe that you will find that the estimates of the U.S. Department of

Labor are that something like 2 million workers in this country are protected by cost-of-living escalator clauses.

Other workers are not protected against the erosion of buying power that occurs as a result of the rise in the cost of living. And I am suggesting, sir, that the rise in productivity is one important factor, but it is not the only economic factor to be considered in wage determinations. There are others.

Senator PROXMIRE. That is right, but when we had more unemployment, more excess capacity throughout the decade of the 1950's, yet prices rose more rapidly than they have since 1960. The price-wage guidelines as used by the President have tended to give us a better price performance.

You just said 1.3—1.4 percent increase in prices between 1960 and 1965, at a time when the economy was tighter. Certainly, the latter years of this 5-year period are much tighter. Under these circumstances, it seems to me, we ought to have a lot of regard for price-wage guideposts before we say let's not apply them.

As I indicated, the inequities of inflation apply not only to workers, but to farmers—small income—proprietors and many others in the society. Price-wage guidelines provide some protection.

Much of American industry is outside the competitive sector in determining prices. They fix prices on an administrative basis. They are the ones at whom the wage-price guideline is aimed. If the President does not use it vigorously, refine it, encourage it, apply it as equitably as he can, it seems to me we are going to give up on a weapon which has been very helpful to us.

Mr. GOLDFINGER. There are no guidelines for profits——

Senator PROXMIRE. There is a price guideline that is supposed to do this, and as you agree, the Council of Economic Advisers will apply this concept to the efficient automated industry that they should reduce their prices, recognizing their superior productivity.

Mr. GOLDFINGER. Well, they should but they have not, sir, and I do not know that they have a mechanism for doing it. Frequently, Senator, there are comparisons between the U.S. experience and experience in other countries and often we are referred to Sweden, for example.

Well, the Swedish experience is a very interesting one and we could learn some lessons from what the Swedes have done, under a labor-supported Government, for over 30 years now. However, what we have to take into consideration is that the size of Sweden is about the size of New Jersey. The population of Sweden is about the same as the population of New York City; the country is essentially racially and ethnically homogeneous, and in a small country they have centralized institutions.

They have a highly centralized labor movement, a highly centralized employers organization. We do not have those kinds of institutions; we live in a country which is racially and ethnically heterogeneous, and furthermore, our country is of continental size.

These are things which the Council of Economic Advisers has not taken into consideration in an attempt to get at a magic number. I think that any magic number rigidly applied in the American economy would not be feasible because of the size and complexity of our economy.

In addition to the issue of equity—and the equity issue is, I think, indicated by the soaring rise of profits of recent years—profits have risen twice as fast as the gross national product in recent years.

Last year profits before taxes went up 15 percent; after taxes, 20 percent. This is an indication of a social inequity, but in addition to that it poses economic problems——

Senator PROXMIRE. Just a minute on that rise in profits. I think all of us, including the AFL-CIO, welcome profits. This is the incentive drive in our economy. We have to consider whether they were at adequate levels, whether the return on investments was adequate when you discuss your statistical history.

It seems to me you can make some case that return on invested capital was not satisfactory during the period 15 or 20 years ago, or even during the period 5 or 6 years ago and that this increase in profits, while it has greatly exceeded other kinds of income, you can get some justification for that and to the extent that the increase in profits has been accompanied by all the other very favorable aspects of our economy with rising income, greater savings, lower unemployment.

I agree that we ought to be aware of the inequities here and try to apply policy that would bring this into a greater equitable balance, but if we have to pay a price of seeing General Motors breaking all records of all times for all companies in profits, well, I think that is a price well worth paying.

Mr. GOLDFINGER. But the issue is not only one of social equity, as I view it, sir. It is also an issue of the sustainability of the economic advance that has taken place in recent years. I do not think that this economy can move ahead, year after year, with profits and dividends moving way ahead of the other sectors of the economy. This emphasis in the economy, I think, has been a poor one in terms of sustainability.

We cannot continue to emphasize savings and investment—profits and business investment in plant and equipment—and expect this kind of emphasis to sustain high levels of economic growth and high levels of employment and low levels of unemployment.

This kind of thing is going to run us into a lack of balance and into some kind of trouble, with the potential of economic declines.

Senator PROXMIRE. But to put it another way, is it not true that labor's share of the total national income is roughly the same? It has not varied more than 2 or 3 percentages, has it, percentage points in the last 5 or 6 years?

Mr. GOLDFINGER. Well, in the last——

Senator PROXMIRE. The share of wages, it has gone down, I know.

Mr. GOLDFINGER. I have forgotten the figures. It has gone down. This trend of decline, I think, is wrong, not only in terms of social equity, but in terms of economic policy.

Senator PROXMIRE. Let me ask you, I have delayed you and you have been very, very patient with me and I appreciate it. I just have a few more questions which I think are more technical and you can handle perhaps a little more readily.

I want to commend you and your investment credit proposals, and I think this is a very practical proposal. We asked the Secretary of the Treasury about what taxes would tend to stem inflation if we get into an inflationary situation, and we discussed the investment credit as one possibility.

However, it seems to me that your suggestion that we require plants to put into escrow part of their investment credit for retraining purposes to be returned in the event that automation does not require it, would tend to make the investment credit less attractive, would slow down investment and this has been one of the real driving expansionary elements in our economy.

In other words, if we slow investment because the investment credit is made less attractive, will this not tend to do just the reverse of everything you and I have been talking about today in calling for a more expansionary fiscal policy?

Mr. GOLDFINGER. I do not think so, Senator, because I think that we have had a very sharp rise of business investment year after year and we are running into the third year, where business investment is now anticipated to rise by about 15 percent in 1966, following roughly a 30-percent rise in the past 2 years.

Business investment in new plant and equipment has been increasing twice as far as GNP. This cannot continue; it is not sustainable. This is clearly our view, but it is also the view of some business economists.

The rate of business investment that we have been experiencing clearly is just not sustainable.

Senator PROXMIRE. On the other hand, you and Walter Reuther and the UAW, CIO have all been in favor of automation, as I understand.

Mr. GOLDFINGER. Yes, sir.

Senator PROXMIRE. Is it not true that if we could have a situation in which innovation, technological change, invention, science is so dynamic that it would be good for the whole society? After all, it is my understanding that 90 percent of all the scientists who ever lived are alive today and the impact of this scientific revolution is going to mean a terrifically rapid technological advance.

It is my understanding that Dr. Seaborg of the Atomic Energy Commission has estimated that we are going to find out more about ourselves in the next 30 years than in all recorded history to date.

If we have this kind of terrific educational and knowledge explosion, is it not possible that we might get a very dynamic and continuing change which would—change our economic technology which would result in very great stepup in business investment?

Mr. GOLDFINGER. But this economy is based upon a balance between business investment, on the one hand, and a demand for goods and services, on the other, and it is the balance which bothers me.

I think this economy has been out of balance in the private sector and is moving more out of balance in terms of the relationship between investment, on the one hand, and the demand for goods and services, on the other. The way we tried to solve this problem previously—in the past several years where we have had a more rational policy—we tried to solve this imbalance in the private sector through budget deficits. We tried to offset the weakness in the private economy either through tax cuts or through increased expenditures by the Federal Government, or a combination of both.

Now, it is my feeling that as we move ahead with this kind of imbalance in the private sector of the economy, we are placing an undue and increasing burden on fiscal policy, not in technical terms, not on a blackboard or in a textbook, but politically.

Will we be able to get large budget deficits year in, year out, even at high levels of employment and low levels of unemployment in order to offset the growing imbalances in the private economy?

This is what bothers me about the sustainability of the improved economic performance of the past few years.

Senator PROXMIRE. Of course, on the other hand, this seems to be contradictory, because it seems to me that it is the investment, the rapid increase in investment which has stimulated the economy and resulted in increase in income, an increase in governmental revenues and a decreased unemployment, a decreased need for so many governmental expenditures and, therefore, this business investment has been something that has been positive, not negative.

Mr. GOLDFINGER. But who is going to buy the products that can be produced by this increasing volume of business investment? Businessmen do not invest for the sheer joy of investing. They are investing in order to increase their ability to produce and to sell, and what I am suggesting is that we may well be building up an unsustainable investment boom here.

I am convinced that we are building up such an unsustainable investment situation. This happened back in 1955–57. I think we are doing it all over again, and I have raised the question, which I will repeat, and that is: What will happen at the point 6 months, 12 months, or 2 years from now when the level of military expenditures levels off or declines?

Will we be able to sustain low levels of employment? Will we be able to avoid a sharp recession and rising levels of unemployment?

Senator PROXMIRE. Let me say I have no doubt on that at all. The impact of the Vietnam war, as Secretary McNamara testified before this committee, is very, very modest. As a matter of fact, we are spending less in relation to our gross national product than we did in 1956, 1957, 1958, 1959, 1960; and that is only about 3 percent of the gross national product.

It seems to me by tax cuts, by other means which are readily at hand, we are in an excellent position to take advantage of peace if it should come.

Mr. GOLDFINGER. Oh, I hope you are right. I think you are right, but I am not sure that we will move as rapidly as needed with increased Government expenditures to take up the slack. In relation to the capital investment boom, 1966 will be the third year where business investment in new plant and equipment is rising twice as fast as GNP.

This is the issue, will we have an overhang of large amounts of idle productive capacity at which point business would cut back its investments? Will we take up that slack fast enough when it develops?

Senator PROXMIRE. I want to thank you very, very much. I find I have to go to the floor. The bank merger bill is coming up, I am involved in that. I want to thank you——

Mr. GOLDFINGER. I hope you do right on that, sir.

Senator PROXMIRE. I want to once again apologize for detaining you at this length. This is a very, very substantial and helpful contribution to the committee hearing.

This afternoon at 2:30 in this room Mr. Elisha Gray, chairman of the board of the Whirlpool Corp., will appear before the Joint Economic Committee and we are looking forward to hearing him. So, the committee will stand in recess until 2:30.

(Whereupon, at 12:25 p.m., the hearing was recessed, to reconvene at 2:30 p.m. on the same day.)

AFTER RECESS

(The committee reconvened at 2:40 p.m., Senator Proxmire presiding.)

Senator PROXMIRE. The committee will come to order.

Our witness this afternoon is Mr. Elisha Gray, and, Mr. Gray, you are very welcome. You are chairman of the board of Whirlpool Corp., and an extremely articulate spokesman for your viewpoint, a man with an excellent reputation among Government economists and Members of Congress. We are delighted to have you here and have your advice on the President's Economic Report.

Proceed in your own fashion.

STATEMENT OF ELISHA GRAY II, CHAIRMAN OF THE BOARD, THE WHIRLPOOL CORP.

Mr. GRAY. Mr. Chairman, first I am pleased to be here and to have been invited; perhaps I can keep the thread of my remarks more clear if I scan through the paper that I have put together, it is somewhat on the brief side?

My name is Elisha Gray II. As chairman of the Whirlpool Corp. my business is the making and selling of major household appliances. I appear before you under the category of business, but I must make clear that I represent no special business group nor should my remarks be interpreted as being the voice of business.

Parenthetically I might say my background and training is that of engineering rather than that of law or sales or any of the other disciplines.

I shall do my best to reflect a businessman's point of view on the matters under discussion and I am reasonably confident that these views would be shared by a great many businessmen.

I will start with a few points in the President's message and then your questions, I am sure, will get more to the focus of your interest.

In his message the President says:

> The 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.

That is a correct appraisal of our principal economic problem, I believe, so it makes a logical starting place for my remarks. Since I bring no professional or academic competence in economics to this discussion, what I say is just one businessman's feel of the forces at work right now in our economy.

Unquestionably there are presently, all through our economic system, strong forces bringing us closer and closer to real inflation, and many words are being spoken to this effect by people to whom the general public listens. Too many words, as I shall discuss later. Each speaker has his notion of what element in the economy is the real culprit. And of course many of them are right because there are many different forces at work today that are still contributing their part to the push. What are they and which ones are most dangerous?

I would venture the opinion that the defense buildup is only one of the pressures, and by no means the principal one. In a total economy the size of ours, it does not seem to me that an additional 6 or 7 billion over the past rate of spending for defense will in itself have a striking effect. After all, last year alone our GNP increased $47 billion and many people expect it to do the same thing this year.

Business and consumer spending are the mainstays of our prosperity and while our increased defense push of 6 or 7 billion is in the accelerating direction, it is not of itself the most important element we have to watch.

There is much discussion on this point of whether the budget is inflationary.

While there are some differences among competent people on this point, I read it that the influence cannot be called very great one way or the other. I think it is cutting it pretty fine to say that a Federal deficit—or for that matter a surplus, of 1.8 billion is in an economy of 700 billion, is either inflationary or deflationary. Perhaps in an academic sense, that can be proven, but I think this kind of an exercise misses the real thrusting force of our economy.

If consumers are confident, they are going to buy. And all lines of commerce are going to try to anticipate those demands and move quickly to provide the products to meet them. This involves more facilities, more materials, more man-hours of work and more money to finance the effort.

The twin thrust of an eager consumer and an aggressive businessman accumulates to a force that in my view will dwarf the relatively minor arithmetical surplus or deficit that a particular budget may show. Obviously the reverse is true. When consumers desert the market because of uncertainty, belief that prices are going down, or just lack of ability to buy, the massive void that this reaction can produce is likely to be much greater than can be replaced quickly by any stimulating action the Federal Government might take.

The influences of the budget differences, it seems to me, are more important in their psychological effect in this year's budget, than in actual effect. That can be influenced greatly by the tenor of the public discussions about them.

For instance I think most businessmen would agree with the President that there should not be a moratorium on social progress, but I believe it would be well received by the country at large if the administration were to take a little more time to test the programs. How much will they cost, not only this year but more importantly in 1970 and 1975, and what impact will those sums have on our economy then?

Are we inaugurating changes in our social structure that will subtly undermine the incentives and driving energies that have built this country? Some plans undoubtedly should be refined, some perhaps increased, and undoubtedly some discontinued. Such a field test period, or pilot run if you like, I suspect, would do much to erase the rather widespread feeling I sense, that the rush to do some good for everyone has gotten a little out of hand.

Here again the immediate money involved is not enough one way or the other to affect inflation greatly but the connotation is one of freewheeling spending, with no limit in sight.

At the present time, we are doing our best to talk ourselves into inflation. Every headline tells of fears of shortages and price increases. Men in important positions are saying that we may soon have controls and rationing. The cost of living moved up 0.4 percent in December alone. If you will consider it for a moment, there has been a crescendo of talk in the last 2 months rising to a pitch this very week—all of which tells the consumer, "If you want that widget, you had better get it now."

Again referring to my term "the thrusting force" of our economy, consider what motivates every single person in his decision to buy.

If he has the need or the desire even without the need he will consider the purchase. If he has the money for it he can act when he chooses. Nowadays, however, credit is adequately available, someone will lend him the money.

Now he is set to buy. If he thinks the price and the supply will remain constant, he can take his time. If he believes the price will go down, he will wait. You may be interested to know for example that last year, June and July, appliance sales softened markedly for 2 months while the removal of excise taxes was debated, because customers were uncertain as to whether the lower prices would become effective or not. There was a quick and widespread response by manufacturers in our industry to trim expenses and inventories a bit.

Right in the middle of what has been a very fine year. On the other hand, if a consumer thinks the price is going up or the supply will disappear, he will buy as fast as he can.

Human nature has operated in this fashion since the beginning of man. It is still in force. Department store sales for January were up 17 percent over last year. Surely no one thinks our society has grown that much. Some thoughtful people in the hard lines, such as automobiles, appliances, and the like, think that the present surge of sales is borrowing from the future. My own company's shipments of course, they are just a tiny bit of the total, were up 33⅓ percent over last year in January and even 16 percent over the very bullish estimates we had just 60 days ago.

We thought we were pretty good estimators. We did not suddenly get that good. What I believe is happening is that suddenly the consumer psychology has turned overly bullish—or maybe it is a little scared.

If this observation is correct then this sudden upsurge is borrowing business from the future which will be balanced by a corresponding lull sometime in the future. This pattern, of course, has occurred very frequently in our economic history. The upward trend line of our economy has not been an unbroken straight surge up. The key question is whether this present unusual pressure is temporary and will subside of its own accord, or whether it has such force that it should be restrained by extra artificial deterrents.

During a bulge of this kind there will naturally be strong upward pressures on prices all along the line.

As, of course, you know, plant and equipment expenditures by all industry increased by 15 percent in 1965 and some estimates say 14 percent this year—both unprecedented. In manufacturing industries, physical capacity increased about 6 percent in 1965. I have no doubt that the physical plant of this country will be more than adequate to supply the needs. If this is so, then basically prices will not get out of hand. Here again, the disciplinarian for all businessmen is the competitive system. If it is allowed to operate freely it will fiercely enforce efficiencies, cost-reduction programs, investment in modern equipment, and all the rest of the progressive actions of business that have characterized this amazing American economy.

Senator PROXMIRE. The figures you give are very, very impressive. May I ask, do you give your source for this statement that our nationwide capacities have been increased by 15 percent in 1965 and an estimated 14 percent this year, I take it 1966?

Mr. GRAY. I believe those figures——

Senator PROXMIRE. It is a very important statement, because so many people just assume that we are crowding capacity because we are at 89 or 90 percent, and this is an impressive answer.

Mr. GRAY. The Commerce Department who issues the figures get them from McGraw-Hill surveys that are made. Source data, I am told, is McGraw-Hill.

Senator PROXMIRE. Thank you. Fine.

Mr. GRAY. I heard a figure used this morning of 7 percent for this year which is at quite a variance with this. However, then it still is lower than what will be needed.

Senator PROXMIRE. You are talking here about manufacturing capacity?

Mr. GRAY. Yes, productive facility and that is a generality, of course, it is an aggregate thing, but I do feel that—and I think it is quite clear—that the capacity is going to be there for any reasonable growth and that is not being—that is not going to be the bottleneck.

The point I am going to make is that a free competitive force is a great disciplinarian and keeps businesses at such a level of efficiency that they continually get more out of given facilities and out of given processes.

The appliance industry happens to be a good case in point. As you know, the President was kind enough to specifically cite this twice in his message for its record and in price reduction. According to the Consumer Price Index, appliance prices have gone down by 26 percent since 1947–49.

Senator PROXMIRE. I would like to commend you on that, I think it is a magnificent record and I think it is an indication exactly what you have said, what competitive forces can do in this industry. We have had witness after witness, we had one this morning, we have them continuously here, who contend it is fine to have wage price guidelines, and it is fine to talk about business reducing prices, but they never do it.

You have done it in this industry. That is a startling figure, 26 percent since 1947–49, since the price level has risen itself very substantially in this same period. It is amazing.

Mr. GRAY. I go on to say how it has risen, because I do think it illustrates my thesis.

In the first place it would be fatuous of me to claim these price reductions were motivated by altruism. As managers of publicly owned companies we have all been trying our darnest to earn a respectable profit and I don't ever recall a businessman reducing a price except to maintain position in the competitive market. In our business the most active competition you can imagine has stimulated more efficient production methods in our industry. For instance, the basic raw materials used in the production of an automatic washer has gone up in cost over 100 percent—105.3 percent—since 1947–49, labor cost per hour has increased 96 percent, and final selling prices, as you see, are down 26 percent—and we have room in there for a modest profit.

Senator PROXMIRE. I hate to keep interrupting you, because I know you would prefer to have the questions later, it is more orderly that way.

Mr. GRAY. I wish you would go ahead and interrupt.

Senator PROXMIRE. Does this allow for quality improvements? I know they have been substantial.

Mr. GRAY. No, it does not. And there is not a very good way of measuring that and this is a straight arithmetic statement.

Senator PROXMIRE. You would agree that the appliance industry has been characterized by very significant increases in quality in various ways, more service——

Mr. GRAY. I can document that, Senator, fully if you will forgive me using our own figures, they are the only ones I really know. An automatic washer in this base period would average about five service calls a year in the home. Today it is one-quarter of one service call a year—in other words, if you happen to buy the average you will have a service call every 4 years on your automatic washer, which is one pretty good index of quality, it seems to me.

Senator PROXMIRE. It certainly is.

Mr. GRAY. To say nothing of all the little refinements in the design that go along with it.

Of course, to make a change of this kind requires immense changes of design, complete changes of processes and also high volume of production. This sort of thing comes easiest and best when you are in the growing thrust of volume. When you level out there is not quite as much to squeeze out of it and that is what is taking place in our industry.

But my own point is that, being a highly competitive industry it has policed itself very dramatically, as you can see.

Now the labor supply, I believe, is another matter. I have said I think the physical capacity will be available to meet our economy's needs, but you cannot plan to increase labor capacity next year by about 7 percent as we have done with plants.

At this point I would take a little exception perhaps to the testimony this morning that statistically we say we have about 4 percent unemployed, but I think that is a little deceiving. It would be more to the point to try to determine the number ready, willing, and able to work who are looking for work but who could not find employment. These figures, I am afraid will be repetitive to you, but the point I make is that I believe for practical purposes, with the exception of a few nonindustrialized locations, we have approached a minimum of unemployed.

Estimates are that there are 73 million people working and another 3½ million, give or take some, who are cataloged as unemployed. As you know, some of these are just changing jobs, and I was astonished to get the figure that 8 million people change their job every year; 800,000 only want part-time work; 800,000 are boys and girls from 14 to 19 (some probably duplicated in the part-time figure).

When you have analyzed your way through the people listed as unemployed who really do not fit the employer's needs, I really think there are very few left. Another indicator of this is the precipitous rise of the help wanted index from 137 to 186 in the 12 months ending in December.

So if the supply of product falls short of demand in 1966, as a general thing I believe the reason will be shortage of labor—not physical plant capacity.

To be consistent I would have to say that if present very strong demand keeps up for an extended length of time we will fall short of supply in many products and we will experience a strong upward push on prices. I don't think anyone can forecast the turn accurately. I am confident that the Council of Economic Advisers has the statistics and the sensitive grasp of things to make a pretty sound decision on whether or not we should supply some more artificial restraints to this economic enthusiasm.

Personally, I would wait and see. But I would watch it 24 hours a day. If the supply actually can't meet the demand, even though it may be temporary, then all kinds of second markets and other dislocations of many kinds take place.

Mr. GRAY. I think the Government would then be wise to put a restraining brake on the economy, because this country cannot tolerate a broad-based inflation at this or any other time.

Insofar as we can bring it about, business will do its share to prevent inflationary trends in wages and prices and thus avoid the need for restraints, but it is only one of four major factors, as you know: the Congress, the administration, labor leaders, business heads.

By dealing in an evenhanded manner with the four major elements of the equation, in such a cooperative effort, the President will have the wholehearted support of the American business community.

If and when the decision is made to slow down the rush, the nature of the restraint used is most important. There are many restraining devices, most of them time tested. So far the administration has used persuasion and a bit of monetary restraint. If these prove not to be enough, they must dig deeper into the arsenal of tools.

To my untrained economic mind, the place to put the restraints, if they do become necessary, is on the demand side of the scale, which is done, of course, by such devices as increased taxes, tightened credit terms, and so forth. If, on the other hand, we act in a shortage situation by only placing an arbitrary ceiling on prices, a number of undesirable things start happening at once. Quality usually suffers first; black and gray markets spring up; profits, and thus the incentive for wide distribution, are reduced, and the benefits of the product are denied to the public.

My point is simply this: that while we may encounter bulges and sags in our economy and probably also in our pricing from time to time, our competitive system will quickly move in to correct inequities if it is free to do so. I think the administration should use every persuasion toward restraint, as it has been doing, but it must recognize that some adjustments just must occur in a fluid economy if we are to preserve the market forces that control competition.

WAGE AND PRICE CONTROLS

I can be very brief on this subject. In my view there is no case at all for wage and price controls. They are absolutely the last resort we should turn to and only in a drastic emergency.

By their very nature they destroy market forces. I don't mean just forces aimed at making money, but those involved in producing efficiently. The market with its millions of daily, indeed hourly decisions, is a far more effective mechanism than regulations, no matter how carefully drawn.

I do not need to go into the ramifications of the considerable bureaucratic structure necessary in these situations. It is quite obvious.

Other types of restraints are legion and they should all be used before direct control are resorted to.

Now in the question of guidelines—

I have discussed this with many of my colleagues and, while their views cover quite a spectrum of enthusiasm of various degrees, I think the consensus would be that the guidelines are better than nothing. There are several ingredients I could point to in the guidepost concept that trouble businessmen.

Senator PROXMIRE. You think they are better than direct controls?

Mr. GRAY. Oh my, yes. I have no doubt about it.

In a discussion with businessmen about this, when they have finished their criticisms of it and you ask, "What would you suggest?" and they struggle with courses that might be used, this comes out as a better alternative than anything else they can think of. This is not at all universal, you understand, but I think it would represent the majority view.

Also, I think businessmen are practical enough to recognize and accept that they worked pretty well in these last few years. I do not know that it would apply in the downturn, but they accept the fact that it has been a useful device. With all of the disagreements they may have with it, it is better than nothing.

The question of enforcement, of course, is a difficult one. To be sure, these are voluntary guideposts, but it would be naive to think that in an economy as vast and complex as ours that the system would everlastingly work without continual publicity to bring moral suasion and public opinion on the side of compliance.

Naturally, and I think unfortunately, this focuses on the very few and the highly visible situations, while thousands of others are moving in response to natural market forces.

Furthermore, as a practical matter, the not too subtle hand of persuasion can bear much more effectively on prices than it can on labor.

The second point that troubles businessmen is that the new social security taxes are essentially a legislated increase in pay—in the vicinity of 1 percent of payroll. It depends on the level of wages in one's unit to get the exact percentage. This is a legislated labor cost that should be considered in the 3.2 percent guidepost on wage increases. It is a labor cost that is entirely for the benefit of labor. I want to make it clear as a businessman I do not object to them, and I don't think others do. I simply think they should be credited to the right account. The same, of course, must be said of any additional legislated costs that may accompany future legislation, accruing to labor, such as new ideas of unemployment insurance, and so forth. Perhaps the administration agrees with this, but I haven't heard it said that 1 percent of the guidepost is already paid for in 1966 and only 2.2 percent is left for negotiations. And surely this isn't the impression held by the general public or the wage earner.

Third, these productivity indexes are admittedly very inexact. And, furthermore, if the average really is 3.2—and I have no way of quarreling with that—you can be sure that some industries or services are just about zero while others are 6 or 8 percent. I just saw from Mr. Ross' statement, made before this committee yesterday, which ones are high and low, and they do rank from almost zero to about 8 percent. As a practical matter, at the same time you can understand the predicament of a union leader to try to rationalize to his members a settlement of less than the guideline, so the guideline frequently becomes his floor—not his ceiling.

In other words, I do not believe such an indicator can be precise enough that it should be hardened into national economic policy as a repetitive factor. While it has been useful in the full flush of ever-increasing volumes, it would quite possibly not be in a declining situation.

MINIMUM WAGE

In the popular mind, of course, it is regarded as an unalloyed boon. I think, however, if it is overdone, just the reverse may be true. If there is such a thing as a permanently depressed class it is the unskilled, untrained, and the young, foreclosed from employment by the minimum wage rates. If the minimum rate is raised too abruptly employers will then be obliged to hire fewer of the less skilled, less experienced people. There are many fine people of limited ability, perhaps because of lack of skill, or maybe advanced age, or more probably the opposite, the youngster who seeks and needs part-time work whose contributions to the economic scene simply can't be justified at a greatly higher wage.

When these matters are discussed here in Congress, I urge the left hand to be sure it knows what the right hand is doing. We are launching great programs and costly ones to train the disadvantaged so that they may find gainful employment, and I certainly applaud this. But if we raise the minimum wage by too large an increment all at once we will go a long way to putting more marginal people out of jobs than we can ever lift up into jobs.

I want to make clear I think it is logical in this expanding Nation that minimum wages should trend upward, also, but the trend should be gradual and more in concert with the other economic trends in our economy, not a 40-percent jump as is being suggested in some quarters. My opinion is really just one of degree.

CONTROLLING POLLUTION

I do have one word to say on pollution, and it is because I have a strong bias in the matter and I really think almost all business would agree with me on this.

I think it is positively shameful the way we Americans are fouling our own nest. We agree that this problem must be met and we are happy to see the President lead the way by his Executive orders regarding Federal use of our precious resources.

One successful attack on the pollution problem was mentioned recently in Time magazine in its excellent review of "Water, Worldwide." The incident they mentioned was the Ruhr River flowing through West Germany's industrial heartland where a cooperative society has been organized. Their method of operation is simple and effective: whoever pollutes pays for purification. As a result, less water is used per ton of steel produced and the river is swimmable through its course along the stack-lined industrial complex.

I admit such a system would cause many local community governments and some industrial users of our water resources to strain some to get on with the job, but who can quarrel with the principle involved? The privilege of using a resource should require its care while under our custody and whatever that costs is simply an added cost of doing business which must eventually find its way into the cost of the product or service.

CONSUMER PROTECTION

Another item close to the businessman's heart is difficult to discuss, because these suggestions are somewhat in the category of motherhood. One is callous if he even discusses them. Or he is accused of recommending the heartless application of "caveat emptor." I am sure all business will applaud and support every effort to erase deception from the commercial scene, but I think there is room for considerable discussion as to the methods that would be most effective.

First of all, there are presently on the books, laws that adequately cover many of the conditions that proposed legislation is intended to deal with. I refer to the Food and Drug Administration Act and the Federal Trade Commission Act. To be more specific, section 5 of the FTC Act declares as unlawful, unfair, or deceptive acts or practices in commerce. This section has been interpreted to encompass deceptive advertising, labeling, packaging, and merchandising. It probably is not a matter of new laws, but of adequate enforcement of the ones that we have.

Second, in a cooperative spirit, an immense amount of corrective action has been taken by various industries themselves. Examples with which I am personally familiar would be the standards of cooling capacity that were adopted in 1962 by the air-conditioning manufacturers to clear up the confusion in consumer's minds caused by conflicting claims of capacities of various units. This voluntary action required that all window cooling units of manufacturers participating in the rating program—and that was all of them, incidentally—bear a permanently attached metal nameplace showing the number of B.t.u.'s capacity in that unit. The products are checked at random by an independent laboratory and any departures of more than 8 percent of rated loads are cited for correction. The same approach has clarified the so-called cubic foot capacity of a household refrigerator, which was a very abused factor. I am sure the consumer as well as the manufacturer is better protected now.

A notable industry accomplishment—and it found its way into the Congressional Record recently—of recent vintage is the voluntary action of the detergent industry when they stopped making products that were not biodegradable. When the severe problem in sewage disposal that was caused by hard detergents became apparent, the industry set about in its laboratories to develop a product that would disintegrate from natural biological action after its use. A date was set (June 30, 1965) for stopping production of the old product and this has been effected. No laws were involved and I suspect the improvement for the consumer happened more quickly than if the long trail of legislative process had been used.

So, in your deliberations on legislation in this field, I urge you to consider this constructive alternative method of approach.

I can't close my remarks on this subject without observing that the American consumer is a very wise buyer. She will unerringly judge values to suit her individual needs. That judgment is swift and final for any inferior product. With the exception of outright deception, I hope you will leave the imaginative merchandisers in our economy free to present their wares in the most attractive, informative, and effective ways they can develop. The American consumer will be the winner, as she has been for decades.

BALANCE OF PAYMENTS

May I make a brief comment about the balance-of-payments problem. My credentials in this case are that I am a member of Secretary Connor's Balance of Payments Committee and one who brought very little prior knowledge with him to the first meetings, but who has absorbed some knowledge and a few convictions in the past year's work.

First of all, I am sure the voluntary approach was the best one. It was quick, and it has produced splendid results in its first year. The business and financial sectors of the economy have overwhelmingly supported it and I am sure will continue to do so in its now slightly revised form for 1966.

I would like to say that the wise administration of this precedent-making program for the business sector by Mr. Connor and his associates has in my opinion been the key reason for its success. The mutual feeling of confidence and understanding that has characterized this entire undertaking reassures me that together we can handle the new problems that will unfold to this country as we move into new economic circumstances.

A prudent man must say, however, that good will and good intentions alone will not permanently hold in check the natural flow of money and goods. This country, strong as it is, does have a limit to the wealth that it can continuously send beyond its borders, if the flow is going to be all one way.

You know, I am sure, that the only sector of our entire national activity that produces a plus input to our balance of payments is the business sector. It is striving mightily to offset the chain of negative items in the overall balance of payments of which the important negative ones are: the U.S. Government account (including both defense spending and foreign air) and U.S. tourist spending abroad.

President Johnson listed in his message seven headings that bear on this problem. The first four are for us to pursue and I assure you that will be done. The last three are legislative and fall in your area of responsibility. I would add one more he did not mention; namely, a demonstration of fiscal prudence by our Government in all of its affairs to demonstrate to our foreign friends that we are responsible, and to attract their confidence and their money to our shores.

In summary, I would say that I believe the vast majority of businessmen endorse the President's economic message in most respects. The problems it poses for 1966 are born of success. How much more difficult they would be, if they had been born of economic failure. In shaping solutions to them, I just urge that you rely heavily on our superb competitive system and that you keep intact all of the business and personal incentives that today stoke the fires of that competition.

Senator PROXMIRE. Thank you very, very much, Mr. Gray, for a stimulating, thoughtful and impressive statement. I apologize for the fact that so many of the members of the committee are tied up today.

I intend to call your statement to their attention, and as you know, your whole appearance will appear in the record, including your statement in full.

Mr. Knowles, the director of the committee, has called to my attention that the question that I raised on page 6 about your statements as to increase in capacity being 14 or 15 percent.

Mr. GRAY. Yes, sir.

Senator PROXMIRE. That the reason that there may seem to be a conflict is that, as he explained it to me, the increases in expenditures for plant and equipment were 14 or 15 percent in those years, but much of this would go into replacing obsolete equipment and replacing retired equipment, and the actual increase in capacity would be in the neighborhood of 6 to 8 percent and, therefore, about half of the figure which you give here.

Now, that would reconcile it and explain why the figures might be different.

Mr. GRAY. That is correct. Thank you; 15 percent of the year before is also expenditures for physical plant.

Senator PROXMIRE. I think your point is very, very well taken. The fact is we assume because we are at 89 or 90 percent that we are going to have automatically an inflation caused by inadequate plant capacity, and your point that we are expanding the way we are suggests that with any reasonable degree of increased productivity, and nobody predicts it will be more than 7 or 8 percent in real terms, we should be able to meet that.

Mr. GRAY. Unless we continue this unusual bulge.

Senator PROXMIRE. Yes.

Now, when you talk about real inflation. Could you be a little more specific? You say that——

Mr. GRAY. Senator, as I said, I was trying to reflect the feel of the businessman and not perhaps the analysis of an economist, but first off, such an unusual bulge on top of already splendid business certainly is not growth in business. This is borrowing from somebody.

Senator PROXMIRE. Let me explain what I had in mind. I do not mean to be niggling or insist on excessive precision. What I had in mind was that yesterday we had testimony by the new Commissioner of Labor Statistics, as well as by Secretary Wirtz, and the Commissioner said that he expected prices to go up between 2.5 to 3 percent in the coming year. This would be a sharper rise than we have had in the past, but a lesser rise than we have had, say, in the decade between 1950 and 1960 and lesser than in most countries abroad.

In fact, he put it that our increase in prices would be less than in other countries.

Mr. GRAY. Yes, sir.

Senator PROXMIRE. Would you consider this to be inflation by your definition?

Mr. GRAY. No, sir. I would not say so, because I am aware the 2 percent we had last year was the lowest of any industrialized country in the world, and by a wide margin.

I think what I am highlighting here is that these things do not come out evenly and it is my feeling that we are currently in a considerable bulge and these statistics lag a little, and I suspect that as we look back upon this moment 6 months from now, we will see that the activity was really greater than even we now know it to be as we sit here. It moves so fast.

I think if that were to continue for any period of time, you just will not be able to restrain the price activity—just supply and demand will bring it about.

If you were to come out at the end of the year at 2 percent or even 3 percent, as you suggested, certainly that cannot be called real inflation, to answer your question specifically.

Senator PROXMIRE. I welcome very enthusiastically your section on defense buildup. I would agree wholeheartedly. Secretary McNamara appeared before the committee and confirmed just what you said.

The fact is, the Vietnam war is tragic, the loss of life. Of course, we cannot value it, it is so great, but there is no question that this is not the kind of inflationary factor that the Korean war represented, World War II. The economy is now much, much bigger than it was in either of those occasions.

The relationship, the effort in Vietnam is far smaller. As a matter of fact, one of the most startling statistics was the fact, as I recall it, we spent more for defense in 1956, 1957, 1958, and 1959 in relation to our economy than we are going to spend for the full pessimistic assumptions and escalation in Vietnam this coming year.

Mr. GRAY. I have seen those figures. A corollary to that is that the estimate for 1966 is about 7 percent of the GNP and the Korean was 11.5 or something of that character.

Senator PROXMIRE. I was talking in terms of the relationship of the gross national product. In actual terms we are spending more, but compared to the size of our economy, it is not as much.

You have suggested we ought to have a moratorium on social progress, there should not be more deterrents to progress but we should take a little more time to test the programs and we should be a little more cautious and prudent about them than we have been in the past.

You are talking about the programs we enacted last year. Last year was known as the Education Congress; so was 1964. We passed a massive amount of aid for education programs; elementary and secondary education, higher education.

As a matter of fact, the poverty program is about 95 percent an education program. Also, manpower training programs, vocational training programs.

Would you suggest that we retard those further than the President recommends in his present budget?

Mr. GRAY. First, I should make clear there should not be a moratorium on them, but an ordinary fellow like myself is staggered at the number of them and the directions from which they come.

I was interested to get the catalog [1] which you have probably seen and it just staggers the imagination to see the index of all of these that are available now, and there is a "handy-dandy" guide here of how to find the one you are interested in quickly and who to call to get it going, divided by: "Children," "Youth," "Family."

It is an excellent job of documenting everything that is available. It just stretches my imagination, and I think of most businessmen, to think that we can launch all of this firmly and effectively in a very short space of time.

