407

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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CONTENTS

STATEMENTS

ADDITIONAL INFORMATION AND EXHIBITS

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 5, 1968

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

The Joint Economic Committee met at 10:05 a.m., pursuant to notice, in room S–228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Javits, Jordan of Idaho, and Percy; and Representatives Bolling, Reuss, Moorhead, Curtis, and Widnall.

Also present: John R. Stark, executive director, James W. Knowles, director of research, and Donald A. Webster, minority staff economist.

Chairman PROXMIRE. The committee will come to order.

As chairman of the committee I am going to do something I have not done since I became chairman of this committee, and I promise that this will be the very rare exception. I hope I will not feel the need to do it again, but if I do, it will probably be only once or twice.

I do it this morning because I anticipate that in the hearings we are beginning today, from the very large proportion of administration witnesses and witnesses from the economic establishment, we are going to have a very strong series of arguments in favor of increasing taxes.

I think that in view of the position that the American people have taken, as reflected in the Gallup poll, and that many Members of Congress share, that there should be some kind of statement showing that this opposition is not an act of political cowardice, because we are opposed to tax increase as a matter of reasoned concern with the economic interest of the Nation.

So, with that in mind, I am going to go ahead with this statement and get through with it as rapidly as I can.

OPENING STATEMENT OF SENATOR WILLIAM PROXMIRE, CHAIRMAN OF THE JOINT ECONOMIC COMMITTEE

Today, the Joint Economic Committee begins its annual hearings on the Economic Report of the President. We welcome the Council of Economic Advisers to open these hearings.

At the outset, I commend the Council for an excellent factual analysis and the responsible efforts they have made to deal with all of the important questions. At the same time, it is no secret, I am sure, that there are many points in the report that trouble me. Certainly, there is no shortage of issues before us for exploration.

It is a fact that we have enjoyed 7 years of unexampled prosperity which coincide with the Kennedy and Johnson administrations. The length and breadth of the prosperity are in part—and, I think, in significant part—the result of the wise economic policies of those two administrations.

But the problem for this committee today is the future, not the past.

This Joint Economic Committee and this Council of Economic Advisers that addresses it here today was directed by the Congress 22 years ago to advise the Congress and the President on those policies that would best foster maximum economic growth; policies that will keep our resources, and especially our manpower, most fully utilized with reasonable price stability.

Slowdown Policy

The emphasis during most of the life of this Council and this committee has been on securing greater economic growth and high level employment. This year the battle has been turned around. The pitch is to "slowdown." It comes after a year in which real growth slowed down to 2½ percent, a year of especially anemic growth in industrial production, a year in which our industrial capacity is about 15 percent idle.

There is a single, stark, and overriding reason for the cry to shove on the brakes: inflation. Prices, including the price of money, have started to rise at an unacceptable rate.

The simple assumption is that prices are rising because the demand in the economy exceeds the capacity of the economy's resources to meet that demand. Fiscal restraint, and specifically, a general tax increase is called for as the right medicine to excise this surfeit of demand from the economy.

This is the burden of much of the Economic Report. This is the heart of the President's appeal to the Congress.

Adverse Effects of Tax Hike

Of course, there is some merit in this view. But what troubles the chairman of this committee is that the proposed tax increase proposal does not seem to be the swiftest or the surest way to slow down inflation. It may seriously increase unemployment. It could slow, stall, even end the 7 years of national economic growth. And in the process, it might not even significantly slow the rise in prices.

Shadows of a decade ago haunt the proposal. In 1957, with unemployment at 4.4 percent and prices rising by 3.5 percent, the Government followed a restrained fiscal policy. The next year unemployment rose to nearly 7 percent and prices still rose at close to 3 percent. How much must the economy slow down? How cruelly high must unemployment rise to stem inflation by purely fiscal measures?

Tax Hike Won't Do the Job

Although repeatedly challenged to do so, neither this Council, nor any other witness that has