I am sure no business would plan to do that much that quickly, because they try to limit their tasks to their abilities to cover them and, as I say, I think there are the three elements.

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[1] Document referred to: Catalog of Federal Programs for Individual and Community Improvement, December 1965. Office of Economic Improvement.

One is how efficiently are they run? There undoubtedly is a best way to do some of them, even the ones they applaud the most, and I think education probably by all orders is probably the best investment we can make, because it multiplies so.

Or this Headstart program which I have personally observed and in its pilot way did a great job where I saw it. But you do not learn how to do these things the first time out, and before I opened the floodgate, I would check it out on a pilot basis.

I do not think this necessarily means slowing up what is already planned for this year, but I would try hard to not get the connotation that the Government had unlimited funds to do anything for anybody. It is the psychological impact of it.

Senator PROXMIRE. You see, the evidence that we seemed to get yesterday from the Secretary of Labor, and I realize he, of course, has a sharply different viewpoint, was that these programs are starting in a modest way.

As a matter of fact, I quoted to him a statement that was in the Wall Street Journal by one person who said before the Job Corps program could become socially meaningful, it has to be increased a hundredfold.

Well, the Secretary denied that that was true, but he did agree that it was a modest beginning.

The point that seems to me to be most dramatic about your testimony here is that you say the main problem is inflation. You say the main force which is creating inflationary problems for us is the shortage of labor or shortage of the skilled and competent labor and so forth. Now these Great Society programs are really designed to get at exactly that: To try and train people who lack the motivation as well as the basic education and the skill, and trying to take people who otherwise would be on relief, out of work, only able to handle odd jobs at low income and give them the kind of upgrading in their skills, the kind of experience in a Job Corps camp perhaps that will help the motivation, the kind of help that will enable them to enter the work force and to get at what you have argued here is the crux of our inflation problem.

Mr. GRAY. If I may try to state my position a little differently. I think the main problem now is the psychological burst that we have at the moment. If we are only going to have 5 or 6 percent growth next year, which the economists have calculated and I am satisfied with that calculation, with an increase in productivity and the million and a half odd that will be added to the labor force, we will have enough to go around. And this can be digested; I will agree with that.

But I am speaking now about what appears to me to be a momentary—I hope it is momentary—bulge of activity now, and at the present pace, I think, is at a much higher level than this 5 percent.

Senator PROXMIRE. I am very much impressed by that, because as a businessman in this particular area, you have a great deal to help the committee with, and I have been in the printing business and have not had the kind of experience you have had with that.

I am somewhat surprised, because it seemed to me that the forward buying by consumers because they anticipated price increases would be pretty much limited to specific areas.

Now, it may be that somebody would buy a car this year because he figures next year the prices are going to be higher, but we have such a remarkable style obsolescence in that field that a lot of people buy cars every year. Others buy automatically every other year; others buy every third year; others buy only secondhand cars.

It is hard to trace it there. Also, you have the effect of consumer credit which has become so dominant in industry, particularly in your kind of industry. People think so much in terms of the monthly payment and, of course, the interest rate factors enter in and they do not look at that price tag quite the way they did in the past, in a different way, more sophisticated, I think.

Mr. GRAY. That's right.

Senator PROXMIRE. I am just wondering if anticipation of the possibility of inflation would have the kind of impact that theoretically it seems to have. Certainly business seems to have done a good job of keeping their inventories down in spite of all the talk.

Mr. GRAY. Yes, sir; they very appropriately have leveled out.

Senator PROXMIRE. I am wondering whether this psychology you talk about is likely to have this effect. At the same time I cannot deny those statistics that there was a 17-percent increase in department store sales.

Mr. GRAY. I think I am reflecting somewhat the feel you get in talking to people, talking to your stores and things of that kind and I trust that it is a momentary thing.

Senator PROXMIRE. What about the possibility of bottlenecks in particular industries that could generate inflation long before there is a general excess demand?

Mr. GRAY. I do not know that I am competent to reply very well to that. I believe you could say that there is a bottleneck in the copper industry right now and the basic availability of it, part of it manmade because of the foreign labor problems and what not, but there are a number of marginal ore bodies in this country that have not been opened up. While they are moving out, it is a slow process.

I think that is the case of the true shortage.

As you know, the Commerce Department is considering limiting exports, putting quotas on them. All products will then reflect the copper situation and are very tight: wiring, harnesses, motors, things of that kind.

Our purchasing people, and again the Association of Puchasing Agents in this last report just a couple of days ago, reflected 63 percent of them were paying more for what they bought now than they were before and that's the highest percentage number that they have reported in years.

I do not have the exact years, but this is a very broad span of commercial activity.

Senator PROXMIRE. I noticed that.

Mr. GRAY. It is a little alarming. It is that sort of thing that I am trying to put my finger on.

Senator PROXMIRE. Now, in getting again at the most crucial elements of the inflationary threat you talk about, labor costs in your own industry going up 100 percent. I presume you are talking about wages?

Mr. Gray. Yes, sir.

Senator Proxmire. Because here you have 100 percent since 1947–49, labor cost per hour has increased 96 percent. Now, this is the gross figure; it does not allow for the productivity increase, I take it?

Mr. Gray. No; that brings it down in our case to $2.97 per hour.

Senator Proxmire. I understand, that is the gross figure. I am talking about the fact that a man in your industry, because of a terrific increase in the productivity in your industry and the efficiencies you have introduced and the automated equipment that I presume your industry has, a man can produce a lot more.

Mr. Gray. Yes, indeed.

Senator Proxmire. For that reason, the increase in labor cost per hour distinct from wages per hour, labor cost increase might either be very little or negative?

Mr. Gray. It is down, Senator, cost per unit is less.

Senator Proxmire. That is a point I wanted to clear up.

Mr. Gray. Yes, indeed.

Senator Proxmire. This is such a crucial point in assessing the reason for price increases and I notice that yesterday in his testimony before us, Arthur Ross, the Commissioner of the Bureau of Labor Statistics, said this:

> From the standpoint of labor cost per unit of output, American manufacturers are in a better position relative to foreign producers than they were in the 1950's. For the United States and Canada, unit labor cost has been stable since 1957, whereas such cost has risen in Europe and Japan.
>
> The stability of U.S. labor cost applies both to the production and nonproduction work segments of the manufacturing labor force, particularly since 1960.

I notice in the paper there was a revision of the current labor statistics which showed from June to December, the December figure was preliminary—this is a period when there has been rising prices, that labor costs in manufacturing actually went down—from 98.8 to 98 percent, so that this labor element, it seems to me, is one that has been performing quite well on the basis of the statistics we can get.

Mr. Gray. I agree. Per unit basis it is splendid.

Senator Proxmire. This is the crucial point as far as you are concerned.

Mr. Gray. I agree, that is crucial in our reduction of prices.

Senator Proxmire. Now, you talk about the fact that we have reached a minimum of unemployment, we cannot reduce unemployment a great deal further, you seem to indicate. This would seem to me—maybe I misinterpret what you say—it would seem to clash with the testimony we have had that by training the people who are unemployed, particularly by a better civil rights program of admitting to employment minority groups that have been denied it, that we can reduce—reduce somewhat substantially on it.

Mr. Gray. If I might elaborate on that, I heard Mr. Goldfinger this morning in speaking about the 4 percent and then have another interim goal of 3.5, and when you reach that have one at 3 percent, and I agree wholeheartedly. And I further agree that the training programs will steadily erode that group now who are very difficult to employ.

My point is that as of now qualified people who are available to meet a current production need, we have just about got them all at work.

I am sure if these demands keep up, this will continue to inch down and heaven knows what the goal should be to get above that.

I am not one who stands with the economic theory that there is some magic place of unemployment that you have to have in order to prevent inflation. I just don't understand that way of putting it and I do not think it would be true, so that my reference is one of the situation as I see it at the moment, to the extent that we are able to train and bring into the labor force any of these other people, that helps to fill the gap and helps to lower the unemployment.

Senator PROXMIRE. Good.

Because I notice that yesterday Mr. Wirtz said this:

> The Manpower Development and Training Act program is currently being reoriented to meet requirements for specific skills in current or prospective shortage. In its first 2 years of operation, it was designed primarily to increase the skills of the hard-core unemployed, so that they could qualify for the job vacancies which persisted even in the midst of widespread unemployment.
>
> The emergence of possible skill shortages, however, has required the broadening of the scope of training efforts under MDTA to include persons who are working at less than their full potential to enable them to meet requirements for jobs in critical demand.
>
> Approximately 35 percent of MDTA training in 1966 will be directed specifically against skill shortages, 40 percent to the occupational reclamation of the hard-core adult unemployed, and 25 percent to disadvantaged youth.

So, the thrust of the whole program would be to meet this problem, which I think you have properly raised, but it seems to me the Government is trying hard to meet it. That is why I say this is the kind of a program which I think we should not curtail or cut back, and that we should proceed with because this is the kind of thing that is going to, as you say, not only going to build our country as education does, but also meet our specific inflationary problem.

Mr. GRAY. I hope not to be misunderstood on this, because I agree exactly with what you have said. As you said earlier, it really is quite a small number of people who are being brought into the labor force this year.

Did I see someplace that it might be 40,000 from this year's activity? It is not a large absolute number.

Senator PROXMIRE. Let me just go back a little bit in which he said:

> It is likely, from available evidence, that this development will mean—

And this development refers to the number of people coming in altogether—

> will mean that the 1.3 million increase in the work force expected for 1966 on the basis of population growth will be augmented by return to employment of approximately 300,000 who are not now seeking work.
>
> Our estimates are that the number of present unemployed will also be reduced by approximately 500,000.

So, that you have this, according to the estimates by the most authoritative experts we can get, the Secretary of Labor and the Commissioner of Labor Statistics, we do seem to have a substantial pool of labor moving in and in the precise area where we need them, if these programs continue and continue to expand.

Mr. GRAY. To the extent that those people can make it and come in, that works exactly to help our situation, as you have said.

Senator PROXMIRE. On page 10 you talk about tightened credit terms. I take it that this is something that you would put in the same category as increased taxes or increased monetary policy, increased interest rates.

You mean regulation W which will shorten, which would require bigger downpayments and shorten the period of payment and so forth? A lot of us, frankly, are interested in this, because we say this: We say that increase in interest rates or increasing taxes obviously hurts the people. It lowers their income one way or another, but if you recognize that bankruptcies have increased in many areas and credit terms have, in some places, gone out of reason, it would seem that a moderate reduction in terms of credit from, say, in the case of some item 36 months down to 30 months, a downpayment of one-third instead of a fourth. This kind of thing would reduce bankruptcies, would not decrease anybody's income, and would seem to be a way of temporarily, in whatever period is necessary—temporarily dampening down demand.

Mr. GRAY. It certainly does that and, of course, we did it before and one can measure exactly the effect of it. The main thrust of what I want to say is, I think we leave the economy in stronger shape if we do decide we need some restraints to put the restraint on the demand end rather than at the——

Senator PROXMIRE. This is your field, because I am sure you sell much of your product——

Mr. GRAY. Sixty-five percent.

Senator PROXMIRE. What is your feeling and, you think, the feeling of the industry toward giving the President standby controls? He does not have them now. They have expired—standby controls so that in the event prices move up, he could use that as one of the alternatives to a tax increase, or Federal Reserve Board increase in interest rates?

Mr. GRAY. I do not know that I am competent to answer you directly and I do not mean to be evasive. Surely that type of restraint would have the effect of slowing down demand and if you did not tackle the problem until it was right upon you, the debate that would take place in the doing would just further urge people to go get it now while they can.

I think you would have a period of rush while this matter was being debated. In fact, probably——

Senator PROXMIRE. On a standby basis.

Mr. GRAY. I understand. I think perhaps even in the discussions that would go forward before you put it on standby in themselves would excite people to buy. Surely not as much as if you had waited until you really were in trouble and then debated it publicly and they knew that if the answer was, "Yes," that the thing would be brought to bear at once.

Senator PROXMIRE. Could you tell us whether, in your judgment, the people in your industry would be vigorously and adamantly opposed to this kind of action by the Government?

Mr. Gray. Maybe I better speak for myself. I would not be vigorously opposed. I would not do it yet, as I have said. I would wait and see, but I am very sensitive, and a little bit apprehensive about the possible need to do some such thing as that.

There are many other things you could do, and we have done them all at one time or another. I am sure the economists have them all lined up in order of priority. The last one should be wage and price controls, I think, and I suspect short of an all-out war, you will never get to that. It will never be necessary.

Senator Proxmire. I agree with you. I certainly hope not.

In discussing guidelines, you indicated, as I recall your testimony, that if labor should get a 1-percent increase in the social security tax, that is a 1-percent increase in benefits paid for by the employer, this might be taken into consideration in calculating what the rest of their increase should be.

In other words, if the guidelines were 3.2 percent that you might reduce that to 2.2 percent, because they have had the 1-percent increase?

Mr. Gray. Yes, it is a wage cost, just as though you paid it in their paycheck and it has the same effect upon the cost of goods.

Senator Proxmire. I agree with you that this is not understood by labor, I do not think it is understood by most Members of Congress as being applied that way, and I don't think the administration has explained it that clearly. It is a good question to raise.

Mr. Gray. I read through Mr. Ackley's statement and he does not say it is not in there or that it should not be in there. I just wanted to highlight it, because there is one thing businessmen do agree on, when they all get in a room, is that these legislative costs are getting higher and higher and higher, and apparently more to come, and they all have a social thrust to them.

That is what they are paying for, it is a social benefit at the end of the line and I am not one to say that that is not fine. But it is a wage cost and if you are going to go with the theory that there is a productivity increase and the cost of labor should get the benefit of that entire increase, then this is a part of the cost.

Senator Proxmire. I think that their thinking runs—they will not explain it this clearly, because they do not think it would serve their purpose to do so, but just between you and me and the record, I think that this is the way their thinking really runs based on what they have said.

They anticipate there will be a price increase, they are not calculating this wage-price guideline on the assumption there would be no increase; if they were, then I think the thrust of your argument would be very strong. In fact, it would cut down the wage-price guidelines even further.

They have only testified to a productivity increase of between 2.8 and 3 percent. They anticipate—Commissioner Ross did yesterday—that there will be a price increase of around 2.5 percent. You take that price increase of 2.5 percent, you provide for a productivity increase of about 3 percent, this adds up to a 5.5-percent total increase.

Now, if labor gets a 3.2 wage and fringe benefit increase, plus a

1-percent social security increase, that's only 4.2 percent. Subtract that from 5.5, and that still leaves 1.25 percent left over from a combination of labor's increased productivity and the increase in price, plus the fact that management and ownership also has the increased productivity they get on the nonlabor element of cost, which is theirs.

So, that on this basis, I would anticipate that even though wages are allowed to rise by 3.2 percent, including fringes, even though you have a social security tax increase of 1 percent, that if prices go up 2.5 percent, you are going to have better profits next year than last year—better opportunity for profits.

Mr. GRAY. Well, I would not know, but perhaps that is exactly what they are figuring, they are sort of playing with the guideline idea. They state, on the one hand, what they want as guidelines, with no price rise, and 3.2 to labor; then noting that it will not come out zero, flog that 3.2 a little bit because they know it will just about do anyway.

Senator PROXMIRE. What happens, of course, is that in your competitive industry there is no problem. There is no problem in the farming industry. You have competition and the market takes care of it, but the administered-price industries where the people fix their price without as much regard for competition, some regard but far less than you have, these people are not probably going to decrease their prices as they ought to.

The theory is that the automated higher productive industry will cut prices, a typical industry with average productivity will maintain them, and the industry with little increase in productivity will increase prices and prices will average out at a stable level.

That is the theory, but the theory does not quite work out that way. Nevertheless, this is a restraint which is a great deal better than nothing; it is voluntary, it does give labor something to shoot at, it does provide for only a modest, relatively modest increase in the price.

Mr. GRAY. That is correct. You mentioned a moment ago that labor gets the increment on labor and management gets the increment on all nonlabor items. We belabored this thing with economists, and it gets very obtuse as a theoretical discussion, but I think if one were to go all the way through it, he would find that this nonlabor section on which presumably the industry is getting the 3.2 percent only obtains when volume is going up and given stable or decreasing volumes, I question that it would operate that way.

I have spent a great deal of time—I had it in the paper and took it out, because it was simply too much to be discussed. For whatever it is worth, many businessmen have doubts about that economic——

Senator PROXMIRE. I think it would be very helpful if you have any calculation of that kind, any thoughts on it, if when you correct your remarks, you might consider including that.

I would be interested, and I think other members of the committee would be, too, to get your view on it. This is a new concept.

Mr. GRAY. At your invitation, I will give it a try.

(The following table was subsequently submitted by the witness:)

Production and sale of 1,000,000 units

EFFECT OF GUIDELINES ON WHIRLPOOL CORP. CHARACTERISTIC PRODUCT

	Unit cost	Present		3.2-percent labor improvement to management [1]		3.2-percent labor improvement to labor [2]		3.2-percent labor improvement to consumer [3]	
		Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Material	$50.00	$50,000,000	50.00	$50,000,000	50.00	$50,000,000	50.00	$50,000,000	50.16
Labor	10.00	10,000,000	10.00	9,680,000	4.68	10,000,000	10.00	9,680,000	9.71
Other costs [4]	30.00	30,000,000	30.00	30,000,000	30.00	30,000,000	30.00	30,000,000	30.10
Total cost	90.00	90,000,000	90.00	89,680,000	89.68	90,000,000	90.00	89,680,000	89.97
Profit	5.20	5,200,000	5.20	5,366,000	5.37	5,200,000	5.20	5,200,000	5.22
Tax (Federal)	4.80	4,800,000	4.80	4,954,000	4.95	4,800,000	4.80	4,800,000	4.81
Sales	100.00	100,000,000		100,000,000		100,000,000		99,680,000	

[1] Fewer laborers needed (3.2-percent less). The same individual pay. Sales units and per unit prices constant. Owners get greater share of sales dollar, labor lesser share.

[2] Fewer laborers needed (3.2-percent less) but at 3.2-percent higher individual pay. Sales units and per units constant with both labor and owners maintaining same share of sales dollar.

[3] Fewer laborers needed (3.2-percent less) at the same individual pay. Sales units constant but unit prices lower by amount of dollar improvement. Owner gets slightly greater share of sales dollar, labor gets less.

[4] Other costs have been held constant on a per unit basis thus allowing owners under increased production to have funds available for expansion at the same rate of increase as experienced in productivity. The reverse is true in the event of sales unit decreases.

Production and sale of 1,032,000 units

	Unit cost	Present		3.2-percent labor improvement to management [1]		3.2-percent labor improvement to labor [2]		3.2-percent labor improvement to consumer [3]	
		Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Material	$50.00	$50,000,000	50.00	$51,600,000	50.00	$51,600,000	50.00	$51,600,000	50.16
Labor	10.00	10,000,000	10.00	9,990,000	9.68	10,320,000	10.00	9,990,000	9.71
Other costs [4]	30.00	30,000,000	30.00	30,960,000	30.00	30,960,000	30.00	30,960,000	30.10
Total cost	90.00	90,000,000	90.00	92,550,000	89.68	92,880,000	90.00	92,550,000	89.97
Profit	5.20	5,200,000	5.20	5,538,000	5.37	5,366,000	5.20	5,366,000	5.22
Tax (Federal)	4.80	4,800,000	4.80	5,112,000	4.95	4,954,000	4.80	4,954,000	4.81
Sales	100.00	100,000,000		103,200,000		103,200,000		102,870,000	

[1] Same number of laborers needed at the same individual pay. Sales units up by 3.2 percent and unit price constant. Owner gets greater share and labor gets lesser.

[2] Same number laborers needed at higher individual pay (3.2 percent higher). Sales units up by 3.2 percent and unit price constant. Owners and labor both get more dollars but the same share of the total sales dollar.

Same number of laborers needed at the same individual pay. Sales units up by 3.2 percent and price down by dollar amount of saving. Owners get slightly greater share of sales dollars while labor gets lesser.

[4] Other costs have been held constant on a per unit basis thus allowing owners under increased production to have funds available for expansion at the same rate of increase as experienced in productivity. The reverse is true in the event of sales unit decreases.

Production and sale of 968,000 units

	Unit cost	Present		3.2-percent labor improvement to management [1]		3.2-percent labor improvement to labor [2]		3.2-percent labor improvement to consumer [3]	
		Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Material	50.00	$50,000,000	50.00	$48,400,000	50.00	$48,400,000	50.00	$48,400,000	50.16
Labor	10.00	10,000,000	10.00	9,370,000	9.68	9,680,000	10.00	9,370,000	9.71
Other costs [4]	30.00	30,000,000	30.00	29,040,000	30.00	29,040,000	30.00	29,040,000	30.10
Total cost	90.00	90,000,000	90.00	86,810,000	89.68	87,120,000	90.00	86,810,000	89.97
Profit	5.20	5,200,000	5.20	5,195,000	5.37	5,034,000	5.20	5,034,000	5.22
Tax (Federal)	4.80	4,800,000	4.80	4,795,000	4.95	4,646,000	4.80	4,646,000	4.81
Sales	100.00	100,000,000		96,800,000		96,800,000		96,490,000	

[1] Fewer laborers needed (6.4 percent less) at the same individual pay. Sales units off by 3.2 percent and with prices constant. Owners get greater share of sale dollar, labor gets less.

[2] Fewer laborers needed (6.4 percent less) at higher individual pay (3.2 percent more). Sales units 3.2 percent less and per unit prices constant. Both owners and labor retain the same share of sales dollar.

[3] Fewer laborers needed (6.4 percent less) at the same individual pay. Sales units off 3.2 percent with per unit prices constant. Owners get slightly greater share of sale dollar—labor lesser.

[4] Other costs have been held constant on a per unit basis thus allowing owners under increased production to have funds available for expansion at the same rate of increase as experienced in productivity. The reverse is true in the event of sales unit decreases.

Senator PROXMIRE. In your discussion of minimum wages, we have a lot of history on this. October 24, 1938, it was 25 cents; it was increased the next year by a nickel to 30 cents, but the following year to 40 cents—I beg your pardon—October 1945 to 40 cents; then January 1950 it was increased by almost 100 percent. It went from 40 cents to 75 cents—January 25, 1950. March 1, 1956, it went up another one-third, it went up to $1. And as you know, we have had an increase recently from the $1 to $1.25 with a one-step basis. (Page 547.)

Now, I have not seen any argument that these increases in the minimum wage were responsible for any very substantial increase in the price table. As I say, we have had this experience. It is a greater proportionate increase by and large than the increase from $1.25 to $1.50, which is the most serious proposal recently made.

Mr. GRAY. I had an example that would illustrate what I am trying to say. I think it is purely one of speed and degree because furthermore, I do not know the response, for instance; January 1950 when this occurred in a move of 100 percent—I simply do not know what happened to the prices. And it also was at the Korean time which would probably overshadow what was happening anyway, but more importantly would be what happened to the people who were at work at a minimum wage and comes the moment when the wage is doubled. How quickly can the industry adjust to accept those employees at double the rate but no difference in production, which is what momentarily happens.

Senator PROXMIRE. Mr. Goldfinger this morning, I believe, and others have testified that there is no evidence that they have been able to find that unemployment was increased by this.

Mr. GRAY. A survey was made by a Chicago University professor, documented it, that the unemployment of the group in those wage brackets was increased and was made more solid by the advances in the price of their labor.

Senator PROXMIRE. One difficulty is that so many of the people in this teenage bracket, working women bracket, and so forth, are not covered, and many of them would not be covered under any proposals. Therefore, they would not really be affected and it is hard to tell how the remainder would be affected.

Mr. GRAY. That is correct. I have a little example that goes right to this point that happens to be a small company within a quarter of a mile of our main headquarters, and they make transformers which is largely a hand operation, a handwiring job. They are in a small town of Benton Harbor, Mich. He employs 40 people, including 5 part-time students. He tells me that his 1965 profit was $16,000, which was 4 percent of sales. His direct labor costs are over $100,000 a year.

We knew roughly of his labor rates and posed the question to him, let's raise the minimum rate to $1.75 right now. It would run his labor costs up to $130,000, something like a 30-percent increase, because, of course, everyone is not at the minimum now.

He would have to raise his prices in his particular business 15 percent to break even, just to come out even, and he would have to raise prices 30 percent to maintain the 4 percent profit which is what his business has been showing.

The other way around, he could cut his employment by 10 percent, not raise prices by so much, and then, of course, the relationship of his overhead would give him profit.

This happens to be the characteristic of the small transformer business, the same is true of wiring harnesses and many other things like that.

Senator PROXMIRE. What kind of employees do they have? Teenagers?

Mr. GRAY. Mostly women, some teenagers, a few men, and, as I say, there are only 40 people. Five of them are part-time schoolboys who work part time.

Senator PROXMIRE. What would you think of the proposal for a split minimum wage, with a lower minimum wage for teenagers than for adults?

Mr. GRAY. I only was exposed to that this morning and we have been trying it out in our own discussions. Venturing a personal opinion, I would be afraid that it would react against the people who are in the higher bracket, because if you were going to split it by teenagers and older people, because many of these teenagers are crackerjacks——

Senator PROXMIRE. Here you have a situation where 12 percent of the teenagers are out of work, and only 1.8 percent of the married men; the adult men, about 2 percent are out of work.

Mr. GRAY. Many of the people are in the elderly bracket. After all, 30 percent of the women in the country are working today. During World War II it only got to 40 percent, so there is pretty full employment.

Senator PROXMIRE. You cannot discriminate against women. Too many women vote. You know, more women vote than men, so Congress can get in real trouble. Teenagers don't vote.

About consumer protection. Let me ask you about two specific bills. Do you have any position of the Douglas truth-in-lending bill?

Mr. GRAY. Yes; we have a position here——

Senator PROXMIRE. By "we," you mean——

Mr. GRAY. My company. I cannot really speak for business, it is quite a range of positions that business takes.

Again, it is difficult to oppose a thing which has such a euphonious name. Naturally you want to have truth and no deception in your business practices. I think administratively it would be a most difficult thing to do and for the retail stores, particularly, to be able in each circumstance to quote the simple interest cost of a given transaction. As the account changes, some is prepaid, and so forth, it is a most difficult thing to physically comply with.

Some amendments last year were offered which simplified that to some extent.

It is well known that in the general finance business rates run in the character of 18 percent, simple interest. The suggestion is that that lender is charging a usurious rate, 18 percent for his money. Actually what he is charging for the money is 5 or 6 percent, depending on his borrowing costs, but the bookkeeping, rent, light, heat, the whole procedure of running the business is the rest of the cost.

And I think some of the business objection is the connotation that it gives to the art of moneylending.

Senator PROXMIRE. I think this is a very, very honest answer and I agree with much of what you have said, although I am for the bill and I am a cosponsor of the bill. Back in Wisconsin they call it the Proxmire-Douglas bill, but I do think that this is a measure which would not be nearly as hard to administer as business seems to think.

We have a number of banks, business people, retail people, including one of the top people in Sears, Roebuck, that testified it is practical, that it could be used.

You put your finger on the difficulty. Business feels that people would feel when they realize they are paying 18 percent, that it is usurious. They are not paying it for money, they are paying it for bookkeeping and other services.

But why shouldn't they know that? Why wouldn't they know that when you go into a high-pressure furniture store, you might pay 60 percent interest or more? Eighteen percent can be very moderate and proper, but at least they should know what they are doing, of course. Also, a lot of people under these circumstances would be constrained to do what I think would be perfectly acceptable to you; decide to pay cash.

They will go to a bank and take their loan out, maybe they will increase their mortgage a little bit. In any event, it means the consumer would be operating on a better informed basis where he knows what he is doing with his money.

Now, as a matter of fact, Sears, Roebuck makes it clear they are charging you 1.5 percent a month, and anybody with a third-grade education knows that means 18 percent a year. They do very well, and Montgomery Ward and others do that also.

Mr. GRAY. I think the problem would be greatly alleviated if the working amendments of the thing can be so constructed that there is a flexibility that for the type of credit that might be tailored for any particular circumstance; clothing stores have one certain kind of need for credit, furniture stores another, and automobiles another.

And it just isn't too precise and rigid, so that it leaves the merchant or the seller, whether it is a merchant or not, with a line of tools to use in appealing to the customer. My objection would not be that you tell a customer what credit is costing him, as it is now; it is there in dollars. And I agree with you, many never figure it out.

I certainly could not take the position that he should not know. But if it is not too restrictive to the ordinary commercial practices so that there is a speed to it and not the jeopardy of the retailer or seller not being in compliance because he could not work it past some accountant, for example, and he really ought to notify them—but now it is calculated out at a different rate.

Senator PROXMIRE. That is exactly why I think you cannot state in advance precisely what your annual rate is going to be if you permit people to take an endless amount of time to pay, or if they pay on terms which are going to be determined later.

What you can do is say, this will be calculated on the basis of 1.5 percent a month, or 18 percent a year annual rate, whichever they decide to do.

How about truth in packaging? Do you have a specific position on that?

Mr. GRAY. I had thought that the FTC section 5 administered, well, came pretty close to covering the whole thing. Here again you cannot say that you do not favor truth in packaging.

What I fear there again is that the thing will get too rigid. For instance, that the name must be in letters 1 inch high if the box is so big, or that all cereals should be in ¼-, ½-, 1-pound packages, when actually they weigh differently and create a different problem or confusing problem, let us say.

Any working rules would have to be practical. I do not think you would do the consumer any favor by regulating merchandise under a set of codes, because the varying products do not present a simple base—it is not like the money system which is based on decimals.

Senator PROXMIRE. There have been abuses, though, that do not seem to be correctable by applying present law. You get a package that is only partly filled, you get the gross misuse of words: giant, super, colossal, whatever they want to use, so that the words begin to mean almost nothing and there doesn't seem to be any basis for measurement.

Mr. GRAY. I say deception hurts everybody, including the bad practicer.

I am sure of this: If one of us presents our product deceptively, Mrs. Jones is not going to be fooled each time. She might miss once and the penalty is very great on the guilty purveyor of goods.

Surely false—the things you speak of, half-filled packages, the weights and measures in various cities and States do quite a job on that. If there are some practices that are not reachable by present law which would come under the heading of just pure chicanery, I would certainly vote for covering them in a broader coverage.

I do not know that it needs to be nearly as restrictive as the early versions of truth-in-packaging were, and, as a matter of fact, I guess Senator Hart has modified that position to a considerable extent.

Senator PROXMIRE. Yes.

Mr. GRAY. Also, leave a little verve in the business, a little imagination——

Senator PROXMIRE. So you don't know what you are going to get—there will be some suspense left?

Mr. GRAY. No, I mean the use of color and the use of color photographs and the things that make commerce, and particularly supermarkets, pretty bright places.

I would hope that any further codes or restrictions would not get this thing down to where it is like reading the telephone book to see exactly what you get in the package.

Senator PROXMIRE. I want to ask you about the balance of payments and one other question.

Are you familiar with a suit by the taxpayer of Standard Oil in which it is charged that the corporation should not have borrowed abroad at a higher rate, 1 percent higher, which is quite a bit, and that in doing so deprived the stockholder of part of his property?

Mr. GRAY. Yes, I read that yesterday.

Senator PROXMIRE. I noticed that the Washington Post—I was amazed, the Washington Post said this was a very good and sound action on the part of the stockholder, whether the court decides the stockholder is right or not. This is something that ought to be tested.

Since the Washington Post, as I understood, supported the President's program, it surprised me. You are an expert, at least you are associated with the President's program and you are familiar with it.

What is your reaction to that?

Mr. GRAY. I have a reaction. I am sure this being the land of law, we will have to run it through the courts and see. If it is decided that a stockholder can take that position because it is true that the company is paying more, even though it is not very much, but at the time you figure it out on an after-tax basis, I think it costs the company $2,500 per $1 million borrowed, which is small, and the management has decided that it is to their total interest, their long-term interest because of the circumstance that the country is in to do this, to pay the little higher price because they are just as interested in balancing the payments and keeping the dollar sound as anyone else, so they went at it as a management decision—and many have done so, as you know.

This reaches up to $400 million that has been borrowed abroad now on higher terms in each case. But if this man makes this theory stick, then any little bit will be enough for a stockholder to make a suit and if the director is liable, this will be, I think, a very great detriment to the balance-of-payments program.

Senator PROXMIRE. This goes to the root of the question of whether this is a proper way for the administration to interfere with a free market.

Mr. GRAY. Let me put this parallel case, because this has been discussed in stockholder meetings every once in a while.

As a corporation we make charitable donations, and rather generously, I believe, as these things go, and some stockholders have taken the view that's our money that you are giving away. Just pay it to us in dividends; we will make the donations, and they make quite an articulate argument about it.

As management we do this because we think it produces better communities, that is where most of our money goes, in which to operate our business. We think it is good for our business to support the communities and as a result of this sort of approach—incidentally, all industry, I think, averages about eight and a half, eight-tenths of a percent of profit before taxes in their charitable donations. I think that is about the average rate.

They do it out of really self-interest and to advance the climate in which the corporation operates. I think it is quite parallel to this other thing.

This company that has borrowed money abroad is trying to protect the economic system in which it is going to operate in this country. And I think it is a valid management decision and it will be a sad day if they are enjoined from doing that.

Why would not the same theory apply where we are purchasing whatever—let us say, a motor? You buy it from this fellow and pay him 20 cents more than we could buy it from this fellow. The reason is we need two sources, for example, or any one of several others. We are perhaps trying to build this man up where we think he is going to come along with a better development.

Senator PROXMIRE. Make it more precise. Would you pay a little more to one bank than you would have to pay to another? You want to have a dual credit source, a relationship in the future that is more competitive.

Mr. GRAY. That is exactly so, and I think these are parallel decisions and if the court were to decide that a stockholder can intervene when the management made a move like this, particularly with the national interest element to it, that this particular one has, it would be a very sad thing.

Senator PROXMIRE. I think you make a good argument and I am delighted to have you develop it, because I frankly had not thought of the implications other than for the President's balance-of-payments program.

It obviously has far broader implications.

On page 18 you indicate that except for the businesses, the private sector of our economy, you say is carrying the whole load on the balance of payments and that tourist spending and the Government are the guilty parties.

Why is not tourist spending business? You get a real argument out of——

Mr. GRAY. American Express?

Senator PROXMIRE. American Express, which has appeared before this committee, if you said they are part of the Government or socialistic or something, you know. They seem to feel they are a very, very important part of our commercial operations and they are negative as far as the balance of payments is concerned.

Mr. GRAY. Yes, the tourist figure ran something like 1.9 billion last year.

Senator PROXMIRE. At least.

Mr. GRAY. It is an amazing thing. That is, out-tourist. It is offset partly by in-tourists, which was a figure of something in the $300,000 or $400,000 bracket, but it is an amazing figure anyhow.

Senator PROXMIRE. That is a private sector item, really, is it not?

Mr. GRAY. Purely.

Now, many things can be done, and in answer to American Express or Pan American, we corporations are giving it some thought now and I would confess we had never given any thought as to how our men were traveling abroad.

If they went Air France, they went Air France. They don't any more, they fly American lines. We try to ship by American lines. Just paying attention to this little thing would make quite a difference. Insofar as foreign tourism goes on American carriers, it is a piece of American business. But I believe that if I understand the source of the figures, this represents money that went there and stayed there, the 1.9, and I do not know what you are going to do about it.

Senator PROXMIRE. My last question is that you conclude by talking about fiscal prudence and calling for more of it, and, of course, that is the kind of thing we are all for. Do you mean we should spend somewhat less than we are spending?

For example, I favor a cutback in our public works programs. At the time of World War II we eliminated them. At the time of the Korean war there were no new starts. This year there are 25 new starts. We are devoting many billions of dollars to public works altogether.

This is something that can be postponed and have an immediate lessening of this effect on inflation and that kind of thing.

Then in the second place, I notice we are increasing our subsidies for aviation. When I came here in 1957 they were $220 million; this year they are well over $900 million—a very profitable industry last year, almost every firm made record profits. Yet, we are devoting more to it.

These are the areas where I think we could cut back. I am wondering whether you have any other areas in mind.

Mr. GRAY. The first thing I had in mind, I was confused last year after the budget and the proposals were put, I believe the Congress voted an additional $6 billion of one thing or another——

Senator PROXMIRE. Mostly requests by the administration for supplemental items. As I understand it, the Congress voted less than the administration requested over the year. You are indeed right, they voted more than the administration requested initially.

There are always the supplementals, you know.

Mr. GRAY. Then I would stand corrected. I was going on the assumption that the Congress was more liberal in individual cases than the immediate requests. I had in mind the pay-raise bill. It was a very great one.

Senator PROXMIRE. I think of the 14 appropriation bills—the appropriation measures, I think. I am on the Appropriations Committee and, as I recall, there are 12 or 14 appropriations bills and Congress was below the President on every one but 1 or 2. And, of course, the President does not have to spend what we appropriate.

If we accede to what he wants, he does not have to spend it. Presidents Kennedy and Johnson have both refused to spend appropriations.

Mr. GRAY. The items that you had would be the things that would be in my mind just for the better show we made of being frugal at a time like this. I think it is all in the direction of confidence; confidence at home and confidence of foreign nations.

Of course, it does not help anything when someone looks through a list of projects which are going on someplace in the world and comes up with the name of some very remote thing which it turns out we are supporting, like the fish odor study in some Scandinavian countries. I read about that the other day. I am sure these perhaps are overstressed; we have a little fun with some of these things, but it all adds up to an impression that we really have a lot of money available for anyone with a good idea of how to spend it.

Senator PROXMIRE. I want to thank you very, very much. Congressman Reuss has a detailed question here. What I would like to do is put that in the record and ask you when you correct your remarks, you can give us a reply to that.

Representative REUSS. I have introduced legislation to try to improve our wage-price guideposts procedure. The legislation would essentially do two things:

First, on the setting up of the guideposts themselves, it would require hearings before the Joint Economic Committee in which both labor and management would have an opportunity to express their views. Following the hearings, it would permit this committee to initiate congressional action to alter either wage or price guideposts if, in its judgment, they did not serve the national interest.

Second, once the price-wage guideposts were established the bill would authorize and direct the Council of Economic Advisers to notify the Joint Economic Committee when violations of such importance as to affect the national economic security were proposed. The Joint Economic Committee then would hold hearings on the merits of the proposed action and issue a public report.

The bill would give the Congress a share of the responsibility for the establishment and administration of the price-wage guideposts, which is particularly desirable as the President now has to lay his prestige on the line every time a crisis arises. In addition, public opinion would be focused more fully on the proposed action, and in a more informed manner.

Would you give me your reactions to this proposed legislation?

Mr. GRAY. I will supply that information for the record at your request.

(Material which follows was subsequently filed for the record by Mr. Gray.)

Response to Representative Reuss' question regarding his proposal for legislation concerning the guideposts:

1. I think the Congress must have a real interest in such a basic element of our economy as a guidepost. However, I shudder to think of the pressures that would be brought to bear in public hearings on such a theoretical matter as this.

Even economists cannot agree on the theory of them, let alone their exact application.

It is a fact, of course, that the change in productivity is greatly different from one industry to another. How you could engage that problem publicly to anyone's satisfaction, I don't know.

If a figure finally was agreed upon, it seems to me the public debate would have given it much more substance than it deserves. A workingman would reasonably think it was a wage increase that he was automatically to receive.

2. The second objective of the bill could be pursued regardless of what was done about the first part.

Many businesses would like to have had a chance to tell their side of the story of necessity for price increases. Rollbacks, of course, have hit prices only—not wages.

However, once you start this, you will have to be prepared for an enormous load of work. I seriously doubt that any deliberative group could keep up with it. Nor could the CEA be effective without a set of formal procedures of notifications or price changes, etc. This would, I'm afraid, soon amount to the massive maze that was necessary in the past during periods of full price and wage control.

Senator PROXMIRE. This has been an educational afternoon for me. I do appreciate it, and as I say, I am going to call this statement to the attention of other members, because it is very, very worthy.

Mr. GRAY. Thank you.

Senator PROXMIRE. The committee will stand in recess until 10 o'clock tomorrow morning when we will convene in room AE-1 of the Capitol, to hear four prominent economists.

(Whereupon, at 4:25 p.m., the hearing was recessed, to reconvene at 10 a.m., the following day, Thursday, February 10, 1966.)

JANUARY 1966 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 10, 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, presiding.

Present: Representatives Patman, Bolling, and Scheuer; and Senators 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.

Mr. Jacoby, would you come around, please? The other witnesses are on the way from the airport, and if it is agreeable with you, we will let you proceed and then hear the others as they come in. That way we will not lose any time. We will, of course, have a discussion after the statements, so that all the points can be brought out.

Today we will hear from four distinguished economists on the subject of price stability at full employment. They will deal with the outlook and the policy alternatives available at the present time.

Our first witness is Dr. Neil H. Jacoby, dean of the Graduate School of Business Administration at UCLA. We will have—and they are on their way from the airport now—Richard A. Musgrave, professor of economics at Harvard University, and Robert Solow, professor of economics at MIT. Dr. Henry W. Briefs, chairman of the department of economics, Georgetown University, will also be with us, shortly.

We will ask you to proceed in your own way, Dr. Jacoby. You have a prepared statement, I assume?

TESTIMONY OF NEIL H. JACOBY, DEAN, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

Mr. JACOBY. Mr. Chairman and gentlemen: I have submitted a 17-page statement for the record. I will not try to read this now, but will attempt to summarize my views.

The committee is concerned with the question whether the U.S. economy can maintain full employment without price inflation in the period ahead.

My paper points out that the answer to this question depends on two things: How these twin goals of economic policy are defined? Secondly, what combination of policy instruments is used by the Federal Government to attain them?

It is my opinion that it is possible to approach closely, if not to attain, both of our national purposes of full employment and price stability, provided that the goals are realistically defined and that the Federal Government pursues them through an appropriate combination of policy instruments.

I can summarize my position rather quickly in a few propositions, and will be glad to respond to questions about any of these propositions.

First, as regards the definition of our economic goals: Full employment is properly defined today as President Kennedy proposed 4 years ago: "An unemployment ratio of 4 percent of the labor force."

Price stability, I believe, should be defined as a sustained rise in the Consumer Price Index of *less* than 2 percent a year; inflation is a sustained rise of *more* than 2 percent a year.

These definitions allow for necessary flexibility in the employment pattern of our technically dynamic, affluent, mobile, and continent-wide economy. They also allow for an upward creep in the price index, which probably contains a slight inflationary bias and which, so long as it is kept under 2 percent, has not led to any change in public expectations of inflation and any acceleration.

Secondly, the combined spending plans of the Federal, State and local governments, business firms, and consumers during 1966 add up to a probable aggregate demand that at current prices is far in excess of the real productive capacity of the U.S. economy. Unless this aggregate demand is checked, therefore, it portends a substantial inflation of prices this year.

Third, because the U.S. economy has already attained the full employment goal of a 4-percent unemployment ratio, and because the goal of price-level stablility is now being breached, the overriding economic policy problem of 1966 is to curb aggregate demand and prevent inflation. I would stress that preventative action is needed now, not after the inflationary process has become established.

I would like to point out that the National Association of Purchasing Agents, a group of men whose finger is closer to the pulse of the economy than I think any other group, reported in January that many prices went up and none went down. This report leads the performance of the price index, and to me is strong evidence that the inflationary process is not merely imminent, but has begun.

Fourth, aggregate demand should be curbed both by a moderately deflationary fiscal policy and by the imposition of more restraints upon the growth of money supply and bank credit. I believe that monetary policy should bear the main brunt of reducing inflationary pressures, because it can cope flexibly with the volatility of the war in Asia. We need a flexible instrument in view of the explosive potentialities of our foreign situation. If the war accelerates, monetary policy can quickly become more restrictive, and if happily it should diminish, it can ease up quickly.

I would point out that a tighter monetary policy could also help bring the U.S. international payments into balance—another subsidiary objective of policy today.

Fifth, the Federal budget for fiscal year 1967 should aim for a cash surplus of $3 to $5 billion instead of the nominal cash balance proposed by President Johnson—through either higher taxes or lower nondefense spending than he proposed. I refer to his proposal as a "nominal" cash balance, because the supplemental appropriations that Congress is being asked for seem now likely to throw the actual budget for fiscal year 1967 into a cash deficit.

In addition, the Federal Reserve authorities should reduce the growth of bank deposits and money supply well under recent rates of increase. In this regard, I would point out that during the last 6 months of 1965 the money supply grew at an average rate of over 8 percent per annum. This can hardly be called a policy of monetary restraint.

Sixth, federally enforced wage-price guideposts can contribute little, if anything, to the fight against inflation. Meanwhile, they weaken our competitive market system by, in effect, asking businessmen, labor leaders, to behave noncompetitively. They distort the allocation of resources, to the extent that they are effective by preventing the movement of investment into those industries where demand is most active, and they fail to deal fundamentally with inflation arising either from excessive demand or from inadequate competition in certain markets.

Seventh, I find the administration's analysis of economic prospects and its prescription of policies for 1966 to be faulty in several respects.

First, an unrealistic employment target is projected. I believe Secretary Wirtz proposed an unemployment ratio of 2 to 3 percent. I would say with great confidence that, if a determined effort were made to attain that kind of employment target in 1966, we would have a very strong burst of inflation. Some will argue that the additional jobs would be beneficial; but I would like to point out that the inflation that would accompany them would impose far greater costs on the economy in terms of misdirected investment, in terms of weakening of the incentive to save, and in terms of a weakening of social morale which always accompanies an inflationary process. In other words, a much lower unemployment ratio with serious inflation would be a very bad trade-off for the American people.

The margin of available unemployed resources is exaggerated by the administration, and as a result, inflationary pressures are underestimated by it.

President Johnson has proposed a nominal fiscal neutrality instead of real fiscal restraint.

There is a misplaced reliance upon the wage-price guideposts to suppress the price inflation that will emerge as a result of inadequately restrictive fiscal and monetary policies. These guideposts which were first proposed by President Kennedy as guides, and I quote his report of January 1962:

> Aids to public understanding * * * apparently are to be converted into an unsystematic and unauthorized form of Federal price control which history shows to be ineffective.

My conclusion, then, sir, is that unless the growth of aggregate demand is checked by more vigorous fiscal and monetary measures than those proposed, the United States will have more inflation in 1966 than in any year since the 1950's, and possibly more than any year since the 1940's. At the same time, the structural problems of unemployment and inordinate market power which are a partial cause of inflation should be attacked directly, so that our long-term employment target can later on be raised and be made compatible with a stable price level.

These, Mr. Chairman, are the main conclusions of my analysis which is presented in the paper that I have filed with the committee.

Chairman PATMAN. Thank you, sir. Without objection we will file your whole statement in the record at this point. Is that what you desire?

Mr. JACOBY. If you please, Mr. Chairman; and I would be glad to respond to any question.

(Mr. Jacoby's prepared statement follows:)

WAGE-PRICE GUIDEPOSTS VERSUS MONETARY AND FISCAL POLICIES TO ATTAIN FULL EMPLOYMENT WITHOUT INFLATION

(Prepared statement of Neil H. Jacoby, dean of the Graduate School of Business Administration, UCLA)

Can the U.S. economy maintain full employment without price inflation in the period ahead? The answer depends upon how these twin goals are defined, and what combination of policy instruments is used to attain them. It is possible to approach closely both of our national purposes of full employment and price stability, provided that they are realistically defined and that the Federal Government pursues them through an appropriate combination of economic policies.

A SUMMARY VIEW

I can summarize my position quickly in the following propositions:

(1) "Full employment" is properly defined as President Kennedy proposed 4 years ago—an unemployment ratio of 4 percent of the labor force. "Price stability" should be defined as a rise in the Consumers Price Index of no more than 2 percent a year. These definitions allow for necessary flexibility in the employment pattern of our technically dynamic, affluent, mobile and continent-wide economy; and for an upward "creep" in the price index which probably contains a slight inflationary bias.

(2) The combined spending plans of the Federal, State, and local governments, business firms and consumers during 1966 add up to a probable aggregate demand that, at current prices, is far in excess of the real productive capacity of the economy. Unless checked, they portend a substantial inflation of prices.

(3) Because the U.S. economy has already attained the full employment goal, and because the goal of price level stability is in imminent danger of being breached, the overriding economic policy problem of 1966 is to curb aggregate demand and prevent inflation. Preventive action is needed now—not after the inflationary process has become established.

(4) Aggregate demand should be curbed both by a moderately deflationary fiscal policy and by the imposition of more restraints upon the growth of money supply and bank credit. Monetary policy should bear the main brunt of reducing inflationary pressures because it can more flexibly cope with the volatility of the war in Asia. A tighter monetary policy could also help bring U.S. international payments into balance.

(5) The Federal budget for fiscal year 1967 should aim for a cash surplus of $3–$5 billion instead of the cash balance proposed by President Johnson, through either higher taxes or lower nondefense spending. In addition, the Federal Reserve authorities should reduce the growth of bank deposits and money supply well under recent rates of increase.

(6) Federally enforced wage-price guideposts can contribute little, if anything, to the fight against inflation. Meanwhile, they weaken our competitive market system, distort the allocation of resources, and fail to deal fundamentally with inflation arising either from excessive demand or inadequate competition.

(7) The administration's analysis of economic prospects and its prescription of policies is faulty in several respects. An unrealistic employment target is projected. The margin of available unemployed resources is exaggerated. Inflationary pressures are underestimated. Fiscal neutrality is proposed instead of real fiscal restraint. There is a misplaced reliance upon wage-price guideposts

to suppress the price inflation that will emerge as a result of inadequately restrictive fiscal and monetary policies. The guideposts, first proposed by President Kennedy as guides and "aids to public understanding," apparently are to be converted into an unsystematic and unauthorized form of Federal price control which history shows to be ineffective.

(8) Unless the growth of aggregate demand is checked by more vigorous fiscal and monetary measures than those proposed, the United States will have more inflation in 1966 than in any year since the 1950's. At the same time, the structural problems of unemployment and inordinate market power should be freshly attacked, so that our long-term employment target can later on be raised and made compatible with a stable price level.

PRICE-LEVEL AND EMPLOYMENT GOALS

Any meaningful discussion of economic policies must be predicated upon a clear definition of the price-level and employment goals that are accepted as optimal. Only when such goals are specified in measurable terms can one identify the kind of economic policy problem that the Nation confronts, and usefully debate alternative policy measures that will lead to our objectives.

In his Economic Report to the Congress of January 1962, President Kennedy proposed that an unemployment ratio of 4 percent be taken as a "reasonable and prudent full-employment target," suited to the then current structural characteristics of the U.S. economy.[1] It took into account the fact that ours is a dynamic, mobile economy of continental scope, in which a large amount of job changing and a flexible employment pattern prevail. President Kennedy wisely accepted the consensus of many academic economists and of such study groups as the Committee for Economic Development on this working definition of full employment.

Do events of the past 4 years require a change in this definition? In his Economic Report to the Congress of January 1966, President Johnson argues that the U.S. economy can operate with a lower (but unspecified) employment ratio than 4 percent, without materially raising labor costs per unit of output, because the average education of the labor force has been improved.[2] This conclusion is doubtful. The rise in average educational attainment of the labor force has not been very large in 4 years. Meanwhile, the level of education and training needed for efficient service in jobs probably has risen even more. An increasing fraction of the labor force consists of relatively young and inexperienced people. While a higher employment target is to be desired, it will require time-consuming efforts to resolve structural problems of education, training, discrimination, and immobility affecting youths and minority groups. A persuasive case cannot be made for raising the employment target now. A determined effort to attain an unemployment ratio of, say, 3 percent, during 1966 would produce strongly inflationary conditions from which the American people would lose far more in lower savings, distorted investment, social demoralization, and a weakened dollar than they would gain in additional jobs and output. The "trade off" would be distinctly disadvantageous.

In principle, our price-level goal should be a perfectly stable Consumer Price Index. In fact, this index has been creeping upward at an annual rate of 1 to 2 percent during the past 7 years of relatively stable prices, probably as a result of small inflationary biases in its construction. For this reason, "inflation" may be defined as a persistent rise in the Consumer Price Index of more than 2 percent a year.

In the following discussion, the terms "full employment," "inflation," and "excessive demand" are used in the precise senses indicated.

THE PROSPECT OF EXCESSIVE DEMAND AT FULL EMPLOYMENT IN 1966

That the curbing of price inflation is the primary economic policy problem of 1966 has become abundantly evident. Aggregate demand in the U.S. economy during 1966 promises greatly to exceed the capacity of the economy to produce goods and services, at current prices, unless it is restrained. With the exception of housing and possibly automobiles, for which consumers' stocks have been well built up and little gain in output is likely, all other major segments are planned

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[1] P. 8.
[2] Pp. 75–76.

to increase sharply in response to the Great Society programs as well as to the voracious demands of the war in Vietnam. State and local purchases will continue to grow by 8 to 9 percent a year to satisfy the insatiable demands of the public for education, transportation, and welfare services. Businesses will be buying new plant and equipment at an unprecedented rate to create new capacity and to exploit technological advances in many fields, despite somewhat tighter financing conditions. Consumer incomes will rise in consequence of rising investment by businesses and expanding governmental spending. Surveys of consumer buying intentions reveal a strong disposition to spend forthcoming income. The investment multipliers will work with their usual power.

The U.S. economy is now operating at full employment levels of manpower and industrial facilities. The unemployment rate has dropped to 4 percent of the civilian work force. For married male workers the rate is 1.8 percent or less. Apart from youths and minority groups, there is little avoidable unemployment of manpower. Industrial facilities are operating at close to 90 percent of rated capacity, and little efficient industrial plant remains unutilized. To expand output beyond these margins will quickly force up costs and prices, as less efficient plant and marginal workers are drawn into employment. Indeed, both the wholesale and retail price indexes have begun rising at accelerating rates. For the first time in a decade, aggregate demand is pressing upon a capacity to produce goods and services that is limited by current accessions to the labor force and current additions to industrial facilities. This is what makes the economic policy problem of 1966 basically different from that of 1963, or 1964, or even 1965.

Spokesmen for the administration have argued that some slack remains in the economy. This, plus new entrants into the labor force and new productive capacity, will suffice to meet expanded demand of 1966. This optimism is unwarranted. Much time is required to complete the education, training, and other programs to open up job opportunities for the "hard-core" unemployed. New industrial capacity also requires much time to become operational. Yet burgeoning demands are with us today. The probable gain in the real productive capacity of the U.S. economy during 1966 will probably be no more than about 4.5 percent, in contrast to the 5.5-percent gain of 1965. This assumes something like a 3-percent rise in productivity and a 1.5-percent rise in the size of the civilian labor force. Yet the President has forecast a total gain in monetary demand of 7 to 8 percent—and it will probably be even more.[3] Without restraint of aggregate demand by fiscal and monetary measures, the prospect is for a sharper rise in price levels than the United States has experienced in many years.

This assessment assumes that Secretary McNamara is correct in his judgment that the United States confronts a long war in Vietnam; but that the war will not spread or intensify. Even at its present level, the war will pull at least 300,000 young Americans out of the work force and transform their economic function from producers to consumers of military goods. Regrettably, the prospect of escalation and broadening of the war is larger than of a reduction in military activity.[4]

THE ECONOMIC POLICY POSTURE OF THE ADMINISTRATION

What policies are proposed by the administration to deal with the inflationary threat during 1966? Its posture appears to be one of minimizing the inflationary threat, of reluctance to utilize powerful indirect fiscal and monetary controls of spending, and of trying to hold down the price level by exhortation and threats to enforce the wage-price guideposts. It relies heavily upon interventionism into the economy to hold down particular prices which are rising as a normal consequence of expanding demand. We need only recall Federal actions during the past year to "roll back" the prime interest rate on business loans, and the prices of aluminum and steel, and the Federal requirement of "voluntary" restraint upon foreign loans and investments by bankers and businessmen.

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[3] In this summary of economic prospects for 1966 I have drawn upon the forecasting work of my colleagues, organized and edited by Prof. Robert M. Williams, in the UCLA Business Forecast for the Nation and Southern California in 1966. Graduate School of Business Administration, University of California, Los Angeles, Dec. 8, 1965.

[4] It should not be forgotten that North Vietnam has so far committed only a minor fraction of its military forces to the struggle. With its experience in defeating a French Army of 300,000 men after 9 years of warfare during 1945–54, North Vietnam is unlikely to give up its aggressive intentions easily or quickly.

Of course, spokesmen for the administration disguise the real nature of the new interventionism by references to the need for larger "responsibility" on the part of labor and business executives. A categorical statement of this revolutionary new approach to management of the U.S. economy was made by Secretary of Labor Wirtz at the December 1965 convention of the AFL-CIO building trades in San Francisco: [5]

"There can be no tolerance for the suggestion that the expansion of the economy must be slowed down—in increasing interest rates or in any other way—while there is still so much to be done. If there should develop signs of the economy 'heating up,' the answer wouldn't be to slam on the brakes or put a weaker mixture in the gas tanks. Rather, there may well be a call on all of us for even larger responsibility, but not for less energy or initiative * * * It must be recognized that with a continuous serious underutilization of available manpower, we cannot afford to let up in constant efforts to assure maximum growth of the economy."

Vice President Hubert H. Humphrey has described the "voluntary" balance of payments restraints and the wage-price guideposts as examples of a "new relationship" between government and business which are "not just piecemeal measures" but are "part of a new realization of how business, labor, and government can—and must work together." [6] This contains the disquieting implication that control of the U.S. economy by market competition is generally to be replaced by a new Federal interventionism, in which the iron fist of Federal power will be encased in a velvet glove of "voluntary" compliance. One's misgivings are not diminished by the statement of the president of the U.S. Chamber of Commerce that he would support application of the guideposts, because President Johnson had convinced him that business compliance with them would avoid Federal price control. Apparently, businessmen are asked to make "Hobson's choice" between statutory price control and federally administered guideposts enforced by threat of public opprobrium and the many other penalties that the Executive can impose.

Congress should openly face the question whether the economic situation now confronting the United States calls for the imposition of direct economic controls, systematically applied and enforced. If, as I am confident is the case, its answer is in the negative, it follows that disguised price control by federally enforced guideposts should also be rejected. Prospective requirements of the Federal Government from the economy are not yet so extensive as to call for the imposition of a network of direct controls, a la World War II or even the Korean war. It would be highly inefficient to impose direct economic controls, when use has not yet been made of powerful indirect monetary and fiscal restraints.

THE SHIFT FROM FISCAL EXPANSIONISM TO NEUTRALITY—BUT NOT RESTRAINT

In his recent state of the Union and budget messages to the Congress, President Johnson properly recognized the dangers of inflation. He proposed to reinstate former excise tax rates, to speed up tax collections from individuals and corporations, and to trim some civilian spending programs. He brought forth a Federal budget for fiscal year 1967 which was estimated to show a small ($0.6 billion) surplus on a cash basis. In essence, he called for a shift from fiscal expansionism to fiscal neutrality.[7] He did not propose real fiscal restraint, which would require a substantial surplus in the cash budget attained through still higher taxes or lower nondefense spending than he advised.

While the administration's fiscal proposals move in the right direction, a basic question is whether fiscal neutrality is enough. This question is especially pertinent in view of the tendency of actual Federal spending to outrun expectations in times like these. Such a development would prolong the cash deficit and add to inflationary pressures. In the light of this contingency, it would be desirable that the budget for fiscal year 1967 contain an estimated cash surplus of the order of $3 to $5 billion. This would be in line with the sound budgetary prin-

[5] As reported in the Wall Street Journal, Dec. 2, 1965.

[6] See Challenge, the Magazine of Economic Affairs, November–December 1965.

[7] Fiscal neutrality is used here to mean that the Federal Government makes no net addition to or subtraction from the spending power of the public. Strictly speaking, even a Federal budget balanced on a cash basis affects the volume and composition of aggregate demand in complex ways and is not neutral.

ciple, long advocated by the Committee for Economic Development, of generating a cash surplus under the conditions of overfull employment that will probably prevail during fiscal year 1967. It would enable fiscal policy to contribute to the eradication of excessive demand, while leaving the main role to monetary policy.

ADEQUATELY RESTRICTIVE MONETARY POLICY

The proposed policy of fiscal neutrality must also be judged in the light of the course of monetary policy during the next year or two. If the Federal Reserve authorities actively checked the growth of bank reserves and money supply, and caused interest rates to rise, a policy of fiscal neutrality might suffice. A tight enough rein on the money supply could bring aggregate demand within noninflationary limits, even without strong fiscal restraints. With credit less readily available and costing more, many domestic investment projects would be deferred. Equally important, a rise in the level of investment returns in the United States relative to those in other countries would help to stem the flow of U.S. dollars abroad and help to bring our international accounts into balance.

The volatility of the war in Asia calls for a highly flexible instrument of policy. A combination of strong monetary and mild fiscal restriction is preferable, under current conditions, to a strategy of mild monetary restraint combined with a strongly deflationary fiscal policy.

Unfortunately, the prospects for an adequately restrictive monetary policy are not bright. Increases in the discount rates of Federal Reserve banks in December 1965—strongly opposed by the administration—were approved only by a minimal majority of the Federal Reserve Board. It may soon become a minority group. Up to the present time, the Board's monetary policy has been to acquiesce in a rapid rise in bank loans, deposits, and money supply. Bank reserves available for private demand deposits rose at an annual rate of 5 percent from July to November 1965, and at an annual rate of 11 percent from November to December. The money supply grew at a 7-percent annual rate from July to November 1965, and during the balance of the year rose at a 12-percent annual rate.[8] Influential Members of the Congress, as well as politically potent groups in the economy such as the construction industry, view a further rise in money rates with hostility. All these considerations suggest that any future monetary restrictions will be "too little, too late."

FEDERALLY ENFORCED WAGE-PRICE GUIDEPOSTS TO THE RESCUE

With the prospect of a neutral fiscal policy and an inadequately restrictive monetary policy, it appears that Federal enforcement of the wage-price guideposts may become a major instrument to deal with inflation during the coming year. The guideposts were suggested by President Kennedy as "aids to public understanding" and guides to labor and business executives in making wage and price decisions in the national interest. They were considered necessary in those parts of the economy where firms were so large or employees so well organized that market forces did not necessarily result in competitive cost-price relationships. They were not intended to have the force of Federal statutes. President Kennedy wrote: "Mandatory controls in peacetime over the outcome of wage negotiations or over individual price decisions are neither desirable in the American tradition nor practical in a diffuse and decentralized continental economy." [9]

Productivity changes were proposed as the guide to wage and price behavior. If the price level were to remain constant, hourly labor costs for the economy as a whole could increase no faster than average labor productivity. Assuming no change in the relative shares of labor and nonlabor incomes in a particular firm or industry (and President Kennedy recognized that changes might be in the national interest), the general guide for noninflationary wage behavior by an industry was that the rate of increase in wages shall not exceed the trend rate of average productivity increase for the economy. The general guide for prices was that prices should decline by the amount of the excess of the rise in productivity in the industry over the trend rate of the economy, and rise by the amount of the deficiency.

Now consider the complex modifications of these general guides called for by President Kennedy. Wages may rise more or less than permitted by the general

[8] See Review of Federal Reserve Bank of St. Louis, January 1966, p. 2.
[9] Economic Report to the Congress, January 1962, p. 185.

guide, depending upon whether or not the industry's existing wage rates were relatively low or relatively high, and depending upon whether the industry's labor supply were relatively deficient or redundant. Prices may decline less or more than permitted by the general guide, depending upon whether or not current profit rates are deficient to enable the industry to attain necessary capacity, whether or not current rate of return on its investment is deficient, and whether or not its nonlabor costs have risen or fallen.

Obviously, in applying the guideposts there are enough flaws in available statistics and differences of opinion possible among competent experts to make any precise conclusion about the "socially desirable" wage or price impossible. What past time period truly represents the "trend value" of labor productivity in the U.S. economy? Should the past trend reflect only output per man-hour or output per unit of total factor input? Should national productivity gains be measured only in manufacturing, or include agriculture and government? Should they be adjusted for the fact that farm price supports have prevented the private economy from realizing the savings of increased productivity? Depending upon the answer to such questions, estimated trend rates of increase in productivity can differ within wide range.

But the guideposts have more fundamental defects. It is wrong in principle to gear average annual increases in wages to annual average increases in labor productivity, because this denies any gain in the relative shares of total output to owners, managers, or consumers. Certainly, the need to improve the competitive position of U.S. exports in work markets argues for allowing some of the benefits of rising productivity to be expressed in declining product prices.

Another theoretical fault of the guideposts is that they should apply to individual enterprises and not to "industries." Technological changes and the rise of conglomerate firms have blurred the concept of an "industry" of homogeneous firms. Although much collective bargaining for wages is industrywide in scope, much wage determination and all price determination occurs within the individual enterprise. Within any one industry—such as steel—the status and prospects of individual firms vary widely in respect to percentage of capacity utilized, rate of return on investment, rise or decline in demand for products, and adequacy of labor supply.

Enough has been said to demonstrate the wisdom of President Kennedy's warning that the wage-price guideposts should be considered only as "aids to public understanding" and should not be applied by Federal officials and enforced like Federal laws. Only the executives whose lives are spent in daily contact with the particular markets of each firm can possibly have enough information and "judgment" to interpret and apply the guideposts. Their decisions may be imperfect; but they are almost certain to be less imperfect than those of Federal officials lacking this intimate knowledge.

Executives of steel, aluminum, and other companies try to raise prices only when they see demand rising strongly for their products. This action is a means of rationing the limited supply out to the users who most urgently need it. It can produce the higher profits that are a necessary inducement to invest more money in the industry and to expand the supply of the product. Prices have work to do. If federally determined and enforced guideposts get in the way, there will be a distortion in the use of society's resources. Resource allocation will be less efficient.

Federally enforced wage-price guideposts are selective direct Federal price controls. The economic reasoning used to justify them is not convincing. In essence, it runs as follows: (1) the U.S. economy is subject to inflation in the absence of full employment, as the inflation of 1956–57 showed. (2) This structural defect arises from lack of workable competition in some labor and commodity markets. (3) Large market power enables labor unions to raise wages in the absence of full employment, and businessmen to raise prices even without any upward pressure on their costs. (4) Wage bargains in "pattern setting" industries, particularly those with excess demand and strong profits, pull up wage costs and result in spreading price increases in the economy. (5) Hence, selective control of those wage rates and prices, via enforced guideposts, can prevent general price inflation.[10]

This argument is faulty. First, it exaggerates the extent to which private market power makes full employment incompatible with stability of the price

[10] See Economic Report of the President to the Congress, January 1966, pp. 178–179.

level. During 1956–57, for example, employment was close to full and the unemployment ratio averaged 4.2 and 4.3 percent of the work force. Yet the rise in the Consumer Price Index was a noninflationary 1.5 percent during 1956 and a mildly inflationary 3.5 percent during 1957. Secondly, the implied assumption that all wage and price increases in "pattern setting" industries are attributable to inadequate competition is false. Most of them are a natural response to rising demand and limited supply. Thirdly, the "spreading effect" of price increases in the "pattern setting" industries is possible only if aggregate demand in the economy is supported by a rapidly increasing money supply that makes it possible to bid up prices generally. If the spending power of the public is held within noninflationary limits, price increases cannot spread. Fourth, Federal control of wages and prices in these industries is often adverse to the public interest because it prevents the most efficient allocation of supply and inhibits long-term expansion. Finally, direct controls of wages and prices can only deal with the symptoms of private monopoly power; measures to make competition effective constitute the only effective solution of this structural problem.

LESSONS OF EXPERIENCE WITH GUIDEPOSTS

The United States has had recurring experiences with efforts to curb price inflation by admonition. Hortatory measures have been used on occasion by every President since World War I. The record is clear that they have been ineffective whenever aggregate demand exceeded capacity output at current cost and price levels.[11]

More recent experience with wage-price guideposts in this country, and similar measures in several Western Europe countries (sometimes called incomes policies) demonstrate that they, too, fail to keep the price level stable. Indeed, the country that had relied most heavily upon fiscal and monetary controls and market competition, and least upon direct controls, has had the greatest success in keeping the price level down. That country is the Federal Republic of Germany.[12]

Studies of the operation of "incomes" policies in Western Europe show that their effectiveness was limited, both in extent and duration.[13] They may have suppressed inflation for a short time, but underlying pressures soon asserted themselves. The guideposts are likely to be even less effective in the United States. Our economy is less dependent upon foreign trade. The social goal of "fair shares" commands less support here. There is no labor party or government in the United States. And this country has a relatively decentralized labor movement and system of collective bargaining.

IN CONCLUSION

The problem of making the U.S. economy inflation-proof while maintaining full employment will only be solved by adequate fiscal and monetary controls of spending, and by structural reforms to make competition effective in markets for productive services as well as final products. Price control through enforced guideposts is of little avail in preventing inflation, and can seriously distort the efficient use of resources while diverting attention from fundamental remedies.

Chairman PATMAN. Our custom is, Doctor Jacoby, to hear from each one of you first and then we will interrogate all four of you at the same time. If you have completed your summary, we will hear now from Dr. Henry W. Briefs, the chairman of the Department of Economics, Georgetown University.

We are glad to have you here, sir.

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[11] See Ben W. Lewis, "Economics by Admonition," American Economic Review, vol. 49 (May 1959), pp. 384–398.

[12] See "Governmental Policies To Deal With Prices in Key Industries in Selected Foreign Countries," paper No. 2. Prepared for the Joint Economic Committee of the U.S. Congress. (Washington: Government Printing Office. 1963.)

[13] See Albert Rees, "An Incomes Policy for the United States," Journal of Business, vol. XXXVIII, No. 4 (October 1965).

STATEMENT OF HENRY W. BRIEFS, CHAIRMAN, DEPARTMENT OF ECONOMICS, GEORGETOWN UNIVERSITY

Mr. BRIEFS. Thank you very much. I am very happy to be here and very grateful for this opportunity to speak to the question of the outlook for 1966.

The paper which you have in front of you, which incidentally was completed sometime around 5 o'clock this morning, is the best effort that I was able to mount in the short time I had to get a statistical fix on the outlook for wages and prices in the current year.

Let me be very careful to specify the assumptions which underly my results.

To begin with, I take for granted the Council of Economic Advisers general analysis as regards aggregate demand supply. I do not mean to imply I agree with it. But for purposes of my analysis, I did not question the Council's judgment that in the year ahead "potential" GNP and actual GNP will converge at an unemployment rate of about 3.75 percent and that this represents a condition of approximate balance between aggregate demand and aggregate supply.

I also take for granted the Council's view that in 1966 the level of aggregate demand will be sustained because, on the one hand, private investment will be approximately equal to private saving and, on the other, because the fiscal program recommended by the President will bring about the elemination of most of the excess of Government expenditure over Government income.

Again, I have reservations about this proposition, but I accept it for the purposes of my inquiry.

Finally, I did not question the proposition that the financial conditions attending economic growth in the coming year are substantially appropriate to that growth in the sense that they neither exceed nor fall short of the requirements.

All these points are subject to debate, but I do not discuss them in the present paper.

Instead, I would like to address myself to the Council's contention that, given overall balance in the economic process, there is no cause for serious concern about inflation. This view rests on the argument that throughout most industries, capacity to produce and the demand for these various outputs are likely to remain well balanced in the coming year. A second argument put forward is that labor markets, too, are substantially in balance. Then, assuming a productivity gain for the total private economy of 3.3 percent, say, and a large measure of compliance with the wage-price guideposts, the Council concludes that the general price level (measured in terms of the GNP deflater) will rise no more in 1966 than it did in 1965, about 1.8 percent.

The problem, therefore, to which my paper is addressed, is this: Given overall equilibrium in the economic process, is the outlook for relative price stability such as the Council has proposed in the 1966 Economic Report?

The right way to attack this question, it seems to me, is in terms of the factors which, on past experience, determine the rate of increase of wages. By "wage" I mean total compensation per employee man-hour. That includes straight time hourly earnings; it also includes overtime earnings and fringe benefits. However, to save time, let's simply call it the wage rate.

What are the factors that determine the rate of rise in this wage rate?

This question has been intensively studied in recent years by a number of economists, among them Charles Schultze, the distinguished Director of the Bureau of the Budget, and Joseph L. Tryon, until last year a member of the Economics Department, Georgetown University; another name to be mentioned in this connection is that of George Perry, formerly of the staff of the Council of Economic Advisers.

The relationship I settled on to predict the rate of increase of wages was one developed by Professors Schultze and Tryon for what has come to be known as the Brookings-SSRC quarterly econometric model of the United States. This model is an attempt to bring together the empirical knowledge of the various sectors of the economy and produce a model capable of projecting GNP and its components for policy purposes. The model is by no means in satisfactory shape, but it represents a good deal of what we know empirically about our economy that is relevant for policy formulation.

The wage equation developed by Schultze and Tryon for this model seeks to "explain" the rate of change of wages in terms of Bouz variables. The first of these is the unemployment rate. The theory is that if the unemployment rate is high, this will act to hold down wage increases; and conversely, when unemployment is low, there tends to be less of a constraint from that side.

The second explanatory variable is the profit rate. In part, at any rate, this variable reflects a collective bargaining theory of wage determination. If profits are ample, trade union leaders are going to feel strong pressure to bring home a pretty good size piece of bacon; and if they don't somebody else may take their place. Of course, high profit rates also reflect buoyant demand; in this situation wage rates are likely to rise more rapidly in any case.

The third variable is the Consumer Price Index or CPI; more precisely, the rate of change in the CPI. This element in the equation reflects, among others, the influence of wage escalation clauses.

The last explanatory variable is the rate of change of wages in an earlier period. Let me add that all of the explanatory variables are lagged.

As far as nondurable manufacturing is concerned, the estimates obtained with this equation have some very encouraging statistical properties. The coefficients are significant; the relationship appears to be stable. Less satisfying is the fact that the R^2, which measures the extent to which this equation "explains" the rate of wage increases, is somewhat low at .44.

This means that only about half of the variance in the rate of change of wages is explained by the factors described; it also means, of course, that there are other factors someplace in the woodpile accounting for the rest of the variance in the dependent variable. The wage projection for 1966 resulting from the equation used as a forecasting device was an increase of 6.4 percent.

As regards the equation for durables manufacturing, I tried many variants of the equation and even the best of them had one crippling defect: They all resulted in a wrong sign for the relationship between the rate of change of wages on the one hand, and the unemployment rate on the other.

This seems to say that the greater the unemployment, the faster wages rise; and the lower unemployment, the less wages rise—which just does not make sense.

Faced with this problem, I resorted to what economists always resort to when they are in such situations: I looked at a lot of numbers, I made a lot of comparisons, I thought about it and I tried to add some measure of commonsense. Very frankly, and for the purposes of this committee, the result must be described as "my guess" of the wage change likely in durables manufacturing—some 4.0 percent in 1966.

And combining these two appropriately I arrived at a wage increase in the manufacturing sector of 5.4 percent in 1966.

Senator PROXMIRE. May I ask what page you are on?

Mr. BRIEFS. Page 6 of my paper and table 1 following.

I am going to pass over the next portion of my paper, and perhaps we can come back to the points involved later. My only comment at this point is that an independent estimate of what productivity trends have been or are going to be is not possible at the present time. That is because the GNP accounts are being revised and the relevant figures are just not available.

Turning directly to the conclusions without reference to the qualifications discussed in my paper, permit me to present you with the following:

Combining—as I said a moment ago—the 6.3 percent settled on for the rate of change of wages in the nondurable sector and 4 percent as a likely rate of change of wages in the durables part of manufacturing, we get a total manufacturing rate of increase of the wage rate of 5.4 percent.

Now, the Council implies that in manufacturing, productivity gains are apt to be something like 3.6 to 3.8 percent. Accepting the 3.8-percent figure, the increase in the unit labor costs of manufacturing output can then be simply calculated. And, by adjusting for the share that manufacturing represents in the GNP, and the net effect of this unit labor cost can be used to adjust the GNP deflator for 1966.

On my estimate, the deflator is apt to rise by something like 2.6 percent instead of the 1.8 percent predicted by the Council.

Let me add one note as to procedure here.

The reason I was able to do this was that the Council assumes stability of unit labor costs in the manufacturing sector. If you examine table 2 carefully, you will find that for the total private economy the wage increase forecast by the Council is well in excess of likely productivity gains in 1966.

My calculations suggest a significant increase in manufacturing unit labor costs, and the 2.6-percent figure reflects that increase. Price increases due to other circumstances, notably excess aggregate demand, would have to be added to the 2.6-percent price rise for 1966.

Let me make two final remarks about these projections.

First, a year such as the one ahead is a year which is difficult to gage, because the gaging of it depends on statistics that are not very sensitive to the kind of changes we are going to get.

Take, for example, the statistics regarding capacity utilization on which the Council bases a crucial point of its argument. The flaws in capacity utilization figures are known by economists; they are not very sensitive but, unfortunately, little else is available. The concept is theoretically appealing and, therefore, it is used. But it will be a mistake to depend on a fine reading of this variable to get some notion of whether or not there is apt to be excess demand or just balance in the "product markets." As a result, upward pressure on prices may be underway before utilization statistics show very much.

On the other hand, it is also clear that as far as wage movements are concerned, an estimate such as mine does make assumptions about timing which I am simply not in a position to verify sufficiently. It is possible that my estimates are right, but it will take a year and a half to find out.

Nonetheless, I think for the purposes of this committee I must take my stand and run the risk of being wrong. I fear my conclusion remains; namely, that a more rapid rise in the general price level than the Council foresees is underway—if anything, my projection understates the likely outcome.

Thank you very much.

Chairman PATMAN. Thank you, sir. Without objection, we will place your entire statement in the record at this point.

(Document referred to follows:)

PREPARED STATEMENT OF HENRY W. BRIEFS, CHAIRMAN, DEPARTMENT OF ECONOMICS, GEORGETOWN UNIVERSITY, ON WAGE-PRICE OUTLOOK FOR 1966; AN APPRAISAL[1]

INTRODUCTION

With the economy substantially at full employment and going strong, the danger of inflation is again a top policy issue. The Council of Economic Advisers, however, after appraising our chances of avoiding a turn for the worse, concluded in its 1966 report that prices this year will tend to rise no more than in 1965.[2] More precisely, the Council estimates that the overall price level increase (measured by the GNP deflator) is not likely to exceed last year's 1.8-percent rise, assuming, of course, that the President's fiscal policy recommendations are promptly enacted.

A great deal depends on the substantial correctness of this estimate, not only domestically but also in regard to our economic (and associated political) relations with the rest of the world. At this juncture, therefore, an independent evaluation of the price outlook may be helpful. The present paper is an attempt to contribute to such an evaluation.

THE COUNCIL'S ARGUMENT

A good way to begin is to lay out the essential of the Council's analysis relating to the price stability question. The result one gets is the following:

(1) For the economy as a whole, demand for goods and services is now about equal to "potential" supply of this output; that is, the supply we are able to produce when unemployment is about 4 percent. During 1966, overall "real"

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[1] The author wishes to acknowledge the assistance of Richard J. Lurito, Hiroshi Sadamichi, and E. William Dinkelacker of the department in carrying out the statistical analysis for this paper. Gary Fromm of the Brookings Institution was more than helpful by providing the data deck for the Schultze-Tryon wage equation that was used.

[2] Annual Report of the Council of Economic Advisers, Economic Report of the President, January 1966, p. 54.

demand for goods and services (after adjustment for price change) is likely to grow a little faster than potential output, thereby closing the remaining gap between potential and actual GNP.

(2) Aggregate "real" demand is likely to grow by the 5 percent required to close the gap because (*a*) private investment expenditure will continue its strong rise and tend to equal private savings, thereby generating balanced growth in line with the advance in potential GNP as far as the private sector of the economy is concerned; and (*b*) because the increase in Government expenditure, which also contributes to the rise in aggregate demand and output, will come to be balanced by the rise in Government revenues. This assumes that the four measures affecting tax payments recommended for 1966–67 are enacted and are sufficient to eliminate the shortfall of expected Government receipts relative to high and rising Government expenditure.[3]

(3) The monetary and credit developments associated with the expansion since 1960 have not impaired the soundness of our financial structure. Until mid-1965, the growth of total credit was in balance with the demands generated by this protracted expansion at a cost to borrowers that remained unusually stable. In the succeeding months these costs began to rise as a result of changing conditions in financial markets and the moderating influence of Federal Reserve policy. The report does not suggest, however, that these latter changes militate against the realization of full employment in the period ahead.

(4) The next question is, does balanced full-employment growth as envisioned by the Council carry with it the threat of a much faster rise in the price level than experienced in recent years? The Council answer is that it does not, at least in 1966, because (*a*) in product markets demand and the capacity to supply that demand are finely balanced across the board of major industry groupings, and with the capital expenditure boom in its third year, that balance is likely to continue; and (*b*) in labor markets the overall demand and supply situation will also be sufficiently balanced during 1966—"sufficiently" meaning that the unemployment rate will decline gradually to perhaps 3.5 percent. It is argued that a 3.5-percent rate does not mean overfull employment because of structural improvements in the labor force which, on balance, have tended to improve the employability of labor. Additional reasons for the optimism cited are the continued balance expected in product markets and the higher productivity gains realized since 1960. In strictly economic (market) terms, therefore, the present outlook for wage gains consistent with near-price stability is good, even with the economy operating continuously at full capacity rates.

That leaves out of account union power and its effect on wages. The Council finds, however, that—with some exceptions—wage settlements under agreements reached in 1965 were moderate and broadly consistent with the guideposts for wage-price stability. The Council also points out that many of last year's contracts are in force for a number of years, and that a light calendar of new contract negotiations faces us in 1966. At a result, the rise in union wage scales ahead is not likely to upset the pattern of wage advances established in 1965.

To complete its analysis, the Council then takes up the question of gains in output per man-hour, and estimates that the 1966 improvement for the private economy will be close to postwar trend values, say 3 to 3.3 percent. Comparing this forecast with the rise in employee compensation per man-hour it foresees, the Council concludes that labor cost per unit of output will tend to rise by less than 1 percent; an additional adjustment for the boost in the employer payroll tax which became effective in January raises that estimate to 1.5 percent. In manufacturing, however, the Council expects a more favorable wage and productivity picture and concludes that unit labor cost will remain approximately stable.

This summary is bound to be unfair to the Council's analysis in that it omits some of the qualifications and second order arguments. The summary does pretend, however, to be an accurate statement of the major premises and substantive analytical judgments on which the Council's sanguine conclusions about full employment growth with price stability depend. From the standpoint of this inquiry, therefore, it serves not only to identify certain issues that may arise in regard to this year's Economic Report, but also to specify the focus and limitations of the present attempt to contribute toward an outside appraisal of the Council's views.

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[3] The Economic Report, January 1966, pp. 42–44 and especially chart 4.

THE WAGE OUTLOOK RECONSIDERED

If one leaves out of account, as this paper does, that the Council's expectation of overall balance in the economy is probably not justified, the right way to approach the question of price stability is to reexamine the outlook for unit labor cost developments. In that case, the first issue is whether wages—real total employee compensation per man-hour—can be expected to stay broadly in line with productivity increases.

The factors determining the rate of change of wages have been intensively studied in the past few years. Charles L. Schultze and Joseph L. Tryon, for example, developed estimates to determine wage change for what is known as the Brookings-SSRC econometric model.[4] These estimates were subsequently reworked by Gary Fromm[5] and the results obtained seem good enough to suggest that this approach might offer an empirically meaningful explanation of the rate of change of wages applicable to the present period.

That explanation states that the average annual percentage change in the wage rate (W) in a sector of the private economy is a function of: (u), the overall unemployment rate; (z/x), the profit rate per unit of output accounted for by the particular sector: (CPI), the average annual percentage change in the Consumer Price Index; and (W_{i-4}) the average percentage change of wages a year earlier.[6] In other words, the present rate of wage change is taken to be a function of the past unemployment rate, the past profit rate, the past change in the CPI, and the rate of wage change still further in the past.

On the theory that the Schultze-Tryon and Fromm estimates of the wage relationships, based as they are on the 1948–60 and 1953–62 association between the variables, might not be quite appropriate in the altered economic conditions of the present, it was decided to reestimate this relationship on the basis of the 1959–64 experience. The results obtained are shown in the regression equations that follow.

REGRESSION EQUATIONS FOR MANUFACTURING

I Quarter 1959—IV Quarter 1964

NONDURABLE GOODS SUBSECTOR

$$\frac{W_i-W_{i-4}}{W_{i-4}}=-.07091+\underset{(.2047)}{.7248}\dot{CPI}_{i-4}+\underset{(.01229)}{.02875}\frac{z}{x}_{i-4}+\underset{(.0008845)}{.003068}\frac{1}{u}-\underset{(.3149)}{.8626}\dot{W}_{i-4};$$

$R_2=.441$

DURABLE GOODS SUBSECTOR

$$\frac{W_i-W_{i-4}}{W_{i-4}}=.03499+\underset{(.6915)}{3.205}\dot{CPI}_i+\underset{(.00578)}{.02378}\frac{z}{x}-\underset{(.001044)}{.00507}\frac{1}{u}-\underset{(.1028)}{.3684}\dot{W}_{i-4};$$

$R^2=.636$

[4] Charles L. Schultze and Joseph L. Tryon, "Prices and Wages," The Brookings Quarterly Econometric Model of the United States, James S. Duesenberry, Gary Fromm, Lawrence R. Klein, Edwin Kuh, editors (Chicago: Rand McNally & Co., 1965), pp. 311-324. The initiative for this study came from the Social Sciences Research Council (SSRC).

[5] Gary Fromm, "The Brookings Model: Structure, Solutions, and Simulation." (Paper presented at the First World Congress of the Econometric Society, Rome, Italy, September 1965.)

[6] $\dot{W}=f\left(\frac{1}{u},\frac{z}{x},\dot{CPI},\dot{W}_{i-4}\right);$

where:

$$\dot{W}=\frac{W_i-W_{i-4}}{W_{i-4}};$$

$$\frac{1}{u}=\frac{1}{\frac{1}{8}u_i+\frac{1}{4}u_{i-1}+\frac{1}{4}u_{i-2}+\frac{1}{4}u_{i-3}+\frac{1}{8}u_{i-4}};$$

$$\frac{z}{x}=\frac{1}{4}\sum_{i=-3}^{0}\left(\frac{z}{x}\right)_i;$$

$$\dot{CPI}=\frac{1}{4}\sum_{i=-3}^{0}\left(\frac{CPI_i-CPI_{i-4}}{CPI_{i-4}}\right)_i;$$

$$\dot{W}_{i-4}=\frac{W_{i-4}-W_{i-8}}{W_{i-8}}.$$

These results are only partly successful. The statistical properties of the equation for the nondurable goods sector are sufficiently good to warrant its use as a device for predicting wage changes in 1966. The durable goods sector equation, however, is disappointing because it contradicts the relationship between the rate of change of wages and the unemployment rate suggested by economic theory. The implication from this equation and a great many similar relationships studied in connection with this paper is that the structure governing the association between wage change and these explanatory variables appears to have changed in a fundamental way from what it was in the earlier periods studied by Schultze-Tryon and Fromm. This raises a host of issues that could not be resolved in the short time available for the preparation of this paper. As a result, no predictions could be generated using formal methods for the durable goods sector. Nevertheless, a likely assumption was made about the wage change in prospect for employees in durable goods industries so that the analysis could proceed.

The quarter-by-quarter predictions of wage increases in the nondurable goods sector turned out as shown in table 1.

TABLE 1.—*Quarterly wage projection for nondurable goods sector for 1966*

Period:	*Percentage change in employee compensation per man-hour*
1st quarter	6.4
2d quarter	6.5
3d quarter	6.7
4th quarter	7.2
Annual average	6.7

Since these increases were judged to be high, a 6.4-percent increase for the year as a whole was finally settled on as the estimate to be used.

In the durable goods sector, the procedure was necessarily more judgmental. Taking into account past performance in the durable goods sector, comparisons with wage increases in other parts of the economy, the fact that overtime work—concentrated in durables manufacturing—is rising, and that the majority of workers under cost-of-living wage escalation are also in the durables sector, and finally the recent rise in profit rates, a definite break with the moderate increases that occurred in 1964–65 seems all but certain. The figure settled on in this case was 4 percent rise in 1966.

Formal and informal statistical techniques were also used to study likely wage developments in key nonmanufacturing sectors, such as construction, mining, trade, and services. The results suggested resting content with the Council's implied expectation regarding developments in these areas.

THE PRICE LEVEL EFFECT

The task of deriving the likely price effects implied by these expectations regarding wages requires an examination of productivity trends. Table 2 presents the information, such as it is, about productivity, earnings, and unit labor cost over the past few years. Because of the stem-to-stern revision of GNP accounts now underway, year-to-year changes involving the relevant data are not yet available for the private economy, the private economy excluding agriculture, or for manufacturing. Various estimates, however, were prepared by the Council as shown in table 2. For the manufacturing sector, the Council used the Federal Reserve Board's (FRB) production index as a measure of real output [7]—rather than the corresponding GNP measure—and proceeded with the productivity calculation. One should keep in mind, however, that the FRB index shows a more rapid growth rate than the unrevised GNP measure of real output in manufacturing (available through 1964), and that, even after the current revision, "real product originating" in the manufacturing sector may not

[7] This measure of output has the well-known limitation that some of the component series are based on man-hour data adjusted for productivity change because monthly data on physical production are not available. The circularity involved when this measure of production is used to measure productivity change is not crippling in the case of annual FRB production index numbers because physical output series are available annually for most of the index's components.

have increased quite as much, on the average, as the rise in the FRB measure of production. Accordingly, using the latter to calculate the change in unit labor cost tends to result in a downward bias. Nevertheless, the productivity figures in table 2 are accepted in this paper.

Regarding 1966, the assumption made was that the productivity gain will be the same as the Council's estimate for 1965, namely 3.8 percent. No doubt, this is too high, but that is the figure accepted for the purposes of the present paper.

What remains to be done is to convert our figures—a rise of 6.3 percent in employee compensation in nondurables manufacturing, of 4 percent in the durable goods manufacturing, and a productivity gain of 3.8 percent for manufacturing as a whole—into the corresponding change in the GNP deflator. A rule-of-thumb procedure will be quite adequate to accomplish this conversion.

TABLE 2.—*Changes in productivity, earnings per man-hour, and unit labor costs, manufacturing and total private economy*[1] *(1960–65)*

Period	Manufacturing				Total private economy		
	Percentage change in productivity [2]	Average annual percentage change in productivity (1960–65)	Average annual percentage change in compensation per man-hour	Average annual percentage change in unit labor cost (1960-65)	Average annual percentage change in productivity (1960–65)	Average annual percentage change in compensation per man-hour (1960–65)	Average annual percentage change in unit labor cost (1960-65)
1960							
1961	3.4						
1962	4.0						
1963	4.1	4.0	3.6	−0.4	3.6	4.2	+0.6
1964	4.5						
1965	3.6						
Addendum: [3]							
1965		3.8	3.0	−0.8	2.8	3.7	+0.9
1966, projection					3.0 to 3.3	4.5 to 4.8	+1.5±

[1] All figures except year-to-year productivity changes in manufacturing are given in, or implied by, the Economic Report, January 1966, pp. 79–80.
[2] Author's estimate derived from FRB production index for manufacturing and the corresponding man-hour series for all employees.
[3] Estimated by the Council of Economic Advisers.

In essence, the calculation involves first, combining the two changes in employee compensation into a weighted average for all manufacturing; second, comparing this average increase—which turns out to be a 5.4-percent rise for 1966—with the 3.8-percent productivity gain assumption for 1966; and third, scaling down the resulting rise in unit labor cost in the manufacturing sector by the share of GNP accounted for by manufacturing. This arithmetic yields an estimate of the price level effect of our projections and assumptions which must be added to the Council's expectation of a 1.8-percent increase in the GNP deflator. The Council's figure is premised on stable unit labor costs in manufacturing for the current year.

The conclusion of this study is, therefore, that a 2.6-percent rise in the overall price level must be anticipated in the current year. If anything, this estimate errs in that it is probably too low; the productivity assumption accepted above is clearly high and the wage change projection for durables manufacturing at any rate is surely low.

A further caveat of great importance is that the projected 2.6-percent rise in prices owes nothing to any excess in aggregate demand that may develop in 1966. The effect of overall imbalance on the price level would have to be added to the 2.6-percent figure.

THE QUESTION OF "BALANCE" IN PRODUCT MARKETS

The estimates developed in the previous section depend on an important assumption that should not be left unexamined. The assumption is that the 1.6 percent average increase of unit labor cost in manufacturing implied by these estimates will result in proportionate price increases. Such an assumption derives only limited support from the Council's view that balance between the capacity to produce and demand will be maintained in 1966. With balance as the dominant characteristic, a number of factors would come into play whose effect could be price increases that are less than proportionate to the anticipated unit labor cost rise; in that event, the higher labor costs are likely to involve lower profits per unit of output.[8]

The picture of balance in the manufacturing sector presented in the Economic Report is largely drawn by means of capacity utilization statistics.[9] These are based on the McGraw-Hill Publishing Company's periodic surveys of business operating rates, plans for new plant and equipment, and business executives' answers to questions about their "preferred" operating rate.

Unfortunately, capacity utilization statistics do not permit making fine discriminations as to the degree of demand pressure on capacity, let alone an assessment of the market effect one can associate with given increases in the utilization rate relative to the "preferred" rate.[10] After all, the notions involved in this statistic are not economic notions, leaving out of account as they do the cost variations involved.[11] This is especially true when the economy is near full employment. An additional qualification is the fact that year-to-year additions to plant and equipment as reflected in McGraw-Hill surveys do not parallel at all closely actual capacity increases resulting from investment.[12] In the present state of our knowledge about these matters, other indicators of demand-supply balance in product markets, or lack thereof, should be examined.

TABLE 3.—*Changes in average hourly earnings, all manufacturing, fourth quarter 1962–fourth quarter 1965*

Period	Average weekly straight-time hours worked	Average weekly overtime hours worked	Average straight-time hourly earnings	Average gross hourly earnings	Percentage change			
					Weekly straight-time hours	Weekly overtime hours	Straight-time hourly earnings	Gross hourly earnings
1962	37.5	2.9	$2.33	$2.41				
1963	37.6	3.0	2.40	2.49	0.3	3.4	3.0	3.3
1964	37.6	3.5	2.45	2.55	.0	16.7	2.1	2.4
1965	37.5	4.0	2.53	2.65	−.3	14.3	3.3	3.9

Source: Economic Report of the President, 1963–66, table C–29.

Table 3 throws light on the question of balance in manufacturing. These figures suggest a degree of tightness in the demand-supply situation by late 1965. Surely, the rise and recent acceleration of overtime hours worked reflects growing intensity of capacity utilization. And, linked as overtime hours are with increasing production costs because of the premium pay rates involved, this measure of utilization intensity serves to remind us that wage rates (gross hourly earnings) are one type of cost that is affected by the very process of approaching full capacity utilization. More important in the context of this section, the sharp rise in overtime hours suggests that in manufacturing further increases in unit labor cost must be expected to push up prices in about the same proportion.

COLLECTIVE BARGAINING IN 1966

One last element in the Council's argument deserves a second thought. As pointed out above, the report draws comfort from the fact that the collective bargaining contracts terminating in 1966 will cover an unusually small number of workers. This is true, as table 4 indicates.

[8] In that case, however, the levels of investment on which continued balance between demand and supply depends may not prove sustainable, at least in the somewhat longer run.

[9] The Economic Report, January 1966, pp. 67–69 and especially table 9.

[10] C. L. Schultze and J. L. Tryon, "Prices and Wages," op. cit. The relationship employed by these authors to explain price changes included a capacity utilization variable based partly on McGraw-Hill survey data. Results were discouraging leading the authors to conclude that the fault lies with capacity utilization statistics. See p. 291.

[11] Cf. Lawrence R. Klein's testimony on this point, Measures of Productive Capacity, hearings before the Subcommittee on Economic Statistics of the Joint Economic Committee, 87th Cong., 2d sess., May 1962, p. 44.

[12] Cf. Frank de Leeuw's testimony on the same occasion, op. cit., p. 128.

TABLE 4.—*Expiration date in agreements covering 5,000 workers (1964–68)*

	Number of workers affected (in thousands)
1964	1,889.1
1965	1,576.7
1966	976.2
1967	2,063.9
1968	1,231.1

Source: Monthly Labor Review, December 1964, p. 1372; and December 1965, p. 1427.

The report also explains that in 1966 a great many workers will be covered by agreements made last year and earlier. The increases they will receive, therefore, are largely predetermined and, with notable exceptions, these are moderate. In giving weight to this factor, however, one should not forget that there is such a thing as wage reopening and cost-of-living escalator clauses. Table 5 sets forth the salient facts. The "current agreements available covering 5,000 workers or more" includes the vast majority of such contracts and refers to a universe of some 6 million workers.

TABLE 5.—*Prevalence of provisions for renegotiation and wage adjustment,*[1] *1965 and 1966*

[Workers in thousands]

	All industries	Manufacturing	Nonmanufacturing
Current agreements available:			
1965	4,490.2	2,434.5	2,055.7
1966	5,243.5	2,436.6	2,806.9
Termination:			
1965	1,576.7	1,077.0	499.7
1966	976.2	322.3	653.9
Wage reopening:			
Specific:			
1965	815.1	158.2	656.9
1966	589.6	41.0	548.6
Possible:			
1965	624.8	220.6	404.2
1966	637.7	228.8	408.9
Automatic cost-of-living review:			
1965	939.5	880.5	59.0
1966	1,425.0	1,000.1	424.9
Deferred wage increase:			
1965	2,004.9	1,080.5	924.4
1966	3,399.1	1,790.4	1,608.7
Current agreements not available:			
1965	1,015.3	156.7	858.6
1966	434.3	196.7	237.6

[1] Monthly Labor Review, December 1964, p. 1372; and December 1965, p. 1427. Includes agreements covering 5,000 workers or more by industry.

Two items of information in table 5 should be noted: The number of workers covered by agreements whose wage provisions may be reopened is large—some 1.3 million. These workers are not locked into existing long-term wage agreements. Should the pattern of settlements begin to exceed significantly the 3.2 percent productivity guideline, wage reopening and cost-of-living escalation could work in tandem to break up the existing pattern of deferred wage increases. Public expressions of dissatisfaction with the 3.2 percent wage standard by Mr. George Meany, president of the AFL–CIO and other labor leaders are far from reassuring in this regard.[13]

[13] Mr. George Meany noted recently that labor has never agreed with the guidelines, and expressed particular dissatisfaction with the 3.2 percent productivity gain standard. The 3.2 figure is the Council's estimate of the trend value independent of cyclical swings, as distinct from the average annual productivity gain over the past 5 years. The latter figure would allow something like a 3.6 percent increase in employee compensation. Mr. I. W. Abel, United Steel Workers president, recently called for an increase in the wage guidepost of this magnitude. He also proposed that wages be corrected for price increases by "using a cost-of-living escalator arrangement as part of the guideline policy." (Cf. Wall Street Journal, Jan. 28, 1966.)

A related point, also with reference to table 5, is that the total of those under escalation clauses subject to review in 1966 appears to be much larger than it was in 1965. In short, the effect of a given CPI rise in 1966 on wage rates could become greater in the months ahead, even if the number of workers under escalation provisions were to remain at the present level of about 2 milion.

CONCLUDING COMMENTS

We are sometimes told that a moderate amount of inflation is a price worth paying for reduced unemployment on the part of those segments of the labor force suffering disproportionately high unemployment rates. Such a view assumes that the rate of inflation can be controlled with some accuracy by adjusting certain appropriate policy screws. That assumption is not justified. Wages and prices do respond to demand and supply shifts, but only with considerable time lags. This fact—which shows up in every major empirical study of wage and/or price determination in the form of some lag structure [14]—suggests that a significant acceleration in the rate of increase of the price level will, for a time, be self-sustaining. How long a period of time is not clear, but recent studies—some of which were cited earlier—indicate lags of up to 2 years' duration and more. Given the commitment to "full" employment growth, it is difficult to see what can be done to constrain a price level advance that has begun to go beyond some acceptable rate of increase. The author is convinced that wage-price guideposts will not work under conditions of more or less continuous "full" and even over full employment. The question is: After the guideposts, what?

Chairman PATMAN. Professor Musgrave, before you gentlemen came in, we agreed we would hear from each one of you first and we would interrogate you as a panel.

We are now happy to hear from Dr. Richard A. Musgrave, professor of economics, Harvard University.

STATEMENT OF RICHARD A. MUSGRAVE, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. MUSGRAVE. Mr. Chairman, I would like to apologize on our behalf for being late, but we had to switch planes at the last moment.

I will summarize part of my paper, if I may, and then put the full statement in the record.

The problem which we are to discuss today, the question of stability at full employment, is certainly a very difficult one and I think all economists would agree that it is much more difficult than the problems which have concerned these hearings over most of the last 10 years; namely, how to get to a high level of employment.

At that time most economists believed that a fairly simple answer was appropriate; namely, increase the level of aggregate demand. This answer, I think, proved essentially correct. It worked and it landed us in a much more difficult position, one in which we face a problem to which economists do not have that easy a response.

The question before us might be divided into two parts. First, there is a problem of whether in the year ahead, in this calendar year, the economy will develop a situation of what might be referred to as pull inflation. In other words, will the level of demand be, generally speaking, excessive relative to the supply which the economy can generate?

[14] An interesting variant is the concept of "wage rounds" employed by Otto Eckstein and Thomas A. Wilson in "Determination of Money Wages in American Industry," the Quarterly Journal of Economics, vol. LXXVI, No. 3 (August 1962), pp. 379–414.

Then there is a second problem; namely, supposing that a situation of excess demand does not develop, to what extent will the condition of high employment generate cost price push forces which, in turn, will lead to instability in the price level?

As far as the first problem is concerned, the Council's estimate which suggests that the economy can pretty much repeat the gain in output which it accomplished last year, is on the optimistic side, but I think it is workable and I do not take much exception to it.

I think that some sectoral shortages will develop, and that the problem will not be quite as simple. But assuming the increase in total expenditures to remain within the $45 billion or so limit which the Council has in mind, the economy should be able to deliver this.

On the other hand, I am a bit more skeptical as to whether the growth in the total level of expenditures will really stay within the limit of these $45–$50 billion.

The level of investment may well be larger than anticipated; and I am also impressed with the expansionary area nature of the budget for calendar 1966.

I would like to make two points here: One is that the budget picture looks rather differently whether you compare calendar 1966 with calendar 1965, and the other is that it looks rather differently, depending on whether you look at the national income budget or the cash budget, both of which are legitimate ways of describing the economic picture.

On the first point, it appears that the change from calendar 1965 to calendar 1966 is distinctly expansionary, whether we measure this in terms of increase in Government purchases and/or in terms of changes in deficit.

Looking at the matter now on the national income account basis, most of this thrust comes in the first half of the calendar year 1966, going from the second half of 1965 to the first half of 1966. It tapers off in the second half of 1966 and the prospects (on the basis of present budget figures) for the first half of calendar 1967 are distinctly on the restrictive side. This is why the picture looks more restrictive going from fiscal 1966 to fiscal 1967 than if you compare calendar year budgets.

On the second point, we are all agreed that the administrative budget picture is not the proper one to look at if we want to evaluate economic effects. It is only a partial picture which excludes trust accounts, and so forth.

At the same time, both the national income account budget and the payments to the public or cash basis budget are significant ways of looking at the matter.

Now, it happens for various reasons that the difference in the cash and national income account budget pictures is unusually sharp this year.

We find, for instance, that on the cash or payments basis, fiscal 1966 shows a deficit of $7 billion, while fiscal 1967 shows a slight surplus, which means about a $7 billion decline in deficit.

If we look at the matter on the national income account basis, we have a decline in deficit of only about $1.5 billion. Now the reason for the difference is that certain changes in the budget picture show up as either increased receipts or reduced expenditures on the cash budget basis, but not on the national income account basis.

These include the speeding up of income tax and corporation tax payments; they also include the proceeds or expenditure offsets which result from the sale of Government assets. This is why the cash budget is a good deal more favorable.

My general evaluation is that the national income base budget gives the more realistic picture. It depends on how one evaluates the liquidity effects of some of these changes and much will depend on how they are matched by monetary policy.

But, in all, the national income basis is the safer bet and, on this basis, the budget is fairly expansionary.

All this leads me to feel that there may well be more price pressures than there were last year and that it might be a good idea, if I could go back and do as I wished, to have had some increase in income tax rates effective January 1.

I would have welcomed this especially if it would have meant less need to cut back on the development of the Great Society programs. Such cutbacks, in effect, place an undue share of the Vietnam war burden on those groups of the population which are least able to bear it.

On the other hand, as Professor Briefs pointed out, and as everybody told you here, the situation is highly uncertain. Nobody can really foresee what Vietnam requirements will be, and it may still be necessary—quite possibly, if not likely—to take tax action this year. This makes the present a very appropriate time at which to emphasize the importance of providing some kind of legislative-administrative mechanism by which stabilizing changes in, say, income tax rates can be put through in an expeditious fashion. I would hope that in the course of this year, this committee would concern itself with this problem, which is the most important institutional issue to be taken care of to improve our ability to maintain stability at high employment.

Turning briefly to the other problem, consider the matter of push inflation. I realize that it is very difficult to draw a rigorous statistical distinction between push and demand inflation, but conceptually it is quite clear that there is such a distinction—push inflation deals with the problem of push pressure on prices, which results from the use of market power, from administrative pricing, be it on product prices or on wages, which can occur easily under conditions of high employment even if there is no generally excessive level of demand. This may pose a problem of varying degrees of severity.

As a way of avoiding possible dangers from this source, I would rule out a general retreat in our policy toward maintaining our employment gains and moving further toward high employment. My reason for this is not so much the GNP losses in the process, but the conviction that the social problems which we face and the social adjustments which we wish to carry through, the problem of poverty and all this, can only be handled in this full-employment context.

An inequitably distributed unemployment rate of 3.5 percent may be less acceptable than a more equitably distributed rate of, say, 4 percent.

If this solution is rejected, there remains the moral suasion approach which is posed by the guidelines and beyond this more severe measures ranging from proposals for a cooling-off period with public hearings, but without mandatory ruling on the part of Government, to some forms of wage-price control.

I think that on the whole, the guidepost policy has been helpful. It is to be recognized, of course, that it is not perfect; it is not perfect in its effects on the efficiency of resource allocation in the market; it is not perfect in its equity aspects as far as distribution of shares between capital and labor are concerned. It is limited in applicability to certain types of markets, which are more readily controlled; it is more directed at restricting wages than at restricting prices, but all these things are probably inevitable.

On the whole, the guideposts have worked fairly well and will become of increased importance in the months ahead.

I would, in this connection, like to add a word in support of the Council's decision to stay with the 3.2-percent ratio for wage increases rather than to extend mechanically the 5-year average, which would have given a higher ratio. As the economy has reached high employment, the gain in productivity should be expected to be somewhat less because, after all, over recent years we have had productivity gains both due to technical progress and due to the economies which are derived from fuller utilization.

As the latter factor drops out, the whole movement should be somewhat dampened. In addition, there is also the factor of increased growth rate of labor to be noted.

I think it was correct to stay within the 3.2 percent. In all, we have been extremely successful in reducing the problem of unemployment; but we have some way to go. So far, the problem of price inflation has not been a serious one. Chances are that with proper use of the guideposts, this year we will get by without too much trouble, although I would agree with Professor Briefs' feeling that it might well be a bit more than 1.8 percent, but I would even call his 2.6 percent as falling under my concept of "without too much trouble," especially if in the process we succeed in pushing unemployment to below 3.5 percent. But above all, we have to be flexible. The budget outlook may very well change and tax action may be needed.

Thank you very much.

Chairman PATMAN. Without objection, we will place the entire statement in the record at this point.

(Document referred to follows:)

PREPARED STATEMENT OF R. A. MUSGRAVE, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY, ON STABILITY AT FULL EMPLOYMENT—OUTLOOK AND POLICY ALTERNATIVES

The topic before us is indeed a difficult one. In the good old times, covering nearly the last decade, the problem was much simpler. The issue was how to get the economy to operate at capacity; and the basic answer was "by using fiscal and other measures to provide for an adequate and rising level of total demand." Some people did not like this answer, perhaps because it seemed too simple. But as it came to be applied consistently over the last 5 years, the prescription proved most successful. The economy surged ahead for an unprecedented period, and the wasteful gap between actual and potential employment was nearly closed. The economics profession (present members excluded) may claim its share of credit for this success. But, in the process, we have worked ourselves into a new and more difficult position. Stability at full employment does not lend itself to a simple answer, and we shall have to feel our way as we go along.

PROSPECTIVE INCREASE IN PRODUCTION AND EXPENDITURES

As every textbook in economics shows, a rising level of expenditure (private and public) will be met by increased output, as long as there is an ample supply of unused plant capacity and labor. But as the slack is reduced, further expansion in the level of expenditure begins to meet sectoral bottlenecks and shortages which drive up prices. Sooner or later, shortages become more general, and further expenditure increase comes to be reflected largely in price inflation, rather than increased output. Where does the outlook for 1966 place us in this pattern?

The Economic Report estimates the GNP for 1966 at a range centering on $722 billion. This repeats the 1965 gain in GNP of nearly $50 billion. Allowing for a "normal" price rise of below 2 percent, the report expects an advance of nearly 5 percent in real terms. The first question is whether, given a $50 billion rise in demand, the economy can generate this increase in real output without calling forth specific shortages and price increases above the anticipated 2 percent. The second question is whether the increase in expenditure will stay within this estimated limit.

Expansion of production

To date the rising level of demand has been met by increased outputs without developing significant areas of supply shortage of the bottleneck type. As far as plant capacity is concerned, present utilization rates are not excessive, and with the expected high rate of capital formation, adequate capacity should remain available. The projected average productivity gain of somewhat over 3 percent is also in line with recent experience. The problem will be primarily with labor supply.

The estimated increase in civilian employment of 2.5 percent, after allowing for a sharp increase in labor force, implies a decline in the unemployment rate (annual average) from 4.6 to 3.7 percent, the lowest rate since 1953. While this is below the earlier interim target of "high employment," it is still greatly above unemployment rates in other Western countries. At the same time, the unemployment rate for adult males is already at 2.5 percent, and the remaining groups with higher rates may be less readily absorbed. While it should be quite possible for our economy to reach 3.5 percent or a lower ratio as an eventual target, the question is the speed with which it can be achieved. Chances are that repetition of last year's output gains, beginning from a substantially higher employment level, will encounter more shortages and hence price pressures.

This is the case especially since our efforts at increased adaptability of the labor market, at retraining and similar programs have operated on a rather limited scale. While the private sector has contributed greatly in this respect, it is best in dealing with those groups which are more easily absorbed. Public labor market policy, therefore, must carry a larger share of the burden as the slack is reduced further and absorption becomes more difficult.

Expansion of demand

But though caution is in order, the production target (given the estimated expenditure gain of $50 billion) is not unreasonable. Whether the expenditure gain will stay within this limit is more questionable.

The outlook, as outlined in the Economic Report, suggests that a lesser expansion in capital formation will be balanced by a larger growth in Government purchases, with residential construction and consumption behaving similarly to last year. This picture is reassuring, but investment levels may prove higher than expected, and the expansionary nature of the budget may be underestimated.

Looking at the budget picture on the national income basis, purchases are estimated to rise by $7 billion, as compared with a $1.4 billion gain from 1964 to 1965; and the deficit is estimated to rise by $2.5 billion, as against a decrease of $4.4 billion from 1964 to 1965. On both counts, fiscal policy is substantially more expansionary than it was last year.

The main thrust, it appears, will come during the first half of the year when Federal purchases rise sharply, more than offsetting in expansionary force the rise in payroll taxes. The second half will bring a sharp upswing in transfer payments, reflecting the new benefit payments under hospital insurance, but this will be matched by revenue gains; and the budget will take a restrictive turn in the first half of next year. It is this pattern which explains why the budget outlook appears so much more expansionary if the comparison is between calendar

1965 and 1966 rather than between fiscal 1967 and 1968, where the deficit declines by $1.7 billion and purchases rise by $3 billion only.

It must be noted also that this picture refers to the budget data on the national income basis; and that the situation looks less expansionary (or even restrictive) if viewed on the administrative budget or cash (payments to the public) bases. Comparing fiscal 1966 with 1967, the decline in deficit is $1.7 billion on the national income basis, $4.6 billion on the administrative budget basis, and $6.4 billion on the payments basis. The question is which provides the most relevant picture.

While the administrative budget is not suited for appraising economic effects, since it excludes trust accounts, the cash budget offers a significant alternative. For various reasons, the gap between the budget pictures on income and cash basis is unusually wide this year. The former fails to reflect various features of the new budget which render the cash picture so favorable. One is the $3.6 billion gain from the speedup in personal income and corporation tax payments. Since the income budget is on an accrual basis, these gains are not reflected. Another is the increase in proceeds from the sale of Government assets, including mortgages, which are not reflected in the income data, since they are transactions on capital account. Finally, proceeds from seignorage are up and again do not enter the income base budget.

The question is which budget gives the more relevant picture. The speedup in corporation tax payments will not change the profitability of investment and at best will have a liquidity effect. Since most corporate tax accounting is already on an accrual basis, there may be little effect on the internal flow of funds; and even if such effect occurs, plant and equipment expenditure will not be curtailed in the short run, as investment plans are made well in advance. There may be some effects on customer credit, but here much will depend on the ease (or lack thereof) with which monetary policy permits the liquidity loss to be recouped. The same holds for the effects of loan repayments. These may be likened to open market sales of the Federal Reserve, rather than to fiscal restriction. The effects are on liquidity and interest rates, not disposable income. In all, it appears that the national income base gives the more relevant picture of fiscal change, with the payment base understating the degree of early expansion and overstating that of subsequent restriction.

I am left with the conclusion that the expansion of demand may prove greater than anticipated and that the supply side may have some difficulty in keeping up. Thus, some further tax restraint applicable early this year would have been in order. I would have welcomed this in particular, since a slowdown in the Great Society programs has been considered necessary. As compared to tax increase, this places a disproportionate share of the cost of Vietnam on those least able to bear it. I see little justification for this at a time when the fiscal cost of Vietnam is still relatively slight, as compared to Korea, for instance, and when consumer expenditures are expected to rise by another $25 billion.

Need for flexibility

In all, it is evident that the fiscal outlook is highly uncertain. Even without major escalation in Vietnam, other fiscal needs may prove substantially larger than expected, not to speak of the consequences of a major escalation or, more hopefully, of an early settlement. This is not the time (if there ever was one) at which revenue policy can be made 18 months in advance. Congress, therefore, should be ready for fiscal action, up or down as the situation may require; and to expedite such action when the need arises, Congress should consider in advance just what form it would take. Provision for flexible fiscal policy, I believe, is the most important institutional change which can be made to permit stability at full employment. The availability of monetary policy does not render this unnecessary. While monetary policy is flexible in initiating policy changes, the lag between application and expenditure change is substantially longer than for income tax adjustments. Therefore, the arsenal of stabilization policy can be improved greatly by permitting prompt tax action.

PUSH INFLATION AND THE GUIDEPOSTS

So far we have dealt with the demand-pull aspect of inflation. I now turn to the other side of the coin, which is the problem of wage and price push. When the economy is recessed and markets are weak, the exercise of market power is limited by lacking demand. Buoyant demand and short supplies provide a better setting in which to apply it. Wage or profit demands may be made and met which exceed those applicable under competitive conditions. Thus, it becomes of increased importance for public policy to check such pressures. While it is difficult to distinguish statistically between cost-push and demand-pull inflation, the conceptual difference is fairly clear. Demand-pull inflation is the rise in prices which would result from excess demand even in competitive markets. Cost-push inflation is the rise in prices which results from an exercise of market power, even in the absence of excess demand. It may be the result of union policy to gain wage increases in excess of productivity gains, or of firm policies to raise profits by increases in excess of rising costs or changing patterns of demand.

Undoubtedly exercise of market power is possible in many of our product markets and can contribute to inflation. This potential is the more dangerous if the Government is committed to the maintenance of high employment, thereby having to underwrite (by appropriate fiscal or monetary measures) whatever price increases result. To date, these dangers have not materialized. As is noted in the Economic Report, price levels over the last 5 years have been remarkably stable. Notwithstanding the rapid advance in output, wages have generally moved in line with productivity, and labor costs have been relatively stable. One fortunate factor this year is that relatively few wage contracts will come up for renegotiation. While prices have shown some sign of stirring over the last 6 months, much of the rise in the cost of living in 1965 can be traced to particular situations, such as the shortage in meat and the continued rise in the cost of services. But while the record has been good to date, the risk of instability increases with reduced unemployment, and we need be prepared to deal with it.

Among ways of dealing with the problem, let me rule out a voluntary retreat from high employment. More important even than the resulting loss in GNP is the fact that this would make it impossible to solve the problems of poverty and social adjustment which need to be solved. There remain, arranged in the order of severity (1) moral suasion, along the lines of the Council's "guideposts"; (2) a cooling off period prior to major price or wage changes, possibly with public hearings to explore their justification, but without binding arbitration; and (3) wage-price controls, applied more or less selectively, which make changes contingent on Government approval. While I am willing to accept (2) if necessary, the "moral suasion" approach has worked quite well so far, and, hopefully, no further steps will be needed.

Obviously, the guideposts are not perfect. The restrictions are imposed more specifically on the wage than on the price side; exceptions are not readily dealt with, especially when they call for price reductions; and the entire approach lends itself more to markets which involve few firms and wage settlements which involve large contracts. But these defects are more or less inevitable. The general rule of permitting wages to rise by the average productivity gain while maintaining a stable price level is clearly more feasible than the inverse of a stable wage level and falling prices. Wage increases at the average rate of productivity growth divide the gain between labor and capital in a more or less equitable fashion, although the profit share is doing somewhat better than the wage share of late. This is the case especially in manufacturing, where the wage and salary share in the total of wages, salaries, and profits is down from 80 percent in 1960–62 to 70 percent in 1965, with a corresponding rise in the profit share.

Ideally, the guideposts would not affect changes in relative prices or wages, but only in average wage and price levels. In practice relative changes are narrowed, as the exceptions are not as readily administered as the average rule, and some inefficiencies in allocation may result. Finally, though the effect of technical progress on the international competitiveness of American producers is neutralized by the formula, it is at least protected against deterioration by rising labor cost. In a world of second bests, it is indeed a pretty fair solution to a difficult problem.

There is general agreement with the Council's policy of basing the measure of appropriate wage changes on the trend growth in productivity, rather than on fluctuating annual changes. The question is only how to measure the trend. Under full employment conditions, allowing for only modest cyclical changes around a full employment growth trend, this would be approximated reasonably well by a 5-year moving average. In the present setting, the Council was correct, however, in not accepting the increased ratio which would have resulted by following the formula this year. Over recent years, productivity gains have resulted not only from the normal course of technical change, but also from the increased efficiency resulting from higher capacity utilization. Now that the latter factor drops out or decreases in importance, there is reason to expect a somewhat lower, rather than a higher rate of productivity advance. Recent evidence supports this hypothesis. Given such a kink in the trend rate of productivity growth, an increase in the 3.2-percent rate of wage gain would not have been justified.

Most important, the guideposts must not be saddled with a task which they cannot perform. They are designed to check abuse of market power under conditions of high employment, but without a generally excessive level of demand. If such excess develops, application of voluntary price restraints becomes ineffective and disrupts the efficient use of resources and distribution of goods. Adequate fiscal and monetary restraints remain the first requirement; but given this condition, the guideposts can help to maintain price stability at high employment or, putting it differently, they permit the choice of a more ambitious employment target. Barring escalation in Vietnam, there is good reason to hope that the economy can continue in this framework and that the goal of high employment with stability can be achieved without more forceful measures.

Chairman PATMAN. Our next witness is Dr. Robert Solow, professor of economics, Massachusetts Institute of Technology. We will be glad to hear from you, sir.

STATEMENT OF ROBERT M. SOLOW, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. SOLOW. Thank you, Mr. Chairman.

Although Professor Musgrave and I are friends and neighbors we exchanged our statements to this committee only on the plane coming down here; nevertheless, they sound very similar. I have kept this statement short and I think I will just read from it.

Thinking about economic policy for 1966 has to begin with two obvious propositions. First, our economy is closer to high-level balance than it has been for many years; and second, the uncertainties of forecasting, especially in connection with defense needs and plant and equipment spending by business, are no smaller than usual, perhaps bigger. Therefore, it is unusually difficult to find exactly the right economic policy at a time like this.

Any policy, even a sensible one, may find itself overshooting somewhat into bigger price increases than we care to face, or undershooting somewhat and relapsing into the kind of slack from which we have laboriously extricated ourselves during the past 5 years.

So, my first piece of advice for this committee is not to believe anyone who tells you with great confidence what is the right thing to do right now. I would even suggest you might apply this thought to one another in the course of the year.

But being cautious about economic policy doesn't mean giving up on it altogether. We might as well face the fact that errors in economic policy are inevitable, especially when the economy is in fairly delicate balance. But mistakes in economic policy are quantitative, not just qualitative, in character.

Small mistakes have small consequences; only big mistakes have big consequences. So as long as economic policy is reasonably cautious and flexible, only small mistakes need to be made. But it is still necessary to decide on which side you want to run your small risks.

We seem to have learned this lesson very well with respect to things like unemployment and excess capacity. You can read in the newspapers any day that we calculate unemployment and excess capacity to a couple of decimal points and we say there is only a small margin of idle capacity or a little bit of unemployment remaining to be mopped up here and there.

But very recent discussion often sounds as if the problem of inflation is really different, that inflation is either on or off. Inflation is not like pregnancy, however. You *can* have a little bit of inflation, and a lot more people enjoy it than are willing to admit it.

A small increase in prices is a little worse than no increase in prices at all, but it is a whole lot better than a big increase in prices.

People who adopt the notion that price increases are either all or none seem to be able to come to a simple and definite conclusion. They say, we are on or perhaps over the verge of inflation; therefore, economic policy should be aimed at contraction through reductions in public spending, through tighter credit and perhaps through increased taxes.

You are given the impression then that a major hazard is avoided in this way at no cost to anyone. But the hazard may be only small and there really is a cost. The cost to the Nation is measured in output that never gets produced and jobs that never materialize.

I might as well admit that I think there are worse things than a small increase in the price level and one of them would be a failure to reduce unemployment below what it is today. In some ways, now is the most important time to keep employment rising steadily, because now is the time that the newly created jobs tend to go to those who need them most, particularly Negroes and youth. For example, between December 1964 and December 1965 one of every six new jobs went to a nonwhite worker, although nonwhites are only about one-ninth of the labor force. You have heard it said that the unemployment rate among Negroes is usually about twice that for whites. That is sad evidence of discrimination, inadequate education, and sealed-off opportunity. But to be hard boiled about it, it also means that right now the quickest way to reduce the Negro unemployment rate by 2 points is to reduce the white unemployment rate by 1 point.

Similar, in some ways more dramatic, figures could be given for teenagers. If we can manage a continued steady expansion, we can hope to melt further the hard core of unemployment. It goes without saying that direct manpower policies, education, training and retraining, should be pressed without letup. But don't be misled by casual remarks about occasional labor shortages. Instead, think about the ships and airplanes that were built during the Second World War by workers who were "either too young or too old, either too gray or too grassy green," as I remember it, and reflect that situations like this are what personnel experts get paid for.

I can speak only for myself, but I would miss the extra production that continued expansion would bring. If we adopt a policy of contraction, I'm afraid that it will be education and the poverty program, beautification, and pollution abatement that will be cut back, and those are uses of output that I value more than some others that will not be cut back.

Of course, inflation has costs, too. If I have emphasized the costs of contraction, it is because we hear very little about them. It is worth asking ourselves exactly how a little bit of inflation does its little bit of harm. Remember that I am not talking about runaway inflation; there is no serious danger of that. I am talking about the difference between a flat wholesale price index and a creep of 2 or 3 percent in a year.

The main damage is that inflation redistributes income in capricious ways. In particular, it erodes the real value of savings accounts, insurance policies, pensions and the like. It is mostly small savers who need protection against creeping inflation; big savers are better able to protect themselves through variable annuities, mutual funds and other equity investments.

It should not be impossible to find some way to protect the small saver and pensioner. Some countries have special savings bonds which are tied to the Consumer Price Index and thus guarantee a stipulated real rate of return. One would not want to do that on a large scale, but it might well work out if restricted to a limited amount per person or family. And if that, or some other protective device, permitted expansion to go on a little longer, even at the cost of a little inflation, we might turn into small savers some peole who would otherwise never have the opportunity to save at all.

Another cost of inflation is the damage it might do to our balance of payments at a critical time. Even there, all we require in self-defense is that our prices not rise in comparison with our competitor's. That gives us a little room for maneuver.

Between the third quarter of 1964 and the third quarter of 1965, which are the most recent figures I could find, the consumer price index rose by 2 percent in the United States. France and Italy, both suffering from recession, had 3 and 4 percent increases; Switzerland, 4 percent; Germany, the Netherlands, Sweden, and Great Britain, 5 percent; and Japan, 8 percent. I have not had time to make the more relevant comparison of wholesale prices. That comparison would clearly be a little more pessimistic from our point of view, mainly because of the recession in France.

The sort of inflation that is dangerous is the kind that tends to feed on itself and cumulate into a spiral. Some part of recent—and future—price increase is not of this kind. As production in a single firm or industry moves up, less efficient capacity has to be called into production and perhaps less skilled and experienced labor has to be hired to operate it. This is perfectly natural and to be expected. It means that the last increment to output is more costly than the next-to-last. Since it is unlikely in good times that profit margins will narrow, or wage rates fall, it takes a somewhat higher price to validate the last bit of production. This is a once-for-all price increase; it does not by itself generate a cumulative spiral.

Genuine demand-pull inflation, however, does cumulate. The Council of Economic Advisers sees very little sign of the development of generalized excess demand right now, and I think I have to agree with them. No doubt some may develop later if the current optimistic forecasts for 1966 prove to be short of the mark. The odds seem to favor a somewhat faster increase in GNP than the Council predicts. But I think it would be a mistake to panic now.

It seems to me that the first principle for economic policy in 1966 ought to be to stay lose. Under circumstances like the present, there is a terrific premium on flexibility, on the ability to act fast without the sort of extended production that may contribute to public jitters.

You will remember that some years ago the Commission on Money and Credit made a proposal that some limited temporary discretion to vary tax rates be lodged with the President. The Kennedy administration half adopted such a proposal. The idea has since disappeared, and I can easily imagine why. I suppose that Congress is not about to vote for any such thing. I still like the idea and I can't help thinking it would make the task of economic policy much simpler at a time like the present, and I hope, and I hope you hope, that times like the present will be more frequent in the future than they have been in the last few years.

I do not believe there is any point in beating on a stone wall. But I wish this committee could think of as good an idea. Discretion itself is unimportant. What counts is speed and ease in shifting gears. It may be that the recent proposals that the Treasury has made for advance discussion in this committee and the Congress at large of the form of any temporary tax change, might be enough.

If, as events unfold, some contractionary fiscal policy becomes clearly necessary, I would rather see a corporate and personal income tax increase than a reduction in the desirable civilian expenditures of Government.

No one could be more eloquent on this question than the President was when he urged, in the state of the Union message, that the war in Vietnam not be fought to the expense of the poor. It was noble sentiment; I hope it means something, though the budget was only mildly encouraging.

Finally, I believe we should try to get as much mileage out of the Council's guideposts as we can. They are far from a perfect, or perfectly effective, or perfectly even-handed policy device. But I think they have done some good, and may be able to do a little more.

I don't think I would favor formalizing them very much, because we should avoid anything that smacks of price control. But there *are* concentrations of market power in the American economy, on both sides of many markets. There is no strong presumption that, where there is great market power, the decisions of those who wield it will always be in the public interest. Sometimes market power *does* respond to the pressure of public opinion. I think it might be a good idea if individual Senators and Congressmen sometimes helped to inform and mobilize public opinion, instead of leaving it to the President and the Council of Economic Advisers. Used that way, the guideposts might help buy some time, and during that time perhaps a little more residual inflation might be shaken out of the economy. Just don't expect too much.

One important contribution you can make to price stability is to avoid anything that will diminish active competition, including foreign competition, in our markets. And be ready to change your mind at any moment.

Thank you, sir.

Chairman PATMAN. Thank you, Dr. Solow. We will commence questioning under the 10-minute rule. The members will interrogate the panel.

First, I would like to ask two or three questions. I am pleased with the opportunity to ask such distinguished American economists some questions about price instability and interest rate instability.

It occurs to me that interest rates enter into price stability or price instability in a very major way and I would like to ask you gentlemen, first, to comment—each one of you briefly—on the decision of the Federal Reserve Board on December 6 to increase interest rates. The rediscount rate, as you know, was raised from 4 to 4.5 percent, which is a 12.5 percent increase, and the certificates of deposit for longer than 90 days from 4.5 to 5.5 percent, which is a 22.2 percent increase. The shorter certificates of deposit were increased from 4 percent to 5.5 percent, which was a 37.5 percent increase.

Now, first, do you believe that these increases are inflationary? Do you believe that the Federal Reserve's action is likely to trigger inflation? Do you believe that interest rates enter into the prices of goods and commodities and wages and everything else, and that they will be harmful to our efforts to have price stability and full employment at the same time?

Then I would like to ask you specifically: Would you approve of a 37.5-percent increase as in December 6, 1965, and if you do, how do you reconcile your approval with the opposition to price and wage increases of even a very small fraction of that amount? In other words, I think the guidepost now is 3.2 percent, and this 37.5-percent increase is 10 times the guidepost.

I would like to know how you would reconcile the two; and commencing with Dr. Briefs I would like to have comment on it.

Mr. BRIEFS. To begin with, the increase in interest rates that followed the rediscount rate advance of December does, of course, enter into prices because higher interest rates represent costs of production. If you look at the problem in terms of the CPI, however, the higher mortgage rate, for example, makes very little difference, because its "weight" in the Consumer Price Index is only about 2.8 percent, which means that 2.8 percent times the mortgage rate increase gives you the direct price-level impact of a change in the mortgage rate.

That neglects, of course, the role of the interest rate increases in all other production. But the 2.8 percent illustrates the fact that any increase in the interest rate must be weighted by its importance in the production functions and the specific demand functions that are involved.

The second point to be made is, of course, that rising interest rates also have implications for overall demand—demand implications that are more properly seen in the light of overall Federal Reserve policy in regard to the money supply and the supply of credit.

It reflects actions that really were taken earlier in response to a developing situation as far as aggregate demand is concerned.

Chairman PATMAN. Would you pardon me, please. Obviously, I cannot get through in 10 minutes this way. May I ask each one of you if you approved of the 37.5-percent increase on certificates of deposits?

Mr. BRIEFS. The net of my thinking would be that I approve.

Chairman PATMAN. Did you approve it, Dr. Jacoby?

Mr. JACOBY. Very definitely. In fact, I thought it was belated. I would just like to add this point, that the important effect of an increase in interest rates is to limit the increase in the supply of money which at a time like this is a very desirable thing to do——

Chairman PATMAN. If you have no alternative, no better way, I would agree with you. But I think there are better ways. Of course, we have differences of opinion.

What about you, Dr. Musgrave?

Mr. MUSGRAVE. One question is whether it was wise or appropriate for the Board to do this a few weeks prior to the general formulation of the budget policy, and this I doubt. But given the resulting budget policy, my answer is that I approve.

Chairman PATMAN. You would approve?

Mr. MUSGRAVE. Yes.

Chairman PATMAN. What about you, Dr. Solow?

Mr. SOLOW. Mr. Chairman, I do not think that the increase in interest rates could be described as inflationary; it will certainly, in a way—as Dr. Briefs said—add a small amount to prices, but it is no more inflationary than an excise tax increase would be inflationary under similar circumstances. I think the basic problem is one of coordination; monetary and fiscal policy have to be taken together.

What I do regret about the decision of the Federal Reserve Board is the fact that the decision was made so unilaterally before an opportunity existed to coordinate the fiscal and monetary policy of the administration.

Chairman PATMAN. Do you believe that the existence of so many and so much in certificates of deposits entered into the decision of the Federal Reserve Board, Dr. Briefs?

Mr. BRIEFS. I would think so.

Chairman PATMAN. What about you, Dr. Jacoby?

Mr. JACOBY. I have no opinion.

Mr. MUSGRAVE. I would think that the whole money market situation would be considered.

Mr. SOLOW. Yes, I would agree.

Chairman PATMAN. The testimony before this committee in December, I think, was rather definite along that line. That testimony will be available, I believe, tomorrow. It is in two volumes and I think you will find it to be of great interest.

I think the testimony was conclusive that certificates of deposit, time-bearing certificates of deposits have only become important in the past four years.

Is that not about right? Four or four and a half years ago, that is when they started? And, of course, corporate funds were the ones that were principally used, and by drawing these funds into the certificate of deposit interest-bearing market, it took them out of the short-term market and that, of course, caused the short-term rates to go up tremendously.

Do you agree to that, Dr. Briefs?

Mr. BRIEFS. I would expect that.

Mr. JACOBY. Yes.

Mr. MUSGRAVE. Yes.

Mr. SOLOW. Yes, indeed.

Chairman PATMAN. Therefore, I think that was against the public interest.

I know the Treasury, when it was headed by Mr. Dillon, worked out with Mr. Martin an agreement that they would just arbitrarily raise short-term interest rates, which I think was clearly against public interest and I told each one of them so in public session.

Of course, these interest rates have increased until they are now so high that the Treasury or the administration may make an effort to increase the long-term rate ceiling from 4.25 percent. This will cause more trouble in Congress than anything else has in many years.

I predict that Congress will not pass an increase. Of course, I have been wrong on many things before and I could be wrong on this, but I believe it will be stopped.

Now, Mr. Proxmire?

Senator PROXMIRE. May I say to the chairman I may have to leave promptly because of an expected rollcall.

I would like to join the chairman in recognition of the excellence and competence of this outstanding panel.

Dr. Jacoby, I welcome the specific response that you have given us, especially in your summary view when you hit one point after another. I know this subjects you to criticism which I am going to offer now, but it is very helpful in zeroing in on what the problem is.

You say the combined spending plans of Federal, State, and local governments, business firms and consumers is far—and you underline far—in excess of the real productive capacity of the economy.

Now, if you would care to do so, unless you can refer me to a part of your detailed statement which supports that, I would appreciate it if you could give us the arithmetic on which you compute this, how far it is in excess and how you come to this conclusion.

Mr. JACOBY. Well, there is some brief arithmetic, Senator Proxmire, in the paper, but I can say it in a sentence or two.

Senator PROXMIRE. All right.

Mr. JACOBY. My estimate of the expansion during calendar 1966 in the real output of goods and services of the economy over 1965 is about 4.5 percent.

The U.S. economy has been expanding its real output about 5.5 percent per annum during the past 4 years, because we have been able to take up some slack as we have been going along. In my view, there is no slack to take up at the present time and, therefore, the real expansion will drop from 5.5 percent to about 4.5 percent in this present year of 1966.

The President himself has forecast an increase in aggregate GNP of about $50 billion, which is nearly 7.5 percent. I point to the disparity between the real gain in capacity of 4.5 percent and the monetary gain of 7.5 percent, which indicates something like a 3-percent price rise. And I believe the President's estimates are low for reasons I have explained.

Senator PROXMIRE. The arithmetic we have been given by Secretary Wirtz and Chairman Ackley and others is somewhat as follows: That the plant capacity is expected to expand about 7 percent in the coming year as a result of increased investment in plant and equipment and so forth.

Our labor supply is expected to expand about 1.6 million. In addition to this, as you have indicated, and others have indicated, there will be about a 3-percent increase in labor productivity.

Now, if you put all these things together, it seems to me this would suggest that there is more give in the economy, more capacity to meet the demand, than the 4.5 percent I understood you to suggest. Do you agree?

Mr. JACOBY. About 4.5 percent is my determination.

Senator PROXMIRE. That arithmetic that they have given us seems to contradict yours. I do not want to go into an extended discussion of this, because of the rollcall on the floor that I must run to now. I apologize for having to stop at this point but I would appreciate it if, when correcting your remarks, you would develop this point further.

Mr. JACOBY. I will be glad to. I believe they are overoptimistic, sir, in estimating both the percentage increase in facilities capacity and in labor supply. This is the nub of our differences, I think.

Senator PROXMIRE. Doctor, Secretary Wirtz and Dr. Ross were quite specific and detailed, and we have had a chance to see their statement. Mr. Ross' was especially good, a 68-page statement, backed up with a lot of carefully worked out statistics showing how the labor supply was going to be made available.

In your prepared statement, you say that the main brunt of reducing inflationary pressure should come from monetary policy.

I am concerned about this for many reasons: first; interest rates are now at their 40-year high; second; if you look at the Economic Indicators, you see that the greatest rise in income of any kind is in interest income. It has gone up 110 percent since 1957. That is even more rapid than transfer payments, much more rapid than anything else. It far exceeds the increase in wages and so forth.

The third point is something that economists are less concerned with than Congressmen, but higher interest rates mean that our service costs on the national debt are going to be increased again, and sharply, because the national debt is bigger. Far more important than any of this is the impact of tight money policy on small business.

We have had testimony from the National Industrial Conference Board that, on the basis of their survey of the thousand biggest firms in the country, that they would not be significantly affected by the increase in December of interest rates. But Mr. Martin stated that this is going to affect business and from this my conclusion is that it is going to affect small business.

When we recognize the strong argument based on economic justice, from the standpoint of what it is doing to our society and from the standpoint of our historical experience with interest rates, it just seems to me this is not a very logical place to put our emphasis.

Mr. JACOBY. Of course, when aggregate demand becomes excessive, somebody's demand has to be cut. There is no popular way of reducing it.

My point is that in the current situation we are confronted with a very volatile war which could either explode and add to public spending vastly, or it could conceivably end. It seems to me that in a situation like this, it would be a mistake to make fiscal policy, tax, or expenditure policy carry the brunt of the adjustment.

I believe you leave yourself in a far more flexible position—something that Professor Solow called for I think quite rightly—if you make monetary policy carry the main brunt of it. Then it can be quickly reversed in the event that the external situation changes.

Senator PROXMIRE. I must leave now. You may finish your remark for the record, if you wish. I do apologize, but if I delay any longer I will be late for that rollcall. I have not missed any since last January, and I don't want this to be the first.

Chairman PATMAN. Mr. Bolling?

Representative BOLLING. Go ahead and finish your statement, Dr. Jacoby, as Senator Proxmire suggested, if you wish.

Chairman PATMAN. Yes, indeed, Dr. Jacoby, and may I say in addition to that, you gentlemen may extend your remarks in connection with any matter you want to clarify or you may add additional points or anything else you may wish when you look over your transcript.

Mr. JACOBY. Thank you. One sentence to complete the thought.

I do believe fiscal policy should make a contribution to the restraint of excessive aggregate demand and I have suggested that the budget for fiscal year 1967 should aim for a cash surplus of the order of $3 to $5 billion instead of the $0.6 billion that President Johnson proposes, which is to me a nominal balance of neutrality, because the supplemental appropriations are going to throw it into a deficit.

Representative BOLLING. Mr. Chairman, I would like to ask the members of the panel a series of specific questions and then a very highly theoretical question.

Are any of you prepared to say at this time that there should be a tax increase? Is the answer "No," from all of you?

Mr. MUSGRAVE. I believe that it might have been good to have some tax increase effective January 1. As I see it, the demand pressure from the budgetary side is strongest during the first half of this calendar year. If it could be put through immediately; yes.

If it takes 6 months, no.

By the same token, I would disagree with Professor Jacoby's point that there should be more tightening for fiscal 1967. I think the fiscal 1967 budget is probably going to become too tight as is, in the first half of the calendar year.

Representative BOLLING. Any further comment by any member of the panel?

Mr. JACOBY. I would prefer to see a substantial cash surplus developed in the fiscal year 1967 through some further restraint on the various Great Society programs, many of which are in incipient stages, and at the time——

Representative BOLLING. Will you specify, please, what kind of programs?

Mr. JACOBY. Well, I am talking about transportation, the urban development programs, the poverty programs, et cetera.

Representative BOLLING. You include all the programs that are directed particularly, and immediately, at welfare? You include the poverty, as well as the construction-type programs?

Mr. JACOBY. Yes. I think there are many of them. I cannot comment on them in detail—I have not looked at them in great detail—but I am sure that many of them which are at a very early stage could be postponed. The demands for military spending are certain to be high, and may exceed our present expectations very greatly.

Mr. SOLOW. I would simply like to disagree as firmly as I can with that view. The last thing in the world that I would like to see happen is for fiscal restraint to take the form of a cutback, particularly in the poverty programs.

I might conceivably be led to go along with a tax increase, provided it were precisely for the purpose of maintaining or even expanding slightly the poverty programs. If a tax increase can be made quickly, if we could agree on that, then, however, I see less reason to do it now.

But I would rather watch and wait.

Mr. BRIEFS. I would like to make a comment.

Representative BOLLING. Surely.

Mr. BRIEFS. I think the question of whether or not we cut back or stay with the existing poverty and other Great Society programs is perhaps put too abruptly this way. We now face a new situation: On the one hand we have to look to a new calculus of the advantages to the Nation as a whole rather than looking at each program separately. And, on the other hand, we have to look at the costs as they now appear, considering Vietnam.

We also have to look at the fact that these programs are trying to get underway very rapidly because of the great pressure that is being put upon them. Some of the difficulties with these programs sound as though they are a product of haste.

It seems to me that at a moment when employment is expanding rapidly, some of the reasons which got us thinking seriously about moving on the problem of poverty and restricted opportunity in the first place, are being diminished.

I see good reasons why one should now reexamine the rate at which we seek to build up these programs.

In short, I think we need a new cost-benefit analysis in view of the situation facing us in Vietnam, and it may very well indicate some shifting is desirable.

Mr. MUSGRAVE. Could I add another word to that?

Representative BOLLING. Yes.

Mr. MUSGRAVE. We must keep in mind that, fiscally speaking, the Vietnam problem is as yet very minor. For instance, if you compare it with the problem that was posed by Korea. We have a situation where Vietnam expenditures are going to increase by $10 billion, which is very small in terms of the GNP context. We have a situation where consumer expenditures are going to go up by about $25 billion, presumably a very small part of which goes to the people concerned with the poverty program. At such a time it seems strange to cut back on an increase in the poverty program which is in the $1 to $2 billion range. This is not anywhere near a war economy; it is a lot more butter economy, with a few more guns.

Representative BOLLING. I would like to stop on that subject and use the last 5 minutes that I have to see if I can get some comment on a highly theoretical question.

Let us assume that Professor Solow is pessimistic with regard to the ability of the Congress in the relatively near future to provide the administration—the President—with a limited flexibility in the up and down of corporate and personal tax rates. It took the United States, I suppose, 25 years to arrive at the point where in reasonably prosperous times we were prepared to cut taxes.

We passed that miracle a year or so ago, as I remember it. We may have two miracles in a decade. But let us assume for the moment that the Congress does do some such thing as this: With very relatively narrow limits, limits that would have, say, an impact of 10 up, 10 down, 5 up, 5 down, could we agree on 5 up, 5 down—in terms of billions of dollars?

What then would be the attitude of the panel toward the appropriateness of the present mix as between monetary and fiscal policy in this specific situation?

I recognize how theoretical it is and I am sure you all understand why I ask it. But what I would like to do is compare the present mix of monetary and fiscal policy with a situation in which we have in my judgment a more adequate set of tools to cope with the problem of inflation.

Mr. SOLOW. I would be prepared to take a shot at that anyhow.

It seems to me that something Mr. Jacoby said is quite right, that we rely as heavily as we do on monetary policy because we believe it gives us that extra flexibility, that ability to respond fast to changes in the objective situation. To the extent that fiscal policy became more flexible, I think we would have to rely less upon monetary policy perhaps both in the up-and-down directions.

I think it is a mistake to believe that the effects of monetary policy on the total spending of the economy are neutral. Tight money hits primarily, although not exclusively, investment expenditures.

Fiscal policy may have a wide range of effects depending on the precise nature of the tax change that is voted.

To the extent that the Congress would like to maintain a rapid growth in the economy, the Congress ought to be interested in preserving a high rate of investment expenditure. To the extent the Congress would like to maintain a high rate of investment expenditures, more burden for restraining demand ought to be placed on the personal income tax and less on monetary policy.

If, on the other hand, the Congress view is the reverse, I think monetary restraint is more appropriate.

Representative BOLLING. Dr. Jacoby?

Mr. JACOBY. I would like to give a theoretical answer, theoretical in the sense of being an abstract answer to your question.

If the President had authority from the Congress to vary tax rates within certain limits, under certain defined conditions, this would, of course, make the tax rate a very flexible instrument of policy. I would say in general it is to be preferred over variations in spending policy. In my view, expenditure policy is a highly inflexible instrument for tailoring aggregate demand on the level that we want. But in this situation, I think this is not quite the choice.

We have a situation not of cutting back large spending programs, but of not initiating them, which is a different thing.

Mr. MUSGRAVE. If flexible tax policy is available, you need not rely as much on monetary policy. You then have a choice. Also, by making a flexible tax policy available, you would gain in your overall ability to be flexible. While monetary policy is highly flexible in having changes initiated, this overlooks the fact that the period needed for changes, once initiated, to affect capital expenditures would be considerably longer than that involved in the impact of tax changes on consumer expenditures. Thus, there would be a net gain in flexibility which would be very important.

Representative BOLLING. Do I gather then in this very vague area that I have taken us, that all of you feel that some such limited flexibility is desirable and that at some point in time it would be nice if the Congress would come up to the modern age in this, too?

Mr. BRIEFS. May I make a comment on that?

The way you formulate the question, I think I would have to agree with what has been said, especially the point Mr. Solow made in respect to the total spending that results from lower interest rates. At the risk of stating the obvious, there remains the political and valid practical problem of whether people like to have their tax rates juggled in the way in which economists and other experts think is appropriate.

Representative BOLLING. I apologize, gentlemen, but my time is up.

Chairman PATMAN. May I continue with just two or three questions.

In regard to price controls, I do not think anyone wants price controls. Having gone through World War II in the Congress on a committee that handled price control and wage control legislation, I believe I know a little something about it.

At that time we tried to deal with 8 million prices and wages—it was a difficult job. One of the most difficult problems we had was the rollback. We have this problem here. If we do not selectively stop increases, we will inevitably have a rollback or some price adjustment that is unsatisfactory. Unless you have almost unanimous consent of all the people which, of course, you can never get, you cannot very well enforce price and wage control laws.

In addition to that, black markets show up, which are very difficult to deal with: and we must handle this situation, I think, as long as we can, by selective methods or any proper ethical, fair method of keeping down prices without putting on price controls clear across the board.

I think we are going to have as much trouble over that as we will have over the war.

I would like to ask one more question on this interest rate: The Federal Reserve action to increase the discount rate in December has boosted lending rates all along the line. This means, of course, that workers and consumers have to pay more in interest on their homes, durables, educational loans, and so forth.

Now, do you not think the effect of this increased cost to wage earners is going to make them press for higher wages just as any other price increase puts upward pressures on wages?

Mr. JACOBY. I have looked into that, and my answer would be it is going to help the wage earner, because the higher cost of money is going to cause many investment projects to be deferred, and to inhibit many other kinds of spending that would otherwise have been made, which would have had inflationary consequences.

It would have forced up the prices of the food and clothing and other things that workers buy, and if the higher interest they pay succeeds in reducing the costs of the other elements which constitute 98 percent or so of the price index, it has done a great good for the worker.

Chairman PATMAN. There was a questionnaire sent out recently to the businesses who spend most of this money and their reply was that they are going ahead with their investment plans just the same; they do not expect much reduction.

That would somewhat be in contradiction of your statement, would it not?

Mr. JACOBY. Not necessarily, because we do not know what business expenditures would have been, had the interest rate increase not occurred.

Chairman PATMAN. They indicated in writing what they would have been.

Mr. JACOBY. And the other point is that maybe interest rates should be higher still.

Chairman PATMAN. What should be higher still?

Mr. JACOBY. The interest rate, causing still further deferral of projects.

Chairman PATMAN. You scare us to death on that. Each time the interest rate goes up, and they have just about doubled in the past 15 years——

Mr. JACOBY. Sir, we are still substantially below the level of interest rates that are ruling in most of the European countries.

Chairman PATMAN. Don't get off on that. You find in South America rates are as high as 25 percent. There are a lot of countries that have lower rates than ours, too, so don't overlook that.

These high interest rates, in my book, are doing more to harm this country than anything else. Anyway, that's my opinion and you have yours.

Now, interest rate increases boost the costs of millions and millions of householders and consumers around the country. By and large, the people who receive this higher interest are in the upper income group, so that there is a redistribution of income in favor of the wealthy.

Have any of you gentlemen ever looked into this and developed any statistics on the subject?

Mr. MUSGRAVE. May I say something to this?

Chairman PATMAN. Yes.

Mr. MUSGRAVE. I believe you are correct in implying that the two approaches differ. Suppose you compare restriction of overall demand through tighter money on the one side with similar restriction through a proportionate increase in income tax rates on the other. The incidence of the monetary approach on income distribution will then be regressive as compared to that of the tax approach. This is one reason why I prefer the tax approach if it is available.

On the other hand, if you use the monetary approach, you restrain the increase in money supply, and a concurrent increase in interest rates is an inevitable byproduct of this monetary restriction. If you stabilize by monetary restriction, the increase in interest is inevitable, its incidence is on the regressive side of a proportionate income tax increase.

Mr. SOLOW. Mr. Chairman——

Chairman PATMAN. Excuse me, sir. Senator Proxmire had not finished his previous questioning and I do not mean to take his time.

Senator PROXMIRE. That is a very good question, Mr. Chairman. I would like to hear more.

Mr. SOLOW. I merely wanted to add one further remark to what Professor Musgrave said.

I agree with him about the incidence of higher rates; I would also say further that the chairman is perfectly right, I think, in asserting that increases in interest rates fall most heavily on those classes of expenditures that are financed by credit; that to the extent that house building is financed on credit, to the extent that education is financed on credit, those are the kinds of expenditures that will be reduced most when interest rates are higher.

Now, if it is desired to decrease, to cut back, restrain some expenditures, this is one way to do it, but one ought not forget which expenditures it happens to be that bear the burden of this.

Chairman PATMAN. Thank you, sir.

Mr. BRIEFS. May I add one comment? Given the fact that we do not now have this flexibility with regard to tax rates, we must compare the incidence of higher interest rates with the incidence of inflation and the incidence of inflation is also regressive.

I think you only get half of the picture if you talk about the fact that high interest rates are particularly burdensome on the poor; the impact of inflation is more burdensome to the poor.

Chairman PATMAN. One comment and I will turn the questioning over to Senator Proxmire.

If we had had the same level of interest rates since 1952 that prevailed at that time, which was several years after the end of World War II, our cost of carrying the national debt today would be $6 billion instead of $12 billion, that is a tremendous amount.

Senator Proxmire?

Senator PROXMIRE. Dr. Jacoby, it appears on the basis of this study made by the National Industrial Conference Board that the thousand biggest firms are pretty much—not completely, but pretty much—interest rate insulated. They have internal sources of financing; they have their own enormous depreciation accounts and they have, of course, their massive undistributed profits, and so forth.

They are in a position where they can make reinvestments, especially since the investment credit has been passed, and other devices.

Now, why would it not be both flexible and not regressive for the Congress to give consideration to a modification of the investment credit?

We have been told that this is one of the most dynamic forces which is stimulating business investment. It would seem to me that if we gave the President discretion to vary the investment credit—it is now 7 percent—say between 4 and 7 percent or 4 and 9 percent, or some figure of that kind, he could act in circumstances like this, and he could act to retard investment by the 75 percent of big business, as well as by all business.

It would have, it seems to me, a much more direct, explicit impact in the accelerator area of the economy.

Mr. JACOBY. I think that cyclical variations of the investment credit is an idea well worth exploration.

Offhand I would be inclined to favor some Executive authority to vary it for this purpose. I would like, however, to comment on the differential effects of a tighter credit policy.

I believe some studies have been made showing the distribution of bank loans by size of borrower under successive periods of credit ease and credit restriction. I recall an article several years ago in the American Economic Review which appeared to indicate that there was no relative reduction in the amount of credit flowing to the small borrower under conditions of tighter money. I think it would be very hard to establish——

Senator PROXMIRE. If I might interrupt at this point, is it not true, however, that some studies have indicated that 1 percent of the people have close to one-half of the wealth, that about 40 percent of the people have no savings whatsoever, and those with low incomes—if they have savings—their savings are very small?

For example, the average savings of people over 65 is, I understand it, something like $500 or $600, so that while you can find some savings on the part of people—many people with low incomes—that their savings are so much less than those in the higher income brackets that there is a regressive effect when you increase interest rates.

Mr. JACOBY. I have not seen any studies that prove it. It does, however, seem plausible to believe that the rising cost of credit is regressive, because the poor obviously make more use of credit than the rich, or are likely to.

But with reference to another point, Senator Proxmire, it is true that the large enterprise often has access to sources of funds that the small enterprise lacks. But that does not mean that a higher level of interest rates does not have any effect on its investment decisions, because when rates are higher, its target rates of return on new investments rise, and projects that might have been feasible under the lower level of return do not become feasible at the higher level, so you do get a restrictive effect on aggregate business investment.

Senator PROXMIRE. Just to counteract that then—and I ask you gentlemen to comment, if you wish—by saying that the National Industrial Conference Board indicated that there would be virtually no slowdown, although this was the third successive increase in the rediscount rate, and although it was clear that they expected interest rates to increase, apparently the marginal investment affected by interest rates is almost insignificant for most of these firms which make 75 percent of our business investment.

Mr. JACOBY. You see, what we don't know is what business would have invested in the absence of the credit restriction that took place. We only know they have not cut back their spending, but they might have spent a lot more.

My observation has been that the investment plans that businesses announce in these surveys always fall short of actuality in a time of expanding demand. The actual investment is larger. Merely to say now they have not been cut back does not prove they would not have been still larger in the absence of credit restriction.

Senator PROXMIRE. Mr. Solow?

Mr. SOLOW. I would like to come back to your remark about the investment credit. If the Congress is in a frame of mind to hand around discretionary flexibility, I think this would be a particularly powerful device that you mentioned, because a reduction in the size of investment credit from 7 to 4 percent or something like that would mean to business not only a somewhat lower profitability on current investment, but the clear prospect that by postponing investment, the 7 percent or perhaps even more could be had at some time in the future.

I think that the effectiveness in controlling, managing the total level of investment expenditure in the economy might be quite considerable. I would favor that.

Senator PROXMIRE. I am sorry, gentlemen, that I must leave for a rollcall, as the signal you hear indicates. I am going to have to read your replies. I do apologize. I would like to come back, if I may.

Chairman PATMAN. Yes, you gentlemen may proceed with your discussion for the record on that question.

Mr. MUSGRAVE. This is a fine idea, but there is the problem, Senator Proxmire, that the timelag between change in investment credit and change in investment plans or capital expenditures may be long. If we changed the credit now, it would not affect capital expenditures in the first half of 1966 and barely in the second.

Consumption changes in response to changes in income tax work quickly. This is the advantage of the income tax change. The investment credit change, I think, is more for the longer swings.

Chairman PATMAN. Are there any other comments?

Mr. BRIEFS. That permits me to get back to the discussion of a moment ago regarding the effectiveness of interest rates. Monetary policy that results in higher interest rates, say, takes effect with a timelag. This has been pointed out by a number of studies. It takes some time to reformulate investment plans. They are not made moment to moment and could not possibly be responsive to marginal changes in interest rates except after the new alternatives have been assessed.

You cannot tell from a circular of the kind that Senator Proxmire described just what the effect of an increase in the interest rate is.

The other point to be made is that it is a mistake, I think, to look at the amount of corporate savings and to say, these fellows don't have to go to the capital market, hence are impervious to higher interest rates. Capital market access is an important part of every business strategy of survival and expansion, and a rise in interest rates in the capital markets has an effect on a company's expansion policies even if it does not go to the capital market. Usually there is a mix of financing both from internal sources and from the capital market.

Chairman PATMAN. Dr. Jacoby, it disturbs me that so many of the great economists of our Nation, including yourself, are always agreeing to higher and higher interest rates. I am apprehensive that you do not consider other alternatives. Specifically, I would like to say that we do not have to have higher interest rates every time you need to retard the economy. There is another method that is much quicker and faster and more effective, which is to increase the reserve requirements of member banks.

You can increase the reserve requirements of banks and that has effect immediately.

Now, I will admit that there is a difference there, that the bankers would have to forgo some of their profits, but in an economy such as ours where our prosperity depends largely upon the purchasing power that gets to the masses, it occurs to me it would be better to ask the bankers to forgo some of their profits in the interest of the economy rather than place the whole burden on the poor.

What is your answer to that?

Mr. JACOBY. Well, Chairman Patman, I am glad we found something to agree on.

I have written a book and several articles on the subject of flexibility of reserve requirements of commercial banks as a tool of monetary policy. In my opinion, it is a tool that should be utilized on occasion, and perhaps we have come to a time when it ought to be. We ought not to rely solely on changes in the discount rate and open market purchase and sales of Federal securities.

Chairman PATMAN. I am glad to hear you say that.

Mr. JACOBY. However, I would like to point this out: In my view, a general rise in the reserve requirements of the commercial banks, the member banks, would probably have about the same effect in the long run as a rise in the discount rate. They would move in the same direction.

Chairman PATMAN. There is a big difference there. You see, if more money should be needed, the Open Market Committee could purchase Government bonds to provide reserves for the banks. In this way the people would get the benefits of it, because the bonds are purchased with Government credit for reserves—although interest under the present practices and regulations is continued to be paid to the Fed on the bonds purchased by the Open Market Committee.

The Federal Reserve now has $40 billion worth. They have been paid for once, as you gentlemen know. The people get the benefit of that interest because most of it flows back into the Treasury. It should not hurt the banks too much because they can expand the reserves that they get by about 10 times. That makes the interest rate very, very low for the banks.

I do not think it is asking the banks to sacrifice too much by raising the reserve requirements when there are plenty of ways to supply them with reserves if they need funds quickly or immediately.

I congratulate you in your interest on the reserve requirements of banks. I do not believe they have ever been raised since 1936.

I was the author of the so-called bonus bill which was to pay 3.5 million veterans an average of $1,015 each after World War I. Everybody said prices would soar as a result of its enactment. Of course, we knew they would not, because people had great need of everything that that money would buy. The Federal Reserve got permission in advance to raise reserve requirements and they doubled the reserve requirements of the banks. This action absolutely offset that great increase in purchasing power to the point where we really had a recession instead of a boom. I do not think reserve requirements have been raised since that time.

The banks have been pretty well favored and have benefited by the actions of the Federal Reserve Board in not raising reserve requirements when it would be in the interest of the people for them to be raised.

I am going to get your books and read them, because I read everything I can on this subject.

Mr. JACOBY. Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I would like to come back to Dr. Jacoby. Dr. Musgrave and Dr. Solow have different views on this, so perhaps they would like to comment.

Dr. Jacoby, in your statement you say something that is hard for me to understand. You say federally enforced wage-price guideposts can contribute little, if anything, to the fight against inflation.

Now, it is my understanding that the wage-price guideposts have been used since about 1962, most conspicuously by President Kennedy in the steel situation. But they were discussed in 1961, I believe, and there may have been some influences that early—but, at any rate, they have been a relatively recent phenomenon in American history, or am I wrong?

Mr. JACOBY. I think what we might call admonitory or hortatory price action by the Executive has been used a long time. I believe President Truman began it.

The specific guidepost relationship was first announced by President Kennedy in his Economic Report of January 1962, and I believe this was one of the first times when there was Federal effort to enforce the guideposts by penalties of various kinds that were to be visited on anyone who violated them.

My argument is against Federal enforcement of the guideposts, I see no harm in them as——

Senator PROXMIRE. I want to come to that argument in a minute. What I want to come to first, I want an answer to that first point.

You say federally enforced wage-price guideposts can contribute little, if anything, to the fight against inflation. It has been my understanding on the basis of many studies in this area that we have a very heavy degree of industrial concentration in this country and a great deal of price leadership and administered prices, and where you have administered prices it is obvious that those who determine prices—in the steel industry, the tobacco industry, the insurance industry, to some extent in the automobile industry and others—they do so with some appreciation of the public relations effect and with some understanding of their discretion here.

Now, since we have such a big sector of our economy in which prices can be determined by a degree of administrative action, it would seem to me that an announcement by the President of the United States that a price increase is not justified, could rightly or wrongly—and that is another argument—but could rightly or wrongly have an effect in restraining that price increase. Certainly what happened in 1962 in steel is evidence that it did stop a steel price increase and it also seems to follow that if the steel prices had gone up, there might have been some domino effect—or however you put it—some influence of the steel price increase on other prices.

Now once again I am not talking about the equity at the moment, I want to talk about that in a minute; what I am talking about is the effectiveness.

Mr. JACOBY. Well, my answer would be that there is little doubt that, in the short run at least, a Presidential statement backed up with all of the penalties the Federal power can evoke on a recalcitrant businessman can have some effect on the price.

In my view, that effect is very short-lived and it might very well be pernicious.

Senator PROXMIRE. Let me interrupt there——

Mr. JACOBY. It is short lived because the real restraint on price increase is the state of supply and demand in the market, and not the administrative power of the steel executive.

Senator PROXMIRE. The steel industry in 1962 did not increase prices and how short-lived was that? When did they increase prices after that? A few months ago they increased some prices, but nothing like the price increase they proposed in 1962. It has been pretty long lived, it has been 4 years at least.

Mr. BRIEFS. May I comment? I think if you take a look at steel, you get one picture; if you take a look at the situation in manufacturing in general, you get a different picture.

I did an analysis in 1960 entitled "Pricing Power and 'Administrative' Inflation" on the relationship of concentration to price increases for three periods, 1953–57; 1947–53; 1957–60. The correlation turned out to be nonexistent.

In other words, there appeared to be no significant association between the percent increases in prices and the degree of concentration. Professors Selden and Depodwin reached the same conclusions in a study published early in 1961 in the Journal of Political Economy.

Senator PROXMIRE. I don't know how anybody could make an argument there would be such a correlation. What I am saying is—if you study the pattern of steel prices—it is just impossible for anyone who believes supply and demand determines prices, to understand how an industry that is operating at 70 percent capacity or less can increase prices; but steel does this.

It makes sense if you are in competition and you have 30 percent of your capacity idle and your optimum capacity is far above 70 percent, that you would reduce prices if you were in competition.

If you are not, of course, either you maintain prices or—if you can get away with it, and it is going to maximize your profits and not diminish your demand too much—you increase prices.

At the same time you can argue that there are other industries with other factors——

Mr. JACOBY. I am not arguing that.

Senator PROXMIRE. There are many reasons for more rapid increase in prices in competitive industries; what I am saying is, however, that in the concentrated industries there is no relationship really to the usual supply-demand competitive situation that disciplines prices.

Mr. BRIEFS. That statement is contradicted by my findings. I used the factor of concentration, as well as other explanatory variables in my study, and the degree of concentration, taken by itself or together with other factors, simply did not "explain" the percent change in prices. My point is that one can look at individual industries and make a study to determine approximately what is "appropriate" in the way of price policy from the standpoint of longer term competitive standards.

But this can be done only for a few highly conspicuous industries about which a good deal is known.

We know more about the steel industry than any other industry. This is one of the industries about which statistics are available. When you go on to other industries, the data become very thin. Attempts to monitor their decisions in the sense applied here would become extremely difficult and policy recommendations would become correspondingly arbitrary.

I think this is the point Professor Jacoby raised. Try to supervise private decisionmaking across the board and you simply cannot do it, from an economic standpoint, as well as from an administrative standpoint.

Senator PROXMIRE. Regardless of what the mathematical equation is—which you can work up. Incidentally, we had a Governor of the Federal Reserve Board who appeared before this committee in December and told us that Brookings had a model of the economy and they put the discount rates increase into it and found the increase in interest rates was inflationary, that it increased prices.

So, what can a Member of the Senate or the House, who, in general, are not professional economists as you gentlemen are—say when they come up here and say, "This is what our model shows."

As you know, frequently there are differences among you very competent people and when that occurs what we in Congress have to do is follow our commonsense to the best extent we can. It seems to me that where you have pricing based on the administrative decision without regard to the level of capacity operation, and so forth, that the President can exert an influence in the public interest by pointing out the consequences of this and by asking for a justification. If a justification is not forthcoming and the industry decides not to increase prices, it seems to me that is a total gain.

I would like to ask Mr. Solow to comment.

Mr. SOLOW. I would like to comment briefly on the specific question about the possible effectiveness of the guideposts.

It seems to me to be beside the point really to discuss whether the effects of hortatory policy are permanent or long life or short life. No one has ever claimed that you can have permanent excess demand and somehow or other keep prices from rising by talking them down.

You gentlemen have no doubt heard quoted to you many times the remark that in the long run we are all dead; in the short run most of us are alive, and it is for short periods of time precisely that one could hope for some effectiveness from the guideposts.

I do not really think that the position that since 1961 the guideposts have been ineffective can be maintained. I was working for the Council of Economic Advisers during 1961 and I confess I was far from certain that this enterprise we were engaged in then would turn out to produce very much by way of price stability. I have been very pleasantly surprised over the years.

In the first place, there are many studies of the sort that Professor Briefs described to you at the beginning of the morning, which relate changes in wage rates to the tightness of labor markets, to the size of profits, to past increases in consumer price level.

All such studies that I know of show that if you plug into those relationships, the level of unemployment during 1964 and 1965, the extremely juicy profits that business has been earning during those periods, and such increases in the cost of living as have occurred, the equations all predict a substantially bigger rate of increase in money wage rates than the facts have shown.

This, of course, constitutes no proof that the guideposts explain the difference, but I have yet to hear a better explanation.

Secondly, I really cannot believe that when businessmen complain that the guideposts are used by the trade union they bargain with as a floor, and simultaneously trade unions complain every day that the guideposts are used by the businessmen they bargain with as a ceiling, that these things are utterly negligible in their effect.

It seems to me you only need to read the newspapers to realize that in every major collective bargaining negotiation, in every major visible conspicuous price increase, there has been a lot of discussion about the guideposts.

I think Senator Proxmire is entirely right, that in heavily concentrated industries, public opinion counts for something, and if public opinion can be brought to bear on what we think to be the socially right side of things, so much the better for public opinion.

Senator PROXMIRE. Yesterday we had our one opportunity in these hearings to get the impression of labor and a business spokesman. It is interesting that the labor position was that the guideposts should not be put into effect until prices started rising more rapidly.

The businessman, while he criticized one aspect of the wage-price guideposts, he approved them, said they are better than nothing, prefers them greatly to controls or increased taxes.

He thinks the are a practical, flexible, voluntary system that he felt was acceptable to business, and enabled business to do quite well and under present circumstances with the Vietnam war, and so forth, were desirable.

Mr. BRIEFS. May I comment?

I do not want to be misunderstood as saying that I am opposed to the guideposts. I think in the past period with the relative slack in economy, they have served here and there a useful purpose.

As we approach full employment and move beyond it, price pressures become much more pervasive, and at that point my argument of a moment ago applies. My prediction is you will not be able to monitor and contain price movements——

Senator PROXMIRE. I think you are right. The guideposts are not the only answer. Of course, there are many other things.

Mr. BRIEFS. I think the guidepost policy has been effective in the time Dr. Solow speaks about, precisely because there were not many problems along that line.

Senator PROXMIRE. Here you have a situation in which there is a target for labor to shoot at and to justify. Labor leaders complain about it, but then they can turn to their rank and file and say, "Fellows, we have this problem. The President has announced this; maybe we are a little over the guideposts; maybe the fringe benefits are 3.6, but at least it is in the same kind of area."

If you did not have that, it seems to me there would be much more of a tendency for labor to shoot higher. Of course, under the present circumstances with the power that labor has, I think they would probably be able to get a better wage. I would agree this certainly is not the only element and the President has indicated that. He has indicated he stands ready to recommend changes in the fiscal policy.

Mr. JACOBY. The problem, Senator Proxmire, as I see it, is not that the guideposts are bad in themselves, I do not quarrel with their use as a voluntary guide, I think they are fairly innocuous. But they are being increasingly used by this administration as a substitute for fiscal and monetary controls of excessive aggregate demand. Viewed for that purpose, I am sure they are not only ineffective, but positively perniciuos.

Senator PROXMIRE. You go on to say they weaken our competitive market system, distort the allocation of resources, fail to deal fundamentally with inflation arising either from excessive demand or inadequate competition.

Then, in your statement, I notice you say, "This contains the disquieting implication that control of the U.S. economy by market competition is generally to be replaced by a new Federal interventionism, in which the iron fist of Federal power will be encased in the velvet glove of 'voluntary' compliance."

In the appliance industry there has been a drop in prices since 1947–49 base period of about 26 percent, a remarkable showing in a period in which prices generally have been going up. Perhaps this example suggests that a competitive industry does not need these wage-price guideposts as far as prices are concerned.

But in the concentrated, noncompetitive sector of the economy, where you have big unions and a very few big companies, it seems to me that you do not have this market discipline you talk about. We do not have a competitive market system.

I know you are an extremely competent economist, but I thought the conservative—or however you want to put it—the economists who emphasize the free market did recognize there is a big sector of our economy which just is not subject to price discipline.

Mr. JACOBY. I do not want to go along with that, Senator Proxmire. I believe the U.S. economy as a whole is much more competitive than is generally believed, and I have never thought that the evils of so-called administered pricing are nearly as widespread as are believed.

The real discipline on the U.S. steel price, it seems to me, is the price of steel in Brussels or in Japan. It is the foreign steel price, the foreign steelmaker who has the opportunity to compete in this market. Actually, one-sixth of all our steel is coming in from abroad now.

This is the real discipline on the U.S. steel price, and indirectly on the U.S. steel wage.

I do not deny that there are some parts of the economy where competition is not as effective as it ought to be. In some labor markets—this may be true in steel, I have never been convinced of it, but I am willing to concede the possibility—I think it is true in some labor markets where we do get efforts to raise wages before there is full employment of those skilled in the trade.

I think we have to attack these problems head on, not with guideposts, which is merely a way of suppressing the consequences of failing to deal with the basic problem.

Senator PROXMIRE. Do you oppose any increase in wages of any kind under any circumstances where you do not have close to full employment?

Mr. JACOBY. I think it should be set by competition, bargaining between the employer and employee.

Senator PROXMIRE. There should have been no wage increases throughout the thirties, no wage increases in the 1950's except in the

Korean war period and except in those areas where you have a shortage of labor?

Mr. JACOBY. I think if our labor markets for the various skills were fully competitive, we could let the market fix the wage, and we would not need guideposts or direct controls of any kind. There are many attacks on this problem. It is being attacked through the Manpower Development and Training Act. I think another good attack would be to have an antitrust law that applied to all kinds of private organizations—firms, unions, and cooperatives, as well as businesses.

Let us have a general antitrust law.

Senator PROXMIRE. As the chairman says, banks, too.

Mr. JACOBY. And banks, too. I guess that makes me pretty old fashioned.

Senator PROXMIRE. I notice most of you gentlemen refer to the Great Society program one way or another. Dr. Solow has somewhat the same position, I believe, as Dr. Musgrave. Let me ask Dr. Musgrave first.

You say, in comparing the choice of a slowdown in the Great Society programs with a tax increase, the slowdown places a disproportionate share of the cost of Vietnam on those least able to bear it. In other words, you are opposed to a slowdown in the programs, and, of course, my bias is to agree with you on this.

But none of you make the point which I think is a point of great importance, that the Great Society programs in their education and antipoverty impact meet the most serious aspect of our inflation problem: They increase trained manpower.

The Secretary of Labor said that several hundred thousand additional people are coming into the labor force in the coming year—having their skills upgraded, I should say—very largely because of these programs and the number is going to increase greatly toward the end of this year and next year.

Now, in view of Dr. Jacob's analysis that the main difficulty is the labor shortage and in view of the common analysis that this is the difficulty, it would seem to me that it would be most shortsighted just from the sheer point of price stability to cut back on the Great Society programs, at least the antipoverty program and the education programs.

Mr. MUSGRAVE. Yes; there are these parts of the Great Society programs which feed directly into easing the structural problem of inflation. As far as these parts are concerned, there is no conflict at all. But even here, I feel that our efforts have been considerably short of what they might have been, and they are short even now.

At the same time, there are other aspects of the new programs which are not immediately reflected in labor market situations. You are going to train children at preschool age, you are going to clean up slums, you are going to do a lot of things which are not immediately reflected in the labor market; and if these programs are carried on at a higher rate, then you have to cut back somewhere else, or else you have to let it be reflected in a higher level of taxation.

Thus, I think to some extent the new programs are helpful even in the short run as far as the inflation problem goes, but in other parts they are not and require some offsetting measures of tax policy.

Mr. JACOBY. I would agree with that distinction Professor Musgrave has made; I think that is quite important.

Senator PROXMIRE. You would except from your criticism of extending now the Great Society programs the educational and the manpower training and the antipoverty-Job Corps program?

Mr. JACOBY. Let me state it more precisely. I would except from my earlier statement that we should defer expansion of Great Society programs those that have a direct bearing on increasing the supply of manpower.

Senator PROXMIRE. Dr. Solow?

Mr. SOLOW. I wanted to make one further comment on the MDTA sort of programs. It is terribly difficult to know how much of the reduction in unemployment we have had in the course of 1964 and 1965 is a consequence of the training and retraining programs.

Secretary Wirtz has used the figure like 300,000 that you mentioned. That is about four-tenths of 1 percent of the labor force.

For some years now we have talked about a 4-percent unemployment rate as "an interim target." The interim arrived during the first week of January in 1966.

If, however, it is true that the training and retraining programs have added something like four-tenths of 1 percent of the labor force to the trained pool, to that part of the labor force which is able to take a more active part in the industrial economy, then it seems to me that suggests that an appropriate unemployment target might now be lower than 4 percent and perhaps something like four-tenths of 1 percent lower than 4 percent, as of now.

By the end of the year it might perhaps be even lower than that.

Senator PROXMIRE. Let me ask on that point, I have asked other witnesses and you are far better qualified than some others who have discussed this: What technically is the effect of having a so-called full employment surplus calculated, No. 1, on a 4-percent level of unemployment, and No. 2, on, say, a 3.5 percent level of unemployment?

As I understand it, the present budget is calculated on about a 3.75-percent unemployment surplus and shows a $500 million surplus for the national income accounts and a $500 million deficit for cash, so it is fairly neutral on that basis.

If you calculate it on a 3.5 percent, which many have proposed in view of the fact we have gone through this 4-percent target, that would mean that this would be a budget that would have fiscal drag in it, it would be a slightly deflationary budget rather than a neutral budget.

Am I correct or incorrect?

Mr. SOLOW. Well, the full employment surplus, as the Council and others calculate it these days, is calculated on the basis that full employment represents 4 percent of the labor force being unemployed. If for any reason whatever 3.5 percent is now a more appropriate definition of full employment, then that means that at full employment the economy would produce rather more output than it would at 4-percent unemployment.

It might produce something like $7 or $8 billion more of output than at 4 percent unemployment; that extra $7 or $8 billion more of output would imply a somewhat higher figure for Federal receipts on income and product account, and therefore a higher surplus.

But I have not at my fingertips any estimate of what the full employment surplus at 3.5 percent unemployment would be.

Mr. MUSGRAVE. If the $8 billion guess is taken as a basis, then it would go up to, say, $2.5 billion.

Mr. SOLOW. The full employment surplus would be 2.5 to 3.

Mr. JACOBY. This would be a process of helping to balance the budget by producing inflation?

Senator PROXMIRE. That depends on whether we can get down to 3.5 percent.

Mr. SOLOW. It would also be a process of helping the economy by producing more output.

Mr. JACOBY. The administration argues that price increases today are merely sporadic and highly selective and few, when, in fact, there is very impressive evidence that they have become general. I refer to the January report of the National Association of Purchasing Agents, in which they list a large number of commodities and reported they found no price decreases and many price increases. Now, this is the first time this has happened. I regard that as a very sensitive and leading index of price action, which is later on reflected in the indexes that we get. This is the basis for my own assessment that we are not just facing potential inflation, we are *in* it; we have moved into it.

Senator PROXMIRE. I just have one more quick question. I apologize again for detaining the committee and the witnesses so long as I have on this round but, as you know, a member of this committee, Congressman Reuss, has introduced a bill to provide that the price-wage guidelines would be reviewed by the Joint Economic Committee. This might give the guidelines a greater degree of recognition, maybe a greater degree of integrity. We would hold hearings on them, and so forth.

We would have no power, of course, to change them, but we would have the authority to consider them.

Now, I want to make sure, Dr. Solow, in view of your last paragraph, where you say:

> I do not believe I would favor formalizing the wage-price guidelines, because we should avoid anything that smacks of price control.

Whether you would prefer to leave them as they are, rather than have Congress move in, in this way, or not?

Mr. SOLOW. It is a tough thing for me to say, because it is hard to know in advance precisely what form the congressional review of the guidelines would take.

I will say this: I think that the particular figure that is publicized and used, the current 3.2 percent, for instance, ought not to be a negotiated figure. It ought not to be something that comes out of bargaining, give-and-take, of business, labor, and representatives of the public generally; it ought to be so far as that is possible a figure that comes out of statistical procedures, relatively impersonal procedures that can be arranged, rather than something that is bargained out and discussed.

I think it would be better, perhaps, if the guideposts were stated in terms of a narrow range rather than a single figure; it would reflect more the degree of confidence that you can put, can honestly put——

Senator PROXMIRE. From a practical standpoint, would it not mean that labor would go to the top of the range?

Mr. Solow. And business to the bottom. And that would leave some room for maneuver. When I say a "range," I do not mean a range between 2.5 and 4.5 percent.

Instead of 3.2 I think I could live with something between 3 and 3.4, something of that sort.

I think that there is very much to be said for review, publicity, discussion of the guidelines, but above all not for bargaining over it.

Senator Proxmire. I take it, Dr. Musgrave, you assent to that?

Mr. Musgrave. Yes.

Chairman Patman. If it is satisfactory to you gentlemen, the members of the committee who could not be here will be given the opportunity of submitting questions to you in writing, and you can answer them when you look over your transcript.

Will that be satisfactory? That applies particularly to Mr. Reuss who wanted you to comment on the question of price-wage guideposts procedures. Mr. Curtis of Missouri has given me a speech entitled, "Guidelines and Wage Laws, How Should Wage Changes Be Determined?" by Prof. Yale Brozen, of the University of Chicago, and without objection it will be placed in the record at the end of the hearings. (See p. 529.)

Chairman Patman. We have another distinguished Member of the House with us, who is not a member of this committee, but he is a regular attendant of this committee. He has great interest in this subject and great knowledge of what we are doing, so I would like to yield to him to ask any questions he would like at this time.

Representative Scheuer. I would like to make a disclaimer of great knowledge, but I do admit to great interest and I wish to thank the chairman for his kindness and courtesy.

I would like to just ask a further question apropos of the questions you have just heard on the real advance of the Great Society programs to the problem of employment. I might make reference to Professor Musgrave's statement that the distribution of unemployment is important, and I think getting away from the theoretical to the practical, the Watts riots and the demonstrations in Harlem proved that in our society-at-large there is a good deal of frustration and unhappiness about the distribution of this very apparently satisfactory unemployment rate of less than 4 percent.

I would like to ask all of you, specifically Professor Solow, a question based on Professor Solow's statement that perhaps the quickest way to reduce the Negro unemployment rate by 2 points is to reduce the white unemployment rate by 1 point.

The overall unemployment rate is now just under 4 points, and white male unemployment, age 25 to 35, is about 1.5 points.

It seems to me that you have gotten to the point where the application of general fiscal and monetary policy further to reduce the unemployment rate is going to be at a great cost—at the cost of producing great inflationary pressures, and I am sure that Dr. Jacoby, who unfortunately is not here now, would agree to that, and I am not sure that that is a cost that we are willing to pay.

The extraordinary cost in the generation of inflationary pressures that we would achieve if we try to attack the unemployment rate, further reduce the overall unemployment rate by general economic and fiscal and monetary policies.

I wonder if when you look at the ingredient elements of the unemployment rate, and I can recall that Secretary Wirtz testified a day or two ago that Negro teenage male and female unemployment rate were presently at the rates of 22 and 27 percent, respectively; whether in view of that, and the structural implications of some of this unemployment, do you not have to put away your shotgun and pick up a rifle and structure programs aimed at mobilizing and energizing these constituent elements in our society that seem to be structurally unemployed and flushing them into the general work force by programs designed to meet their needs and their specific limitations?

Mr. SOLOW. Yes, Congressman Scheuer, I would agree with that fully and wholeheartedly.

What I think I might disagree with is the implications in your question that the choice between moderately expansionary fiscal and monetary policy and these more sharply pointed—aimed, direct manpower policies—that those are strict alternatives.

Representative SCHEUER. I would agree we can employ them both.

Mr. SOLOW. I do not think it is necessary to choose between them.

Representative SCHEUER. But is it not necessary to adopt the second in addition to these mildly——

Mr. SOLOW. Beyond any shadow of a doubt in my mind that at a time like this the payoff to training, education, generally making people ready for the labor market, the payoff to that sort of thing is extraordinarily high.

I would also add this: Among the best practitioners of manpower policy in the United States are the businesses who employ labor. Most of the training and retraining that goes on in the American economy goes on on the job in businesses. There is nothing like some scarcity of skilled and educated labor to induce businesses to find ways to transform unskilled labor into skilled labor, to restructure jobs so that people without a high school education can manage to "sell soap in a department store."

I think that these two sorts of things—the pull from direct labor market policies and the push from a sharp demand for labor—work hand-in-hand much better than either of them can possibly work separately.

Representative SCHEUER. I would like to ask you your reaction to some of the published statements about experience in the Job Corps.

The Director of the Job Corps had a piece in last Sunday's New York Times wherein he said that one of the problems of the Job Corps, the problem of the Negro teenagers in the Job Corps, was markedly higher than the white. Also, that many of the teenagers had such skills and talents and trades that had they been white, they would have had no problem in gaining employment in the general economy and were only in the Job Corps as an unhappy alternative to employment, which they were prepared for and capable of managing.

Do you feel in this connection perhaps that some kind of public employment, public service program on the subprofessional level, the aide category, teacher's aide, doctor's aide, park and playground recreation aide of the kind recommended in the Automation Commission report and that was recommended by a group of 15 Congressmen, might be one of the specific "rifle" approaches which might provide a "halfway house" to employment in the private sector of the economy after a year or two or three, as a complement to the general economic policies which are you advocating?

Mr. SOLOW. Since I was a member of the Automation Commission, I could hardly disagree with that recommendation and, of course, I do not disagree with it. I favor it very much, indeed.

When one finds, as we find now, the combination of concentration of unemployment among Negroes, among young people, and at the same time vast unmet needs in cities, in hospitals, in educational institutions, in very many places in our economy for the sort of work that clearly does not require very sophisticated skills, it seems to me that one could hope with an absolute minimum of added inflationary pressure to get useful things done in the society by instituting a program of this kind and expanding it as opportunity presented itself.

I would be entirely in favor of that.

Representative SCHEUER. Could you also make the point that to the extent you are taking people out of a subgroup status and training them and equipping them to fill jobs which needed filling, and that ultimately some of them will find their way into the private sector and reduce pressures there for scarce labor, that at least insofar as this aspect of that program is concerned, it would be deflationary?

Mr. SOLOW. Yes, I think it would relieve tightness in labor markets and relieve inflationary pressure.

By the way, another important kind of training that goes on in our economy is the holding of any sort of job. The teenagers who now—the very same people, individuals, who now experience an unemployment rate like 20 or 25 percent—will, when they are 25 years old, be experiencing a much lower unemployment rate.

The main respect in which they will have changed is that they will have acquired some job experience.

Mr. BRIEFS. May I make one comment?

Representative SCHEUER. By all means.

Mr. BRIEFS. I think one subpoint missing in the conversation here is the fact there are lags involved. You mentioned 1.25 percent for while males over 25. You seemed to be implying that this would have to go lower——

Representative SCHEUER. What I am saying is the costs we would have to pay in pressing that figure down to generate employment for the Negro teenagers would be so great in terms of inflationary pressures that I hesitate to believe that our society would be prepared to pay that cost.

Mr. BRIEFS. My point is that keeping the rate low will have its effect on the unemployed over time. Such a low unemployment rate represents a degree of scarcity which will only require a little time before it translates itself into employment for formerly submarginal workers. This effect keeps working even though the rate for white males or whatever may stay at a given level and not drop further.

Representative SCHEUER. Professor Musgrave?

Mr. MUSGRAVE. Your general point is very well taken. It seems to me that the role which the private sector plays in retraining, the relative role which it can play, decreases as you get into absorbing groups which for various economic reasons are more or less outside the labor market.

The private sector retrains the people which are readily retrained, that is important. But to get at these other groups, you need a much stronger effort in public policy and the relationship to general inflation is mainly this: If you can succeed to do something about these pockets of real social distress in the overall unemployment structure, you could have a lower unemployment rate with less inflation; moreover, society may then be willing to accept a somewhat higher overall rate of unemployment, and which the inflation cost is smaller has to be paid.

Representative SCHEUER. One last question:

Is it not true also that our private sector, even though there may be pressure for certain kinds of skills and talents, has substantially satisfied its need for employment of those with minimal skills, virtually unskilled labor, the kind of skills that men get when they are finished with the Neighborhood Youth Corps and the Job Corps, and so forth; and, indeed, are we faced with an enormous retraining and upgrading problem of those already employed in the private sector due to the 40,000 jobs a week or 2 million jobs a year that are right now being eliminated by the process of automation which is eating away at the jobs available at the bottom of the pyramid and perhaps through other processes adding jobs in the middle of the pyramid, but raising all of the time on a continuing basis, the level of sophistication and skills required of those in this subgroup who are desperately trying to get on the bottom level of the pyramid?

Is not our private economy almost less and less able each month to bring them out of the bottom and get them onto the lowest level of the pyramid since they had satisfied—in fact, they have a large excess of men over jobs?

Mr. SOLOW. I do not think I agree with that point for the following reasons:

In the first place, it is really extraordinarily difficult to know or to measure to what extent the level of sophistication and training required to hold a job, a decently paying job, in modern industry has changed over the years.

The Automation Commission had some studies made for it on precisely this question and those people who made the studies were unable to produce any evidence that there has been a substantial upgrading in the elementary skills—"worker traits," I guess, is the technical phrase they used—that modern industry demands.

I think the tendency for unemployment to be concentrated among the uneducated and unskilled can be explained without assuming that there has been any very substantial upgrading in the minimum requirements for employment.

It is simply the fact that when there is a pool of unemployment, employers will pick and chose among them, and always we select the best available people—not always, of course, because nothing happens perfectly; but to the extent they can, they will select the best people available to them.

You do not need a high school education to do many jobs for which a high school education is now a requirement. Why?

Because there are people with high school education available for those jobs.

Second, one sometimes tends to think in these terms: There are vacancies for skilled technicians and all the people who are unemployed have no skills whatever to speak of. How can we possibly put those pegs in those holes?

Of course, that is not the way industry does it. The way industry does these things is to upgrade all along the line, and it is the people who now hold the least skilled jobs who move up into the second least skilled jobs.

I think the wartime experience proved this beyond any doubt, and I have little doubt that private industry is even now capable of absorbing more of the currently unemployed population.

Representative SCHEUER. I wish to thank the chairman for his courtesy; and I thank you gentlemen, also, for your responses.

Chairman PATMAN. To you gentleman, please accept the thanks of the committee for your appearance and for your excellent statements and testimony. We appreciate the benefit of your great knowledge.

Without objection, the committee will stand in recess subject to call of the Chair.

(Whereupon, at 12:40 p.m. the hearing was recessed, subject to call.)

APPENDIX

EXTENDED REMARKS AND CONTRIBUTED STATEMENTS RELATIVE TO THESE HEARINGS AND OF VALUE IN A FULL DEVELOPMENT OF SAME APPEAR IN THIS SECTION

59-311—66—pt. 3——10

(The material which follows was submitted by Representative Thomas B. Curtis for inclusion in the record:)

GUIDELINES AND WAGE LAWS: HOW SHOULD WAGE CHANGES BE DETERMINED?[1]

(By Yale Brozen, professor of business economics, Graduate School of Business, University of Chicago)

Before launching into a discussion of how wage rates should be set, the role of the wage guidelines, and the effects of wage legislation, I would like to say a word or two on the general philosophy of social organization which will underlie my remarks.

First, I prefer a system which limits the harm bad men can do. I do not want to live in a system which depends upon finding men with the infinite wisdom of gods and the compassion of a wife or mother for its continued functioning and progress. Nor do I want a system in which big brother tells me what is good for me, which job I must hold, where I must live, or what I must consume. If I wish to be such a fool that I prefer a car with tailfins rather than without, I do not want anyone telling the automobile companies that they cannot produce one for me if I am willing to pay the price.

Also, I do not want a system in which I am prevented from taking a job for which I am qualified because that job is the private preserve of people who belong to a certain union which has a monopoly hold on that job and all similar ones. I do not like a society in which some people are granted privileges or power which others are not allowed to have—a society in which who you are is more important than what you are—in which whose brother you are is more important than the capacities and abilities you possess.

Our country was built by the initiative of individuals—not by the orders of a commanding general or a Great White Father in Washington nor by following the plans of a few men skilled at getting votes. I want to see our system of decentralization and of individual initiative continued. I want to see our freedom to run our own lives and our human rights maintained unimpaired.

In the remarks which follow, I will make the assumption that you, too, prefer a world with individual initiative—not a world in which we take orders from Washington or from privileged groups given power not allowed to the rest of us. I will assume that you, too, prefer a world in which we each have as much freedom as possible as long as the same freedom is allowed everyone else.

I should add that I am heartily in favor of those measures and those laws which maximize wage income and minimize inequality. If the labor legislation which I plan to discuss and the guidelines proposed for determining changes in wage rates were good for labor as a whole, that would be the end of the matter for me. I question the virtue of these measures because they decrease labor income, limit the opportunity to obtain jobs and to engage in meaningful activity, and increase inequality.

In the light of these caveats, let us turn to a discussion of recent proposals to set guidelines for determining wage changes.

GUIDELINES FOR WAGE SETTING

Along with the weather, sex, health, and taxes, one of the most widely discussed topics in America is wage rates. We have had an abundance of guideposts offered for determining the changes which should be made in wage rates. Union strategists have insisted in times past that wage rates should rise when the cost of living goes up, whatever cost of living may mean. They did not accept the converse proposition that wage rates should go down when the cost of living goes down, however. They then argued that a decline in cost of living

[1] Presented before the Wisconsin Manufacturers' Association, Sept. 10, 1965.

meant a depression was coming or had arrived and, therefore, wage rates should be increased to increase purchasing power and prevent a depression.

Another guidepost offered in times past (and last year by Mr. Reuther) concerns the relationship between wage rates and profits. Still another relates wage rates to an acceptable level of living. Most recently, wage rates and changes in them have been linked to changes in average output per man-hour. The General Motors contract of a decade ago provided for changes in wage rates linked to the change in the Consumer Price Index of middle income urban families plus an annual improvement factor which happened to be approximately the same as the increase in output per man-hour in the American economy in the preceding several decades.

Three years ago last January, the Council of Economic Advisers entered the discussion of guideposts for wage rate increases. They were moved to do this because, as they said at the time, "* * * wage decisions affect the progress of the whole economy" and, therefore, "* * * there is legitimate reason for public interest in their content and consequences."[2] They repeated their suggested guideposts in 1964 because, as they said, "If cost * * * pressures should arise through the exercise of market power * * * we would be forced once more into the dreary calculus of the appropriate trade off between 'acceptable' additional unemployment and 'acceptable' inflation."[3]

The economic advisers have advised that: "The general guide for wages is that the percentage increase in total employee compensation per man-hour be equal to the national trend rate of increase in output per man-hour."[4]

The Council has provided a measure of recent trends (1952–64) in the annual rates of growth of output per man-hour in the private economy. They suggest that the latest 5-year trend in productivity, amounting to 3.2 percent, should be the guide for wage rate increases. They seem to believe that if wage rates plus fringes in each industry rise by 3.2 percent, then the average cost of labor will rise by 3.2 percent.

If hourly labor costs increase by 3.2 percent on the average in each industry, however, average compensation per man-hour would rise by 4 percent. Many wage earners obtain wage increases by leaving low-paying jobs (such as those in agriculture) for higher paying jobs without any change in the rates paid for specific positions. The average wage rises, then, without any change in wage rates, about 0.6 to 0.8 percent per year. Netting this out of the 3.2-percent rise in output per man-hour for the total private economy implies that the Council's suggested guide rate would be achieved with an average annual rate of change of 2.5 percent per year in money wage rates (including fringe benefits as part of the wage or employee compensation) in each industry.

The Council does not believe that every wage rate should be increased exactly by the rate of overall productivity increase. Their report says that "specific modifications must be made to adapt [the guideposts] to the circumstances of the particular industry."[5] For instance, they say, "Wage rate increases would fall short of the general guide rate in an industry which could not provide jobs for its entire labor force."[6] Also, they would fall short where "wage rates are exceptionally high because the bargaining position of workers has been especially strong."[7]

BIG WAGE HIKES FOR SOME HURT THE LESS FAVORED

The Council of Economic Advisers should be complimented for its recognition of the fact that wage rates in some industries are too high to permit all those who would like to have jobs in those industries to obtain them. They should also be complimented for recognizing that money wage rate increases must be

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[2] Annual Report of the Council of Economic Advisers, Economic Report of the President (Washington, Government Printing Office, 1962), p. 185. Hereafter referred to as report, 1962.

[3] Annual Report of the Council of Economic Advisers, Economic Report of the President (Washington, Government Printing Office, 1964), p. 117.

[4] Annual Report of the Council of Economic Advisers, Economic Report of the President (Washington, Government Printing Office, 1955), p. 108. This same advice appeared first in the 1962 report where the advisers said: "The general guide for noninflationary wage behavior is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of overall productivity increase" (p. 189).

[5] Report, 1962, p. 189.

[6] Ibid., p. 189.

[7] Ibid., p. 189.

smaller in the future if we are to have more rapid economic growth and decreased unemployment without inflation. The Council recognizes that the upward movement of some wage rates and prices is the result of agreements between strong unions and employers and that "the post-Korean years were marked by the coincidence of relatively large wage increases with declines in industry employment."[8] The fact that unduly high wage rates decrease the number of jobs available and the number of people working in an industry is obviously understood by the Council and is clearly implied in its report.

Several things are left unsaid, however, which should receive explicit recognition. The Council dwells on the inflation which may be caused by large wage rate increases. They fail to recognize that large wage rate increases for some workers come not only at the expense of causing some to become unemployed, absent inflation, but also at the expense of workers in other sectors of the economy.

I would estimate that 10 percent of the labor force of the United States receives wage rates about 15 percent higher than they would in the absence of wage laws and governmental support of trade unions.[9] The result is that 90 percent of the U.S. labor force receives wage rates about 5 percent lower than they would otherwise obtain. The net result is greater inequality in the division of income and about a 3 percent less total wage income for U.S. wage earners, or about $10 billion less than they would otherwise earn as a group (including those whose wage rate is excessive).

To illustrate this in terms of the experience of one State, let us consider some occurrences in Michigan. Wage rates in transportation equipment manufacturing in Michigan not only rose more than in other manufacturing industries in the State, but also rose, between 1950 and 1957, by 10 percent more than in the same industry in the other four East North Central States (Wisconsin, Ohio, Indiana, and Illinois).[10] Overall employment in the auto industry declined in part as a result of overly large employment cost increases. In Michigan, where the greatest increase in wage rates occurred, the decline in employment was greater than for the industry as a whole. Between 1954 and 1958, there were 85,000 more jobs lost in Michigan than in the other four East North Central States. In 1954, Michigan employed 41,000 more workers in transportation equipment manufacturing than the other four States. In 1958, it employed 44,000 fewer workers in the industry than the other States.[11] Michigan became a depressed area, in employment terms, largely because employment costs increased so drastically in its major industry.

Not only did employment in Michigan suffer; in addition, workers in other industries in Michigan suffered. Those becoming unemployed in the transportation equipment industry sought jobs in other fields. Many found jobs in other manufacturing industries. The consequence was, however, lower compensation for those in other industries. More jobs were made available only by restricting the rise in wages which otherwise would have occurred. Hourly earnings in these "other" industries rose 6 percent less than the rise in these same industries in the other four East North Central States.[12] (Employment in these industries in Michigan increased more than in other States, but this is a less productive use of the labor than its employment in transportation equipment.) If wage rates and other employment costs in transportation equipment had not been raised so much in Michigan, hourly earnings would have gone up more in the other manufacturing industries. High hourly earnings for autoworkers came at the expense of workers in other industries.

This brings us to the second point which the Council failed to make explicit in its concern over the inflation impact of unduly large wage rate increases. The power of unions is focused on certain sectors of the economy such as transportation, auto manufacturing, and coal mining. Their use of power and the consent of employers to agreements which incorporate unduly high costs of employment decreases the number of jobs available in these sectors of the economy.

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[8] Ibid., p. 175.

[9] See H. G. Lewis, "Unionism and Relative Wages in the United States" (Chicago, University of Chicago Press, 1963) for the data on which this estimate is based.

[10] Stephen P. Sobotka, "Michigan's Employment Problem: The Substitution Against Labor," Journal of Business, April 1961, p. 124.

[11] The data on which these remarks are based were assembled by Dr. Stephen Sobotka for his "Profile of Michigan" (New York, Free Press, 1963).

[12] Op. cit., p. 124.

Since these are industries in which output per man-hour is high, declining employment in these industries forces men to take jobs in low productivity sectors of the economy. The net result is a lower average output per man-hour for the economy (than otherwise would be attained). Excessive wage hikes in some parts of the economy cause our productivity to rise less rapidly (and average wage income to rise more slowly) than it otherwise would.

The experience of coal miners illustrates this point. Coal mining hourly earnings rose by $1.95 or 163 percent from 1945 to 1960.[13] Bituminous coal mining employment dropped from 384,000 to 168,000.[14] By way of comparison, in the same period, manufacturing production worker hourly earnings rose $1.24 or 122 percent and manufacturing employment rose from 15,524,000 to 16,762,000.[15] The differential in hourly earnings in favor of coal miners increased from 18 to 39 percent. Many of the coal miners who lost their jobs (and men who would have found employment in coal mines) took manufacturing jobs. In these jobs, their productivity and their wage income is lower than in coal mining. If we had more coal miners mining coal and fewer coal miners in other industries today, average output per man-hour in the private sector of the economy would be higher (and the record of the annual rate of increase in output per man-hour would be better), average wage income would be higher, and inequality would be less.

Excessive wage hikes in some industries slow the increase in output per man hour in the economy as a whole for another reason besides forcing people out of high productivity into low productivity occupations. To make men worth employing in coal mining or auto manufacturing at high wage rates, the amounts of capital per man employed must be increased enough to raise the productivity of the men remaining in the industry to the point where employment costs can be covered. (This is the process known as automation.) Concentration of large amounts of the available capital on a few men in these industries reduces the capital available per man in the rest of the economy. With less capital per man, output per man-hour in other industries is lower than it otherwise would be. The distortion in the allocation of capital caused by distortions in the wage structure prevents average output per man-hour from reaching otherwise attainable levels. The result is a poorer record of increase in output per man-hour, a poorer record of growth, and lower incomes on the average for all.

The most important point that the Council has overlooked is that their proposed guides will have no influence on the determination of wage rates. They worry about some wage rates being too high, about the unemployment caused in some areas of the economy by the overpricing of labor, about the slowing in the growth rate caused by increasing unemployment, but suggest no effective means for preventing these unhappy events from occurring. They suggest that "an informed public * * * can help create an atmosphere in which the parties to (wage decisions) will exercise their powers responsibility."[16] This is much like expecting the floodwaters rolling toward a threatened town to stop because an informed public recognizes the tremendous damage that will be done.

If an "informed public" does recognize that it and the country are being damaged by excessive wage increases, and that these excessive wage increases are the result of union power and legislative enactments, what should it do? The Council proposed no action. It seems to be sufficient for the Council that the public recognize that the wage increases are excessive and damaging. The President has added that it is his intention to "draw public attention to major actions by either business or labor that flout the public interest in noninflationary price and wage standards."

It is up to the public, evidently, to figure out what it should do. The Council is not about to tackle this thorny problem. One thing the public might do is to tell the Council to tell the Secretary of Labor to stop raising the minimum wage rates he sets under the powers vested in him by the Walsh-Healy and Davis-Bacon Acts. Last year, he raised a great many rates. Most of these he raised by much more than 2.5 percent; usually by 5 percent or more. Most

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[13] [14] [15] Footnotes not supplied.

[16] Annual Report of the Council of Economic Advisers, Economic Report of the President (Washington: Government Printing Office, 1962), p. 185.

of these rates were excessive before he raised them. According to the Council's guideposts, they should not have been raised at all. He raised rates in one case to $6.10 an hour, surely a clear instance in which the advice of the Economic Advisers would have been to not raise such a high minimum wage rate.

PUBLIC SHOULD ASK FOR REPEAL OF MINIMUM WAGE LAWS

Since the Secretary of Labor has surely read the Council's report, however, I would advise the public to forget about asking the Council to speak to the Secretary of Labor. Instead, the public, and that means you and me, should speak to its Congressmen about repealing the Walsh-Healy and the Davis-Bacon Acts. These are pernicious acts which, on the one hand, increase costs to the Government and increase our taxes, and on the other hand, prevent people from getting jobs who would like to have them.

Additional steps I would suggest to make the Council's advice effective is to reduce the power of labor unions. The public should insist on enforcement of laws during strikes. Assaulting and threatening people on their way to work is against the law in any jurisdiction about which I know. Let us insist upon enforcement of laws.

Still another step I would suggest is the repeal of the increases which have occurred in the minimum wage rate set by the Fair Labor Standards Act. On September 3, there was an increase in the minimum wage from $1.15 to $1.25 an hour for a large group of employees, in addition to the group whose minimum wage was raised to $1.25 in September 1963. This will be and was an increase of 8.7 percent in the wage rate of the very groups now suffering the greatest incidence of unemployment. It is on top of a 15 percent increase made 2 years ago. Not only is this a much greater increase than the 3.2 percent rate of rise suggested by the Council—it is an increase for a group of people who cannot now find jobs. The Council has said "wage rate increases [should] fall short of the general guide rate [in occupations] which cannot provide jobs for their [entire] labor force." [17] The greatest unemployment we have is among the less educated, less skilled, low productivity, low wage groups. Teenage unemployment amounts to 13 percent and Negro unemployment is 9 percent. The Council's advice points strongly to the inadvisability of any wage rise in this group, much less an 8.7 percent increase.

Certainly, this is not a time to enact still higher minimum wage rates. Yet, a bill is now before Congress which would increase rates from $1.25 to $1.75 in three annual steps and extend coverage to 7 million additional jobs (H.R. 10518). This must be stopped or we will find the number of applicants for the Job Corps skyrocketing.

We have seen the damage done by previous increases in the minimum wage rates. Newspapers a few days ago reported 1,800 women discharged in crabmeat packing plants in North Carolina because of the increase in the minimum from $1.15 to $1.25 which went into effect last week. When the rate was increased from $0.75 to $1 in 1956, unemployment among workers under 19 and females over 45 rose, despite an increase in total employment by 1.8 million in 1956 over the levels prevailing in 1955 and a decline in unemployment in all other groups.[18] Normally, increasing employment decreases unemployment in all groups. It failed to do so in 1956 because of the overpricing of less skilled workers.

I remember vividly a dramatic example of the effect of the increase in the 1956 minimum wage. I visited friends in Nashville late in 1956 and remarked on the fact that they had acquired a maid since my previous visit in 1955. They told me that they had hired a Negro girl because wage rate of maids had dropped, and they had to pay only 50 cents an hour. I expressed my astonishment and asked what had happened. They told me that local textile mills had been hiring girls at 80 cents an hour in 1955. When the minimum wage rate went up to $1 an hour in 1956, many of the mills reduced their work force and were no longer hiring Negro girls.[19]

Similar results occurred in 1950 when the minimum wage rate was raised from 40 cents to 75 cents an hour. Prof. John Peterson of the University of Arkansas found, from surveys of large southern pine sawmills before and after the imposi-

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[17] Report, 1962, p. 189.
[18] Report, 1962, p. 232.
[19] See Y. Brozen, "Minimum Wage Rates and Household Workers," Journal of Law and Economics, October 1962.

tion of the 75-cent minimum wage in January 1950, that 17 percent of the workers in mills whose average wage had been below the minimum lost their jobs.[20]

When the Fair Labor Standards Act came into operation in October 1938, workers in the seamless hosiery industry in western Pennsylvania suffered unemployment. The imposition of a minimum wage rate of 25 cents an hour at that time caused layoffs and a drop in employment in western Pennsylvania at the very time when employment in the United States was rising.

In addition to the actual unemployment caused by increased minimum wage rates, there is also a decrease in the opportunities for youngsters to obtain training to prepare them for productive employment. To put this in terms of a specific example, an automobile parts jobber testified "We had always had a training program for new employees which in itself is expensive, and when the minimum wage was increased, we had to discontinue this training program and hire only people as we needed them on a productivity basis. In other words, the average number of employees that we now have is about 5 percent lower than before the minimum wage was increased."

I could go on giving illustrations of the unemployment caused by minimum wage laws and their effect on freedom of choice among occupations, but this should be sufficient to illustrate the point. Instead, let me turn to another kind of minimum wage imposition and its effect.

We are very concerned in Chicago about the large number of adolescents who drop out of high school and are unable to find jobs. The problem manifests itself in part in high juvenile delinquency rates. These boys would like to engage in some kind of activity, preferably filling a job. Many of them used to be employed as elevator operators at $1 to $1.25 an hour. The elevator operators union has succeeded in imposing a minimum wage of $2.50 an hour for operators in downtown Chicago buildings. The result is that owners of buildings have found it economic to spend $30,000 per elevator to automate their lifts and make them self-operating. Since the tax, insurance, depreciation, and interest costs of automating an elevator amount to $8,000 per year, it did not pay to automate when two shifts of operators cost only $5,000 per year. The union has succeeded in driving the two-shift cost of operation to over $10,000 per year. The result is elevator automation, no jobs for elevator operators, and a policing problem of unskilled teenagers, which is getting out of hand. I think this example speaks for itself. Thirteen percent of the teenagers who would like to have jobs cannot find them because of the minimum wage rates set by law, by the Secretary of Labor, and by unions.

Perhaps I should quote the words of a U.S. Senate report at this point. "The conditions of insecurity and hopelessness that characterize the lives of many unemployed young people threaten their acceptance of traditional American ideals. What they need and cannot find is jobs. Given jobs, many of them will make a successful transition into the adult world and a useful contribution to the Nation's strength. Without jobs, continuing moral degeneration is inevitable."

UNIONS AND THE GUIDELINES

The power of unions to prevent people from taking jobs they would like to have is a major factor in causing some people to suffer the circumstances described in this Senate report. Perhaps it is an anticlimax to add that the power concentration in union hands is also a major factor in causing some wage rates to rise much more rapidly than the Council of Economic Advisers' guidelines would allow. Yet the Council made no suggestion for limiting concentrations of power. It simply offered some meaningless rhetoric about the necessity for having an informed public opinion as a way of enforcing its suggestions.

There is quite a list of actions the Council could have suggested which would make its words meaningful. The fact that its words are not is demonstrated by a series of wage rate increases which have occurred since their guideposts were suggested wage rate increases exceeding 3.2 or even 4 percent. The New York electricians' increase is a notorious instance. Typographers on New York newspapers struck for a 26-percent increase in compensation, surely an amount far in excess of 3.2 percent. Longshoremen were granted an 8-percent increase as a result of the pressures exerted by the Federal Government during a strike. The

[20] "Employment Effects of Minimum Wages, 1938–50," Journal of Political Economy, October 1957.

teamsters and truckers negotiated a contract providing a 5-percent annual increase just a year ago.

In the first 6 months of this year, the average wage increase in new settlements amounted to 4 percent exclusive of increases in fringe benefits. One-third of the workers covered by new settlements received increases of 5 percent or more. The agreement negotiated last fall between the Communication Workers and the Michigan Bell Telephone Co. provided a 5-percent increase in wage rates and fringe benefits. The UAW won a 4.9-percent annual increase for each of 3 years just last fall. This is 50 percent higher than the guideline.

The Council's guidelines for wage setting are meaningless in either informing the public, providing a guide for employer-union bargaining, or for guiding employers who have no union with which to contend. Certainly, no one has paid much attention to the Council's guideposts, except where unions have used them as an argument for getting a bigger wage increase than they might otherwise be able to justify. However, they are meaningless for very good reasons other than the fact that no one uses them.

SHOULD MONEY WAGE RATES BE RAISED 3.2 PERCENT PER YEAR

First, the increase in average output per man-hour is highly variable year to year. The overall trend of several past years has no necessary relationship to the change in any one year. If you examine productivity changes from year to year, you will find that average output per man-hour decreased between 1920 and 1921, increased between 1923 and 1924, decreased between 1926 and 1928, decreased again between 1929 and 1933, etc. This is highly variable behavior. Any constant rate of increase even in real wage rates, much less money wage rates, would result in unemployment in some years, shortages of labor in other years, and allocation of much labor to the wrong places every year.

Aside from the fact that past output per hour trends do not provide a guide for real wage rate changes in a specific year, they are of no help at all in judging proper changes in money wage rates. Money rates fell from 56 cents an hour in 1920 to 52 cents an hour in 1921—a 7-percent decrease—yet real wage rates went up 4 percent because of an even greater decline in the consumer price index. If money wage rates had been increased 3 percent between 1920 and 1921, we would have had a 14-percent rise in real wage rates and 10 million unemployed instead of 5 million in 1921.

The Council pays little attention to the possibility that real wage rates may increase through a declining level of product prices as well as by a rising level of money wage rates. In view of our balance-of-payments problems at this time, this should be the preferred method of raising real wage rates.

A GUIDE FOR WAGE SETTING

If we are going to engage in the sport of setting guideposts for wage increases, I would like to enter a candidate. I would like to suggest my guidepost in the form of an answer to the question of "How can employers recognize the circumstances which dictate a change in the wage level or wage structure?" Of course, any time a company's profits fall or it incurs a loss, it would like to decrease its wage costs. In some cases, this may be the proper action to take. But, in other cases, a decrease in wage rates may increase costs or may cause the company to lose even more.

On the other hand, when profits increase, as they did for General Motors last year, for example, should wage rates be raised? Again this may or may not be the proper action. It depends upon the circumstances. How can we tell what to do, then, if the proper action is not directly related to profitability?

The best single guide to the proper action is the relationship of the quit rate of currently employed persons to the rate of receipt of qualified applications for jobs. If the quit rate in a given company exceeds the qualified-applicant rate, the wage rate may be too low. People do not ordinarily quit jobs in appreciable numbers unless alternative jobs are available which are more attractive than those they are leaving. If the quit rate is high, we would probably find that better paying jobs, or jobs more attractive for some other reason, are available. A low qualified-applicant rate also indicates this sort of situation. Retaining a work force, then, may require an increase in the level of wage rates.

Now you may notice that my suggested guideline is in the form of advice to employers. I am not interested in getting the public into the act, nor in getting government into the act. The only people in the act should be those who are employing men and the men who would like to have the jobs. (This is true for the determination of overtime rates as well as straight time wage rates. We should not impose penalty rates by law on employers for employing men over 40 hours a week. If men desire additional income, wish to work more than 40 hours per week, and are willing to do so for rates less than those required by the Fair Labor Standards Act, that should be their privilege as freemen.)

Further, you may notice that my advice to management is hardly necessary. It simply says, pay as much as you must to obtain the labor force you require, but do not pay any more than you must. Any company not trying to do this is not a business—it is a philanthropic operation. How long it can survive depends only on how long it can go on giving money away, or perhaps, how long the stockholders are willing to hold stock in a company giving away their money.

Also, any company paying higher wage rates than it must to attract the work force it wants to keep turnover rates as low as it is profitable is not serving the public well. It is providing fewer jobs than men would like to have and less product than its customers would like to have.

If employers will follow their own interests by raising wage rates only when their quit rates go up, or threaten to do so, they will be serving the economy as well as their own interests. As you can see from table 1, the quite rate is low when unemployment is high. This, then, is an inappropriate time to raise wage rates. To do so would restrict the number of jobs at the very time when more jobs are needed. The number of jobs available is a decreasing function of the wage rate, other things equal.

TABLE 1.—*Valley and peak monthly quit rates and unemployment*

Year	Quits [1] (per 100 employees)	Unemployment [2]	
		Number (millions)	Percent of labor force
1932	0.9	12.1	24
1937	1.5	7.7	14
1938	.8	10.4	19
1943	6.3	1.1	2
1949	1.9	3.7	6
1951	2.9	2.1	3
1954	1.4	3.6	6
1956	1.9	2.8	4
1958	1.1	4.7	7
1959	1.5	3.8	5
1961	1.2	4.8	7
1964	1.5	3.9	5

[1] Economic Report of the President (Washington: Government Printing Office, 1962), p. 243. Manpower Report of the President (Washington: Government Printing Office, 1965), p. 238. Quit rates are for manufacturing industry.
[2] Report, 1965, p. 230.

The fact of this inverse relationship is demonstrated in table 2. Since this gives wage rate history, other things have not remained equal from year to year. Therefore, in order to allow for the other things which have changed, wage rate movements are measured relative to movements in output per man-hour. You will notice that when wage rates increase more than output per man-hour, unemployment increases. On the other hand, when wage rates increase less than output per man-hour, unemployment drops (see table 3).

I do not want to be understood to be saying that wage rate changes should be determined by changes in output per man. Wage rates are determined by productivity (marginal value products, to put this in technical, economic terms), not by average output per man-hour, despite the fact that this latter measure is sometimes called productivity, to the distress of the Bureau of Labor Statistics and any economic theorist. However, this distinction is better left for discussion at another time.[21]

[21] See Y. Brozen, "Manpower, Productivity, and Costs" (Chicago: University of Chicago Industrial Relations Center, 1963).

The important point is that voluntary quite rates at the plant level tell us something about the state of the labor market in which the plant operates. If unemployment is high or other jobs available are not more attractive in pay or other terms than those at your particular plant, then your quit rate will be low. Wage rates need not and should not be raised in these circumstances.

The relationship between quit rates and wage rates is shown in table 4 for a depressed year and a prosperous year for several segments of the economy. You will note that low wage industries have higher than average quit rates even in a depressed year such as 1961 as well as in a prosperous year such as 1964.

Movement of productivity, wage rates, and unemployment (in periods of rising unemployment)

Year	Hourly earnings [1] (manufacturing) (1961 dollars)	Percent change	Average productivity (private nonfarm)	Percent change	Change in productivity relative to wage rate	Unemployment (millions)
1929	0.99		1.88			1.6
1933	1.02	3.6	1.81	−3.4	−7.0	12.8
1937	1.30		2.21			7.7
1938	1.33	3.0	2.25	+2.0	−1.0	10.4
1948	1.73		2.81			2.1
1949	1.82	5.2	2.90	3.2	−2.0	3.4
1952	1.99		3.28			1.7
1954	2.14	7.5	3.46	5.5	−2.0	3.2
1955	2.24		3.63			2.7
1958	2.38	6.3	3.74	3.2	−3.1	4.3
1959	2.46		3.91			3.5
1961	2.56	4.1	4.02	2.8	−1.3	4.5

[1] Includes supplementary compensation.

Movement of productivity, wage rates, and unemployment (in periods of declining unemployment)

Year	Real hourly earnings [1] (1961 dollars)	Percent change	Average productivity (private nonfarm)	Percent change	Percent change in productivity relative to wage rate	Unemployment (millions)
1933	1.02		1.81			12.8
1936	1.20	17.4	2.16	19.4	2.0	9.0
1938	1.33		2.25			10.4
1940	1.42	6.8	2.42	7.6	.8	8.1
1949	1.82		2.90			3.4
1953	2.09	14.6	3.37	16.2	1.6	1.6
1954	2.14		3.46			3.2
1955	2.24	4.6	3.61	4.7	.1	2.7
1958	2.38		3.74			4.3
1959	2.46	3.3	3.91	4.2	.9	3.5
1961	2.56		4.02			4.5
1964	2.74	7.0	4.40	9.4	2.4	3.5

[1] Includes supplementary compensation.

Wage rates and monthly quit rates, 1961 and 1964

	1961		1964	
	Quits	Hourly earnings	Quits	Hourly earnings
Manufacturing	1.2	$2.32	1.5	$2.53
Durable goods	1.0	2.49	1.3	2.71
Primary metal	.5	2.90	.8	3.11
Lumber and wood	1.9	1.95	2.8	2.14
Nondurable goods	1.4	2.11	1.7	2.29
Petroleum refining	.5	3.01	.6	3.37
Leather	2.1	1.68	2.4	1.82
Nonmanufacturing:				
Metal mining	1.0	2.74	1.5	2.95
Coal mining	.4	3.12	.4	3.26

You may also note that the primary metal industry has the lowest quit rate among all durable goods manufacturing industries. This is interesting in shedding some light on the appropriateness of the large increase in wage rates just negotiated in the steel industry last week. The steel industry's quit rate was running at a 0.6-percent rate in April and May of this year, the lowest rate to be found in any durable goods industry with the exception of flat glass, cement, turbines, and passenger car bodies. These are all industries either with exceptionally high wage rates or suffering from large layoffs. This would seem to indicate that the wage increase should have been much smaller in the "bargaining" just concluded if the economy were to be well served by avoiding undue restriction of employment opportunities, given the preference of the present steel labor force for these jobs rather than being forced into alternative employments. When we consider our balance-of-payments difficulties and the rising tide of steel imports, there is all the more reason to believe that the steel settlement was much more costly than it should have been.

In advising that quit rates should be the primary indicator in determining the appropriateness of a wage change, all I have really said is that wage rates should be set at the levels at which free markets would set wage rates. Perhaps this might be better said by using a quotation from Henry C. Simons. He pointed out that: "The proper wage in any area or occupational category is * * * the wage that will permit the maximum transfer of workers from less attractive, less remunerative, less productive employments * * *. We imply that any wage is excessive if more qualified workers are obtainable at that wage than are employed—provided only that the industry is reasonably competitive as among firms. Reduction of rates (in these circumstances) would permit workers to enter who otherwise would be compelled to accept employment less attractive to them and less productive for the community or to accept involuntary unemployment.

"The basic principle here is the freedom of entry—freedom of migration, between localities, between industries, between occupational categories. If such freedom is to exist * * * wages must fall to accommodate new workers in any area to which many qualified persons wish to move. Freedom of migration implies freedom of qualified workers, not merely to seek jobs but to get them; free entry implies full employment for all qualified persons who wish to enter. Whether the wage permits an adequate family scale of living, according to social service workers, is simply irrelevant * * *. What really matters is the judgment of workers who would be excluded by an excessive wage as to the relative merits of the employment in question and of employment in less attractive alternatives actually open to them. Other things being equal, the wage is too high if higher than the wage in actually alternative employments. Ethically, one cannot go beyond the opinion of qualified workers seeking to transfer. If in large numbers they prefer employment here to the alternatives and cannot get it, the wage is excessive." [22]

CONCLUSION

I should add that the Council of Economic Advisers itself believes this, although it tries to avoid saying so. The Council does not think much of its own guideposts and prefers the one suggested here. (I will demonstrate this shortly.)

What frightens me about the Council's discussion of guidelines for the economy is the implication that they know how to make wage decisions and price decisions which are in the public interest. Some idiot is likely to take this seriously and set up a regulatory agency to set wage rates and prices. It is not a long step from setting guidelines for the economy to guiding the economy. Down that road lies the path to tyranny.

That the possibility is real is evidenced by the appointment 2 years ago of a member of the Council who believes the Government should set up an industry economics agency which would set specific prices and wage rates—not just generalized national guidelines—and which would hold corporations over a certain size and unions to "new standards of public accountability." The Council has not yet gone this far, but there is talk about a so-called early

[22] Henry C. Simons, "Some Reflections on Syndicalism," Journal of Political Economy, March 1944, reprinted in H. C. Simons, "Economic Policy for a Free Society" (Chicago: University of Chicago Press, 1948), p. 141.

warning group to watch for price and wage changes which do not conform to the guidelines.

The Council of 3 years ago did not even take its own rule for wage setting in terms of change in output per man-hour seriously. After offering its general rule it said, "wage rate increases would exceed the general guide rate in an industry which would otherwise be unable to attract sufficient labor." [23] This, of course, is what any employer does when he finds he cannot obtain as many employees as he wishes. He bids a higher wage to attract more people, frequently bidding substantial premiums above even union set wage rates when he cannot find enough men. Also, the Council said, "wage rate increases would fall short of the general guide rate in an industry which could not provide jobs for its entire labor force." [24] This, of course, usually occurs in markets where there are large numbers of unemployed men and no legal minimums or union power prevent this. What the Council has said in these statements is that supply and demand in free markets should determine wage rates. To this, I say, amen.

THE FEDERAL GOVERNMENT AND WAGE-PRICE GUIDELINES, 1962–66

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BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, February 28, 1966.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. CHAIRMAN: For inclusion in the record of your committee's hearings on the President's 1966 Economic Report, I am enclosing my answers to questions submitted by Senator Javits as transmitted by Mr. Knowles in his letter dated February 3, 1966.

Sincerely yours,

WM. McC. MARTIN, Jr.

ANSWERS BY CHAIRMAN MARTIN TO QUESTIONS FROM SENATOR JAVITS FOR INCLUSION IN RECORD OF JOINT ECONOMIC COMMITTEE HEARINGS

1. 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?

In general, I would agree with Secretary Fowler's statement before your committee to the effect that communication between the Federal Reserve Board and the other agencies of Government concerned with economic policies has been excellent. I believe that what is sometimes described as a failure of coordination last December arose not because of any breakdown in communications, but because the majority of the Board of Governors were convinced that the time had come to act, even though they knew that administration officials counseled delay.

The requirements of Senate Concurrent Resolution 73 were met in the period leading up to the Board's actions of December 3, I think, with two exceptions. The two exceptions were (1) that the meetings of the Quadriad in 1965 were not held "at regular intervals" and (2) that I did not notify the President that the Federal Reserve Banks of New York and Chicago had proposed increased in their discount rates. On the first point, I see no particular advantage in fixing a regular meeting day for the Quadriad, which now meets at the call of the President. The present flexibility allows meetings to be timed so as to coincide with developments as they unfold in the economy. While I see no objection to specifying a minimum number of meetings per year, there were, as you know, more meetings in 1965 than the minimum specified in the resolution. As to the second point—notifying the President of any action taken by a Reserve bank to initiate an increase in its discount rate—it should be understood that these actions were taken by the two Reserve banks on December 2. I had informed the President on October 6—almost 2 months earlier—that I believed a discount rate rise was necessary. I had hoped to discuss the matter with the President further, but his surgery and convalescence intervened, and a meeting that I had expected to take place on November 26 was canceled. But my efforts to keep the Secretary of the Treasury informed of developments included notifying him on the morning of December 3 that an increase in the discount rate would be considered that day by the Board and that I would vote for it. I believe that the President is entitled to, and was given, more information, sooner, than he would get from the notice contemplated in the resolution.

The resolution states a premise that I would expect all to agree upon: There should be "full and free exchange of views and information among the agencies of the Government exercising primary responsibilities in fiscal and monetary affairs." While judgments obviously may differ, I believe that the efforts of the people involved to establish this kind of coordination have been highly successful. We should, of course, try to do even better, and I believe that this effort will continue, whether or not Senate Concurrent Resolution 73 is adopted.

2. 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?

On October 6, 1965, as he had several times previously in that year, the President met with the Secretary of the Treasury, the Director of the Bureau of the Budget, the Chairman of the Council of Economic Advisers, and myself. At the meeting, I expressed the view that the 4½-percent ceiling on interest rates banks could pay on certificates of deposit should be raised and that this would entail a simultaneous increase in the 4-percent discount rate. In the course of the discussions, the President requested that an assessment of the outlook for economic activity and for prices be prepared and presented at a subsequent meeting, to be held in 2 or 3 weeks. Members of the staffs of the four agencies, working together, prepared such an analysis and presented it to their four principals early in November. Although the meeting projected for November was canceled, the regular meetings between Treasury and Federal Reserve representatives continued; that is, I met regularly with the Secretary of the Treasury and his associates on Mondays, and on Wednesdays the Under Secretary of the Treasury for Monetary Affairs and his associates met with me and other members of the Board and its staff. Throughout, I kept other members of the Board abreast of the views expressed by administration officials, and the Board members were informed of developments in the economy as the data became available, through the regular briefings, memorandum, and discussions that are a continuing part of the Board's operations.

Administration officials knew that the actions that eventually were taken by the Board on December 3 were under active consideration and that I favored taking them. The Board members knew that the Administration advocated a delay. The differences in judgments were due not to a failure of communications, but to differing assessments of the need for action.

3. 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?

Ordinarily, the meetings of the Quadriad have not produced policy papers. Rather, we have reasoned together in a less formal atmosphere. On occasion, however, members of the Quadriad and their staffs have produced papers for presentation at the meetings. The information and views contained in these papers have been given to the Board, although the papers themselves have not been distributed. The texts can be readily reproduced for distribution, however, and henceforth those that are distributed at the meetings will be distributed regularly to Board members.

4. 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?

Although it was evident that developments in Vietnam were requiring significant upward revisions in Federal spending plans over the balance of fiscal 1966, the Board did not have the Administration's figures for the fiscal 1967 budget (if, in fact, those figures had been determined). In my judgment information about the proposed new budget was not relevant to the decisions the Board then made. The 4½-percent ceiling on certificates of deposit and the 4-percent discount rate were unrealistic in the light of market conditions prevailing not only on December 3 but for several weeks before. Although the President announced his budget proposals in January, their true impact will be felt 6 to 18 months later, as the Government's total tax and expenditures policies are translated into action.

I find it difficult to add to what has already been said regarding the extent to which the Board was informed about the Administration's estimate of the economic outlook. The underlying economic data were presented to the Board and analyzed by the Board's staff in memorandums, briefings, and discussions. Certainly in broad outline the Administration's point of view was communicated to the Board. If my efforts in this direction were not enough, the deficiencies should have been remedied by the public statements of three Cabinet officials in the week preceding December 3, which were called to the attention of the Board.

5. *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?*

For the reasons given above, I would not.

6. *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?*

The concern that has been expressed about the informality of the present arrangements is somewhat puzzling to me. In part, this seems to reflect a belief that the arrangements should be reduced to writing and promulgated, perhaps by Executive order. While there may be some advantage to this kind of formality, there is at least a possibility that procedures for coordination would then be harder to change, and thus less easily improved. The fact that the regular meetings between the Federal Reserve and the Treasury take place at lunch has occasioned some comment. The meetings between the Council of Economic Advisers and the Federal Reserve, which have occurred at irregular intervals in the past but which are now scheduled to be held every 2 weeks, are also luncheon meetings. I see no reason to prevent busy men from having lunch while they talk. Nor do I think that conversations are any less fruitful at an informal lunch than they would be at a formal 10 o'clock meeting without so much as a cup of coffee. In the end, it seems to me that personal relationships rather than formal procedures are primary in facilitating communication and cooperation.

Delaying the December 3 action by 4 to 6 weeks might or might not have meant that it could then have been taken with greater agreement within the Board or with the endorsement of the administration. No one can be sure of that. But in my judgment action was already overdue when it was taken. I cannot say what decisions might have been made by the administration between December 3 and January 14 if the Board had waited; I can say, however, that no decisions were made in that period which would have given me cause to change my vote had I known of them on December 3. I do not mean by this that any such decisions ought to have been made. On the contrary, I believe that conditions prevailing in the economy in the weeks preceding December 3 called for the actions the Board then took, without regard to the decisions on tax and expenditures policies that are to be made in 1966. The economic intelligence that has since come to light supports the view that the actions taken by the Federal Reserve on December 3 were correct, and should not have been delayed further.

7. *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?*

The members of the Quadriad draw upon the staffs of their respective agencies where needed. I see no reason to establish a separate staff for Quadriad meetings.

The following material was submitted in response to Senator Proxmire's request during the hearings, February 4, 1966. (See p. 271 of pt. 2, hearings.)

FEBRUARY 11, 1966.

Hon. WILLIAM PROXMIRE,
Senate Office Building,
Washington, D.C.

DEAR SENATOR: Pursuant to your request, I am sending you some material in regard to gross farm income in the range of $5,000 to $25,000.

The 2 pages enclosed are from the current "Farm Cost and Returns." You will note that a number of different types of farming are included in the tables. I am calling your attention particularly to the dairy farming figures in Wisconsin. In east Wisconsin dairy farmers grossed $9,773 and had a net income of $3,332. In west Wisconsin dairy farmers grossed $8,673 and had a net income of $2,837.

In the Corn Belt hog-dairy farmers grossed $18,258 and had a net income of $7,173. In the spring wheat Northern Plains area wheat, small grain and livestock farmers grossed $14,673, and had a net income of $8,690.

I hope this material fulfills the requirements of your request. We will appreciate it being incorporated into the records of the hearings.

Sincerely,

ANGUS MCDONALD,
Director of Research.

TABLE 1.—*Net farm income, specified types of commercial farms, 1964, with comparisons*

Type of farm and location	Average 1951–55	Average 1956–60	1963	1964 [1]
Dairy farms:				
Central Northeast	$3,753	$4,196	$4,101	$4,178
Eastern Wisconsin:				
Grade A	4,859	5,330	6,005	6,541
Grade B	2,509	2,496	3,257	3,332
Western Wisconsin, grade B	3,032	3,350	4,831	2,837
Dairy-hog farms, southeastern Minnesota	4,016	3,878	4,545	3,904
Egg-producing farms, New Jersey	4,130	2,751	2,093	2,470
Broiler farms:				
Maine	2,060	2,962	3,665	3,692
Delmarva:				
Broilers			2,241	2,433
Broiler-crop	4,002	4,816	5,954	6,022
Georgia	1,111	963	803	718
Corn Belt farms:				
Hog-dairy [2]	5,142	6,728	6,850	7,173
Hog fattening—beef raising	3,442	3,620	3,953	4,395
Hog-beef fattening [2]	7,918	8,346	7,006	8,643
Cash grain	8,412	7,400	11,374	12,205
Cotton farms:				
Southern Piedmont	2,068	2,010	2,891	3,274
Mississippi Delta:				
Small	1,945	1,742	2,708	2,383
Large scale	23,192	21,656	40,167	34,623
Texas:				
Black Prairie	2,727	2,544	5,302	4,668
High plains (nonirrigated)	3,042	6,838	10,320	1,676
High plains (irrigated)	11,350	13,070	17,507	12,903
San Joaquin Valley, Calif. (irrigated):				
Cotton, specialty crop	39,780	45,584	23,723	58,290
Cotton, general crop (medium sized)	26,111	26,798	32,117	36,067
Cotton, general crop (large)	77,115	82,376	93,922	108,785
Peanut-cotton farms, Southern Coastal Plains	2,613	2,878	5,674	5,181
Tobacco farms:				
North Carolina Coastal Plain:				
Tobacco [2]	3,521	4,416	6,099	6,429
Tobacco-cotton [2]	3,392	4,350	6,385	6,362
Kentucky bluegrass:				
Tobacco-livestock, inner area	6,473	7,127	9,786	6,530
Tobacco-dairy, intermediate area	2,361	2,510	3,448	2,678
Tobacco-dairy, outer area	3,890	4,530	6,288	5,323

See footnotes at end of table, p. 545.

TABLE 1.—*Net farm income, specified types of commercial farms, 1964, with comparisons*—Continued

Type of farm and location	Average 1951–55	Average 1956–60	1963	1964 [1]
Spring wheat farms, Northern Plains:				
Wheat-small grain-livestock	4,524	5,058	7,622	8,690
Wheat-corn-livestock	3,922	4,837	6,711	5,062
Wheat-fallow	4,586	3,898	9,073	7,567
Winter wheat farms:				
Southern Plains:				
Wheat	8,006	8,377	9,086	8,271
Wheat-grain sorghum	4,932	7,001	7,024	6,949
Pacific Northwest:				
Wheat-pea	13,712	12,934	17,408	15,190
Wheat-fallow	12,910	13,814	15,275	13,836
Cattle ranches:				
Northern Plains	5,434	4,574	7,385	6,043
Intermountain region	7,976	9,731	10,133	6,860
Southwest	2,588	5,843	5,272	1,310
Sheep ranches:				
Northern Plains	8,134	9,171	12,961	11,765
Utah-Nevada	18,326	16,972	13,261	14,631
Southwest	3,433	7,958	5,926	3,258

[1] Preliminary.
[2] Revised.

NOTE.—Information presented here is on an owner-operator basis primarily for comparability between types of farms. Net farm income is the return to operator and unpaid members of the family for their labor and management on the farm and return to total capital. No allowance has been made for payment of rent, interest, or mortgage.

Source: U.S. Department of Agriculture, Economic Research Service, Washington, D.C. "Farm Costs and Returns," commercial farms by type, size, and location, Agriculture Information Bulletin No. 230, revised August 1965, p. 2.

TABLE 3.—*Resources, costs, and returns per farm, specified types of commercial farms, 1964* [1]

Type of farm and location [2]	Size of farm as measured by— Unit	Size of farm as measured by— Number	Total farm capital, Jan. 1	Gross farm income [3]	Operating expenses [4]	Return per hour to operator and family labor: Current interest rates	Return per hour to operator and family labor: 4.1-percent interest [5]
Dairy farms:							
Central Northeast	Milk cows.	33.0	$45,500	$14,937	$10,759	$0.41	$0.61
Eastern Wisconsin:							
Grade A	do	33.3	71,950	16,906	10,365	.61	.84
Grade B	do	22.1	48,190	9,773	6,441	.18	.36
Western Wisconsin, grade B	do	24.8	38,770	8,673	5,836	.17	.30
Dairy-hog farms, southeastern Minnesota	do	22.2	57,600	11,104	7,200	.19	.39
Egg-producing farms, New Jersey	Layers	5,100	45,430	27,439	24,969	—.03	.15
Broiler farms:							
Maine	Produced annually.	67,900	33,160	7,681	3,989	.91	1.19
Delmarva:							
Broilers	do	53,237	20,090	4,702	2,269	.77	1.01
Broiler-crop	do	59,590	51,320	10,467	4,445	1.22	1.63
Georgia	do	28,314	17,580	2,608	1,890	—.24	(6)

See footnotes at end of table, p. 546.

TABLE 3.—*Resources, costs, and returns per farm, specified types of commercial farms, 1964* [1]—Continued

Type of farm and location [2]	Size of farm as measured by—		Total farm capital, Jan. 1	Gross farm income [3]	Operating expenses [4]	Return per hour to operator and family labor	
	Unit	Number				Current interest rates	4.1-percent interest [5]
Corn Belt farms:							
Hog-dairy	Acres of cropland.	125	74,540	18,258	11,085	.85	1.14
Hog fattening—beef raising	do	138	62,650	12,222	7,827	.23	.50
Hog-beef fattening	do	195	123,720	34,386	25,743	.45	.99
Cash grain	do	233	140,870	22,652	10,447	1.46	2.13
Cotton farms:							
Southern piedmont	do	104	32,750	7,639	4,365	.51	.77
Mississippi Delta:							
Small	do	40	17,250	5,226	2,843	.72	.84
Large scale	do	640	286,620	79,684	45,061	(7)	(7)
Texas:							
Black Prairie	do	240	62,170	10,383	5,715	.49	.86
High plains (nonirrigated)	do	464	94,170	8,905	7,229	−1.97	−1.25
High plains (irrigated)	do	413	151,520	29,784	16,881	1.70	2.57
San Joaquin Valley, Calif. (irrigated):							
Cotton-specialty crop	do	335	307,270	138,909	80,619	(7)	(7)
Cotton-general crop (medium sized).	do	335	304,790	83,937	47,870	(7)	(7)
Cotton-general crop (large)	do	1,178	1,045,430	263,189	154,404	(7)	(7)
Peanut-cotton farms, southern coastal plains.	do	71	25,440	9,857	4,676	1.50	1.65
Tobacco farms:							
North Carolina coastal plain:							
Tobacco	do	47	41,370	12,835	6,406	1.56	1.89
Tobacco-cotton	do	53	44,920	13,613	7,251	1.34	1.67
Kentucky bluegrass:							
Tobacco-livestock, inner area	do	62	111,630	15,524	8,994	.09	.68
Tobacco-dairy, intermediate area	do	25	25,040	5,673	2,995	.38	.49
Tobacco-dairy, outer area	do	42	49,280	11,899	6,576	.59	.75
Spring wheat farms: Northern plains:							
Wheat-small grain-livestock	do	597	60,540	14,673	5,983	2.33	2.71
Wheat-corn-livestock	do	397	63,080	10,367	5,305	.45	.72
Wheat-fallow	do	656	63,810	13,192	5,625	1.52	1.86
Winter wheat farms:							
Southern plains:							
Wheat	do	616	113,490	14,627	6,356	.77	1.40
Wheat-grain sorghum	do	693	133,610	15,218	8,269	−.22	.61
Pacific Northwest:							
Wheat-pea	do	551	203,490	28,554	13,364	1.22	2.16
Wheat-fallow	do	1,066	164,900	24,777	10,941	1.40	2.11
Cattle ranches:							
Northern plains	Cows	104.6	90,370	13,579	7,536	.33	.71
Intermountain region	do	143.5	92,330	14,300	7,440	.45	.77
Southwest	do	159.8	188,200	13,398	12,088	−3.93	−2.79
Sheep ranches:							
Northern plains	Sheep	1,392	104,440	25,567	13,802	1.70	2.11
Utah-Nevada	do	2,217	161,510	38,803	24,172	1.55	2.16
Southwest	do	1,219	222,840	17,109	13,851	−3.33	−2.18

[1] Preliminary.
[2] All except cotton farms in California and large-scale cotton farms in the Mississippi Delta are family operated.
[3] Includes income from farming and Government payments.
[4] Excludes rent and interest payments.
[5] Invested capital at 4.1 percent and production credit at current short-term interest rates charged by production credit associations on loans outstanding.
[6] Less than 0.01.
[7] Not applicable.

Source: U.S. Department of Agriculture, Economic Research Service, Washington, D.C. Farm costs and returns—commercial farms by type, size, and location, Agriculture Information Bulletin No. 230, revised August 1965, p. 4.

The following table is placed in the record as an extension of the discussion between Senator Proxmire and Mr. Gray. (See p. 460, this volume.)

Effective dates of minimum wage provisions under the Fair Labor Standards Act

I. Initial level:
   $0.25, October 24, 1938.
   $0.30, October 24, 1939.
   $0.40, October 24, 1945.
   $0.75, January 25, 1950.
   $1.00, March 1, 1956.

II. Coverage was extended September 3, 1961:
   (*a*) Those under new coverage, $1.00; in 1964, $1.15; and, September 3, 1965, $1.25.
   (*b*) Those previously covered: September 3, 1961, $1.15; and September 3, 1963, $1.25.

Source: Ben Robertson WHPC, U.S. Department of Labor.

The following material is referred to in part 2, p. 249 of these hearings.

FEBRUARY 4, 1966.

Hon. HENRY S. FOWLER,
Secretary of the Treasury,
Department of the Treasury,
Washington, D.C.

DEAR MR. SECRETARY: During your appearance before the Joint Economic Committee on February 4, 1966, considerable interest was expressed by the members of the committee in the proposals which the United States has advanced at the negotiations on reform of the international monetary system now taking place.

I would very much appreciate it if you would supply for the record the substance of those proposals so that those of us who have taken an interest in this subject over the years may have an opportunity to study them.

In addition, I would appreciate it if you would inform the Committee of the legislative action that may be required to implement these proposals, should they be accepted by the Group of Ten and the International Monetary Fund.

With best wishes,

Sincerely yours,

THOMAS B. CURTIS.

THE SECRETARY OF THE TREASURY,
Washington, February 14, 1966.

Hon. THOMAS B. CURTIS,
House of Representatives,
Washington, D.C.

DEAR MR. TOM CURTIS: I have your letter of February 4, 1966, referring to my testimony on February 4, 1966, before the Joint Economic Committee and the interest of the members of the committee in the negotiations now taking place on improvement of the international monetary system. You requested that the substance of any U.S. proposals submitted to the Group of Ten be supplied for the record, and that the committee be informed of the legislative action that may be required to implement these proposals.

In response to your first request, I would like to point out that we have made some tentative proposals that cannot properly be labeled a complete "plan" for improvement of the international monetary system. A number of other countries in the Group of Ten have also put forward their suggestions on this subject. However, the text of our paper has not been made public, since we believe that the negotiations will be more successful if both the United States and the other countries participating retain negotiating flexibility. This flexibility would tend to become restricted if proposals developed for negotiation within the group were explicitly made a part of the public record.

As I mentioned to the committee in my testimony, I welcome the interest of the Congress and that of Joint Economic Committee in particular in this subject and I appreciate this opportunity to summarize for you the main points of the U.S. proposals.

By way of background, I should mention that the administration thinking on which the U.S. suggestions to the Group of Ten are based is reflected in the section of the Council of Economic Advisers Report entitled "International Liquidity Arrangements" which begins on page 155. You will also notice that the ideas contained in this section of the CEA report are generally consistent with the positions taken in the "Guidelines for International Monetary Reform "issued on August 30, 1965, by the Subcommittee on International Exchange and Payments of the Joint Economic Committee.

The U.S. suggestions embody the principle of a dual approach. As one part of this approach we think it would be useful to make use of the technique of drawing rights on the International Monetary Fund by creating new special drawing rights on the fund. Existing rights of a similar nature, called gold tranche drawing rights, have over time proven their value as reserve assets. Fund members generally have a need for a growth trend in their reserves, and this aspect of the dual approach is designed to meet this need.

The second part of the dual approach would utilize a new reserve asset. Such a unit would be created by contributions of national currencies into a central pool and would be direcsly transferable among the participants. Because only obligations of the large industrial nations can give a new unit full acceptability in international settlements, it has been suggested that participation in the Group should include those countries capable of undertaking these heavy commitments.

Both parts of the dual approach would be linked together by deciding in advance the amount of both special drawing rights and reserve units to be created over an agreed period. The aim would be to supply a supplement to gold and reserve currencies so as to assure an adequate growth in world reserves over time without dependence upon limited and uncertain gold supplies.

These suggestions should be viewed as the major aspect of a broader program being discussed for improvement of the international monetary system. For instance, we are hopeful that both multilateral and bilateral credit facilities that have already proven so valuable will continue to be improved. We also hope that the study of the adjustment process now being carried out by working party 3 of OECD will produce helpful results.

After completion of the work in the Group of Ten, a second phase will be needed to insure that the interests of countries outside the Group of Ten will be fully heard and weighed. Once the second phase has been completed there will have to be a third phase in which the countries concerned will obtain formal governmental approval, in accordance with their laws, of the plan that emerges from the second phase.

With respect to your second request, we have given considerable thought to the legislative aspects of the program for international monetary improvement. Both the timing and the specific form of legislative recommendations would be matters to be developed as the negotiations progress, and after further consultation with Members of the Congress, as the elements of an eventual agreement become more clearly evident. Thus, at this early stage, I believe it would not be possible to formulate the legislative proposals that will be required.

Under Secretary Deming, who is representing the United States during current negotiations in the Group of Ten, will be exploring some of the problems involved in improving the international monetary system and the U.S. approach to these problems in the "Washington University Assembly Series Lecture" to be given at Washington University, St. Louis, Mo., on February 16, 1966. I think you and your constituents in the St. Louis area will find this talk particularly interesting and informative and I will send you a copy of it as soon as it is available for distribution.

Sincerely yours,

HENRY H. FOWLER.

(The material which follows, relevant to the balance of payments, was submitted by Edward M. Bernstein.)

FEBRUARY 15, 1966.

Mr. EDWARD M. BERNSTEIN,
Washington, D.C.

DEAR EDDIE: Senator Proxmire would deeply appreciate having a brief statement from you of your views as to the position taken by the President and the Council of Economic Advisers in the January 1966 Economic Report by Secretary of the Treasury Fowler in his recent testimony before the Joint Economic Committee, and also as to the latest verdict rendered in the joint release reported in the press this morning—in this latest release, Secretary Conners and Chairman Martin joined Secretary Fowler.

In addition, he would like any general views you might have as to their interpretation of developments and what is in prospect this year. He is concerned as to the explanation regarding the difference in behavior of the official settlements base measure and the liquidity base measure for 1965. Further, as I indicated to you on the phone today, any additional views you may have which would encourage the officials to use the official settlements measure more than they have been doing thus far.

We will look forward to hearing from you soon.

Cordially yours,

JAMES W. KNOWLES, *Executive Director.*

EMB, LTD., RESEARCH ECONOMISTS,
March 7, 1966.

Mr. JAMES W. KNOWLES,
Executive Director, Joint Economic Committee,
Congress of the United States, Washington, D.C.

DEAR JIM: I enclose a brief statement on the U.S. balance of payments, with particular reference to the official settlements and the liquidity measures of the deficit. I am sure the Treasury will come around to using the official settlements definition as soon as it clearly shows a smaller deficit. That would have been true this year if some Bank of Canada holdings of dollars had not been classified as nonliquid. It will be even more true this year and in the future. I am inclined to wait until the difference is more marked and clearly in favor of the official settlements definition. By then, it may also be important for U.S. policy.

Sincerely,

EDWARD M. BERNSTEIN.

THE U.S. BALANCE OF PAYMENTS DEFICIT IN 1965

According to the data published by the Commerce Department, the 1965 balance of payments of the United States showed a deficit of $1.3 billion on a liquidity basis and $1.4 billion on an official settlements basis. This compares with a deficit in 1964 of $2.8 billion on a liquidity basis and $1.4 billion on an official settlements basis.

In recent discussions of the balance of payments, the administration has preferred to emphasize the liquidity measure of the deficit. In part, this is because the 1965 deficit on this basis was slightly lower than on an official settlements basis. In part, it is because the reduction in the deficit on a liquidity basis was so spectacular—from $2.8 billion to $1.3 billion. There is an understandable tendency to choose that method of measuring the deficit which is most favorable. Of course, many U.S. technicians are entirely objective in their opinion that the liquidity basis provides the only proper measure of the U.S. payments deficit.

Nevertheless, the liquidity basis probably understates the U.S. payments deficit in 1965 and it certainly overstates the improvement in the U.S. balance of payments last year. This can be seen from an analysis of the principal constituents of the U.S. balance of payments. The trade surplus fell by $1.9 billion. U.S. direct investment was much larger than in 1964. Furthermore, foreign sales of U.S. securities increased substantially last year. What then is the source of the alleged improvement in the U.S. balance of payments? It consists essentially of two capital items: a shift of U.S. nonbank funds from an outflow of $900 million in 1964 to an inflow of $300 million in 1965; and a shift in foreign claims reported by U.S. banks from a net increase of $2.5 billion in 1964 to a net decrease of $100 million in 1965. The change in U.S. capital outflow represented by net bank claims was $1 billion more than the reduction in the payments deficit on a liquidity basis.

The one-sided treatment of U.S. foreign banking transactions in the liquidity definition is bound to reduce the payments deficit regardless of the impact of a reduction of net bank lending on U.S. exports and on foreign private dollar holdings in the United States. This is not to deny that the restraint on bank credit to foreigners was necessary and beneficial. But its impact on the U.S. balance of payments cannot be measured by the amount of the shift in bank lending. Allowance must also be made for the adverse impact on U.S. exports and on the slowdown in the growth of foreign private claims on U.S. banks. When this is done, the alleged improvement in the 1965 balance of payments seems to be little more than a bias in the method of keeping accounts.

Although the two measures of the deficit were within $100 million of each other in 1965, there are significant differences in the items included in the liquidity deficit and in the official settlements deficit. The official settlements deficit includes an increase of around $300 million in U.S. Government liabilities to foreign official institutions that are excluded from the liquidity measure of the deficit on the ground that they are "not liquid liabilities." On the other hand, the liquidity measure of the deficit includes an increase of about $200 million in liabilities to foreign private dollar holders and to international nonmonetary institutions that are excluded from the official settlements measure of the deficit on the ground that they are not liabilities to foreign monetary authorities. I believe that there is a much better case for including in the deficit the increase in the excluded "nonliquid" liabilities to foreign monetary authorities, as is done in the official settlements, than for including the increase in the dollar claims of foreign private holders and international nonmonetary institutions, as is done in the liquidity measure of the deficit.

The case for the official settlements measure of the deficit is that it reflects the normal pattern of banking transactions. Quantitatively, this was not important in 1965; but it will be very important in the future as it has been in the past. The liquidity basis for measuring the deficit has an inherent bias, as noted by Dr. M. W. Holtrop, President of the Netherlands Bank and President and Chairman of the Board of the Bank for International Settlements. [1] That bias arises from the fact that the liquidity basis "includes in the deficit the substantial foreign asset business of the banking system (U.S. bank credits to foreigners) without deducting its foreign liability business (foreign claims of U.S. banks)." There may be a reasonable argument as to how U.S. banking transactions should be treated in the U.S. balance of payments—whether by regarding both assets and liabilities as settlement items or by regarding the increase in both assets and liabilities as capital movements. The one method for which there is no justification is that used in the liquidity basis for measuring the deficit—that is, to treat the increase in foreign private banking claims as a settlement item and the increase in U.S. foreign banking claims as a capital outflow.

Although the U.S. deficit in 1965 was about the same as in 1964 on an official settlements basis, it is remarkable that the United States could avoid a serious deterioriation in its balance of payments in a year of such great expansion. The National Bureau of Economic Research has found that the U.S. trade balance tends to fall by about 3 percent of the sum of exports and imports between the high and low years of a cycle. The decline of the U.S. trade surplus from $6.7 billion in 1964 to $4.8 billion in 1965 was 3.9 percent of the sum of exports and imports in the latter year—somewhat more than would be expected in response to cyclical forces. There were exceptionally favorable factors in 1964 and exceptionally adverse factors affecting U.S. trade in 1965. For this reason, among others, there may be no significant change in the trade surplus this year. With the renewed expansion in Europe and the resumption of net foreign lending by U.S. banks, the trade surplus may even increase somewhat this year, despite the further rise in U.S. aggregate demand.

The pattern of capital movements will be quite different in 1966 from last year, although the net effect on the balance of payments may be much the same. U.S. purchases of foreign securities should show little change. Foreign sales of U.S. securities should be considerably less as the United Kingdom's liquidation of its security holdings is about completed. U.S. direct investment will be down under the new guidelines. Other U.S. private capital movements, other than those reported by banks, will shift once more from a small net inflow in 1965 to a small net outflow in 1966. Most important, there will undoubtedly be an increase

[1] Speech before the "Wirtschaftsforum Hessen," Frankfurt am Main, November 29, 1965, p. 7 of the English translation.

in U.S. net bank credit to foreigners, although the tighter credit situation may compel them to hold down their foreign loans. Of course, an increase in net foreign lending by U.S. banks will be partly offset by an increase in foreign private dollar holdings.

On a liquidity basis, there may be no improvement in the U.S. balance of payments this year, particularly if U.S. banks increase their net foreign credits by $500 million or more compared to minus $100 million in 1965. On the other hand, on the official-settlements basis there should be a modest reduction in the payments deficit. That is because we may expect foreign private dollar holdings to increase to meet the business and financial needs of the world economy. Even in 1965 there was an increase of nearly $300 million in foreign private dollar holdings. This was substantially less than the increase of $1.8 billion in such holdings in 1964 and less than half the average increase of the 5 preceding years. The reasons for the smaller accumulation of private dollar holdings in 1965 are essentially those stated by Secretary Fowler in his press conference. One other reason may be added. With the net reduction of U.S. bank credit to foreigners, dollar balances were drawn down to make some payments that would otherwise have been met through bank credit.

By any measure of the deficit, the United States still has an urgent payments problem. That deficit will have to be eliminated in order to halt the gold drain. But as we make further progress in eliminating the deficit, the difference between the measurement of the deficit on a liquidity basis and on an official settlements basis will become of great importance in assessing the U.S. payments position and in determining U.S. policy. I have no doubt that experience will show that the official settlements basis is the better indication of the U.S. payments position, because it takes account of the dynamics of a world in which international trade and investment continues to grow and in which larger dollar holdings are needed by foreign commercial banks and by foreign business firms to finance their dollar transactions.

FEBRUARY 16, 1966.

Hon. FREDERICK L. DEMING,
Under Secretary for Monetary Affairs,
Department of the Treasury, Washington, D.C.

DEAR SECRETARY DEMING: While in Wisconsin yesterday, I learned of the joint press conference on February 14 with Secretary Fowler, Secretary Connor, Federal Reserve Board Chairman Martin, and Federal Reserve Governor Robertson.

From a reading of the press release it is obvious that the Secretary placed heavy emphasis on the liquidity basis for measuring the deficit. This, of course, showed a $1.5 billion savings, whereas the official settlements basis showed a slightly worsening of the balance.

This committee devoted several intensive days last summer to exploring all the ramifications of variations in measuring the balance-of-payments deficit and, after listening to a number of the outstanding experts in the country, along with the most knowledgeable administration officials, it was concluded that both measures should be employed inasmuch as each served certain purposes. A copy of this report is enclosed herewith for your examination.

It will be appreciated if you will enlighten me on several aspects of this question:

1. Does not concentration on the liquidity basis create a false notion that we have made substantial progress in reducing the deficit?

2. What, precisely, are your expectations as to the effect of Vietnam expenditures on the balance?

3. What are the reasons for the big difference between the two measures?

Your response will be appreciated.

Sincerely yours,

WILLIAM PROXMIRE.

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, D.C., February 23, 1966.

Hon. WILLIAM PROXMIRE,
Joint Economic Committee,
Washington, D.C.

DEAR SENATOR PROXMIRE: In the absence of Under Secretary Deming, I am very glad to answer the questions posed in your letter to him dated February 16, 1966, regarding the liquidity and official settlements deficits in our balance of payments last year.

Let me begin with your question 3. There was not a big difference between the two measures in 1965. The liquidity deficit was $1.3 billion, while the official settlements deficit was $1.4 billion. I assume, therefore, you were referring to the fact that the liquidity deficit declined by $1.5 billion from the 1964 figure, whereas the official settlements deficit increased by over $100 million.

The major reason why the changes in the two measures were so different was the fact that there was a very slight increase ($127 million) last year in liquid liabilities to private foreigners, whereas the increase in 1964 was very substantial (over $1.5 billion). A secondary reason was that increases in certain nonliquid liabilities to foreign monetary authorities which are regarded as involving a capital inflow into the United States—a receipt item—in computing the liquidity balance are not so regarded in the computation of the official settlements balance. These liabilities rose from $12 million in 1964 to $210 million in 1965.

The answer to your first question is "No." The small increase in private foreign dollar holdings last year, as compared with 1964, was due to a number of developments:

(1) Private foreigners who had speculated against sterling by moving into dollars in late 1964 and throughout the first half of 1965 reversed their positions as confidence in sterling strengthened. This accounted for a decline in private foreign dollar holdings; but it was a decline that was related to a strengthening of the United Kingdom balance-of-payments position not to a weakening of the U.S. balance-of-payments position.

(2) The gradual tightening of domestic credit in a number of foreign countries last year led private foreigners who had temporarily invested in dollar balances to shift back into their local currencies again. This shift was related to the domestic credit situation in foreign countries and was not a sign of weakness in the U.S. balance-of-payments position.

(3) U.S. firms which had held dollar balances abroad through foreign banks repatriated their funds on a large scale last year to help finance domestic investment programs and to cooperate with the Government's balance-of-payments program. This shift could hardly be interpreted as a sign of weakness in the U.S. balance-of-payments position.

In short, there was a bona fide improvement in our position last year which was reflected in the sharp decline in our liquidity deficit.

With regard to your second question about our expectations as to the effect of Vietnam on the balance of payments, I refer to Secretary Fowler's statement at his press conference on February 14. He said:

"But, it should be kept in mind that the balance-of-payments costs of the Vietnam conflict are not permanent or ordinary costs, and that, although we have made provision for an increase in these costs in our outlook for 1966, it is simply not possible to say at this time how greatly, in fact, they will affect our balance of payments in 1966."

At this stage in our planning, we are contemplating 1966 net military expenditures abroad of roughly $2.1 billion in comparison with a figure of about $1.6 billion last year. This increase is attributable to Vietnam. Domestic expenditures in connection with Vietnam can also exert some indirect adverse effect on our balance of payments which, however, is very difficult to measure.

I hope this reply fully responds to your questions.

Sincerely yours,

PETER D. STERNLIGHT,
Deputy Under Secretary for Monetary Affairs.

The material which follows was submitted by Walter P. Reuther in response to Mr. Javits' request. (See p. 416, this volume for reference.)

MARCH 22, 1966.

Senator JACOB K. JAVITS,
U.S. Senate,
Washington, D.C.

DEAR SENATOR JAVITS: Attached are my replies to the questions which you raised through Nat Goldfinger when he appeared to present my testimony before the Joint Economic Committee earlier this year.

I am very sorry that circumstances made it impossible for me to attend the hearings personally.

I am sending a copy of the replies to the administrative staff of the committee so that they can be inserted in the record.

Sincerely yours,

WALTER P. REUTHER,
President, International Union, UAW.

REPLIES TO QUESTIONS ASKED BY SENATOR JAVITS

1. In view of the practical limitations on Presidential intervention in labor disputes, it is clearly desirable that we find an alternative method of asserting the public interest in labor disputes which seriously affect the public interest. I believe the Price-Wage Board of Review which the UAW has proposed would provide such an alternative. Le me review the proposal as it would apply to a labor-management dispute. If the dominant firm in a key industry notifies the Board that a unoin has made demands on it which, if granted, would force it to raise prices, the Board would call both the union and the company before it for a public hearing, at which time all the relevant facts would be brought out.

We need not be concerned about disputes which do not involve the dominant firm in an industry, because if the dominant firm continues to operate there is little likelihood of any serious damage to the public interest.

No strike or lockout would be permitted until the Board had held its hearing and made a report of findings and recommendations, provided that such limitation would not extend beyond a reasonable period, say 60 days from the date the Board is notified.

The recommendations would not be finally binding on either party. Both sides would go back to the bargaining table free to act as they saw fit, including strike or lockout action. But if the Board had found, on the basis of an objective, unbiased study of the facts, that a union's demands were not justified and would necessitate a price increase, and had so reported to the public with a full statement of the facts supporting that conclusion, the probability of strike action would in my opinion be very close to nil, because any union leader would know that it could not possibly succeed. On the other hand, if the Board had found that the union's demands were justifiable and recommended that the company accede to them, and that recommendation had been made public along with all the supporting facts, I doubt very much that any major company would hold out to the point of forcing the union to strike.

There is one other possible situation which perhaps should be considered. The dominant firm might concede that granting the union's demands would not force it to raise prices, but still refuse to grant those demands on other grounds. In that situation, we would suggest that the union or the company should have the right to so inform the Price-Wage Board of Review, and if the Board after consultation with the President were advised by him that a strike or lockout would be damaging to the public interest, it would be authorized to call both parties before it for a public hearing, bring out all the relevant facts, and report its findings and recommendations to the parties and the public.

This would not deprive the President of any power that he has now to intervene in a labor-management dispute in which the public interest is threatened. But it would greatly lessen the need for such intervention, and if intervention did become necessary it would arm the President not only with a body of facts on which to act, but with the knowledge that those facts were also in the hands of the public.

The whole point of the proposal for a Price-Wage Board of Review is that in major labor-management negotiations as well as in the making of major price decisions, it would impose a new discipline on all the parties concerned—the need to accept full responsibility before a fully informed public for private decisions which affect the public interest. Only by the acceptance of such a discipline can we combine the two essential goals in a democratic society of maintaining the freedom to make private decisions while at the same time protecting the public interest.

2. We support the basic concept behind the price-wage guideposts, which is that both price and wage decisions should be made in a responsible manner which takes account of the public interest. We do not favor the use of rigid wage guideposts which take no account of such factors as high unemployment, continued slack in the economy or excessive profits. Still less do we favor guideposts which represent only someone's arbitary determination as to what limits should be placed on wage increases. As to the price guideposts, our chief objection is that they have not been enforced and are unenforceable without the support of an informed public opinion. We believe that the wage-price board of review which we propose would provide the facts to create an informed public opinion, from which could evolve a concept of responsible action in both the price and wage fields which would be far more effective and far more conformable to the principles of freedom than any guideposts established by the Government.

3. There are some practical deficiencies in Congressman Reuss' bill which would prevent it from achieving the ends he seeks. First, to subject the price-

wage guideposts to annual review by a committee of Congress would, in our opinion, throw the whole issue into the political arena where it does not belong. Even if the members of the committee were able to free themselves from all political pressures and reach a completely objective decision based only on the economic facts involved, there would still be those who disagreed with that decision and who would accuse the committee of playing politics.

Second, the bill provides no mechanism for advance notice of a price increase. Advance notice of wage behavior is usually available, because wages have to be negotiated, usually at some length, before a decision is reached. But prices can be raised unilaterally and overnight. Taking into account the length of time that would be required for the committee to hold hearings and produce a report, the price increase would have been in effect for several weeks, and it is always far more difficult to rouse public opinion against an action that has already been taken than against one that is still pending.

Finally, the bill provides no means of dealing with the problem of industries with above-average rates of productivity advance which refuse to reduce prices in conformity with the guideposts. The Council of Economic Advisers has pointed out repeatedly that in order to have a stable overall price level, such industries must reduce prices in order to offset unavoidable price increases in industries with less than average rates of productivity advance.

Thus, for example, in its 1964 report the Council said:

"* * * It is appropriate to focus special attention this year on *price reductions*. The guideposts call for reductions in those industries whose trend productivity gain exceeds the national trend * * *. If they are not forthcoming, overall price stability will be rendered more difficult, since price increases are likely in industries that are progressing at a less-than-average rate." (Emphasis in original.)

Again in its 1966 report the Council said:

"While individual prices will rise from time to time, others must fall if upward pressure on the general price level is to be avoided."

And Gardner Ackley, Chairman of the Council, in a speech to the Pharmaceutical Manufacturers Association on May 26, 1965, said:

"Most businessmen * * * like to talk about the virtues of a stable price level. I hope they don't forget the arithmetic which says that if the average price level is to be stable, as many prices have to go down as go up."

4. There seems to have been some misunderstanding about my recent remarks concerning machinery for averting strikes in public service industries. I did not put forward any prescription myself. Rather, I proposed that a tripartite committee be established, composed of top people from labor, industry, and Government, to explore the possibility of creating procedures by which workers in these public service industries, such as transportation and power and hospitals, can secure their equity without the need of resorting to strike action.

It is unfortunate that whenever a crisis develops in one of these industries all the public attention is focused upon the damage that a strike might do to the public, and very little concern is shown about the damage that is done to workers and their families by substandard wages and working conditions. In the New York transit situation, for example, I understand the wages of transit workers were out of line with what employees of private industry, including privately owned public utilities, were being paid for the same or similar work. Thus, for example, transit system bus operators had a maximum pay of $3.22 per hour, compared with a maximum of $5 per hour paid to heavy truck drivers in New York City manufacturing industries; transit system railroad clerks received a maximum of $2.75 per hour, compared with $3.87 to $3.97 paid to clerks in public utilities; transit system railroad porters were paid a top rate of $2.65 per hour, and car cleaners received $2.64, compared with the $3.10 maximum for janitors, porters, and cleaners in public utilities.

If the people of New York had established machinery for protecting the equity of these workers and assuring them the same standards of wages and working conditions as workers receive for comparable work in private industry, there would have been no need for a strike.

I do not have a blueprint for the kind of procedures that should be adopted. That is why I proposed a special committee to explore the problem. But I would strongly urge that the key to success is not to think merely in terms of averting strikes, but rather in terms of how you can assure equity to workers so that strike action is unnecessary.

In a totalitarian society industrial peace and stability may be achieved in the absence of justice, but in a free society industrial peace and stability are possible only as they are built on the foundations of economic and social justice.

5. Senator Javits' bill, which would place seizure and operation of the employer's facilities by a Government receiver as an offset to forfeiture by the union of the right to strike is an interesting one, but again it goes to finding a formula that will make strikes that threaten the public interest impossible, or at least illegal, rather than a means of averting such strikes by making them unnecessary. I think the approaches outlined in my answers to questions one and four would prove more satisfactory.

O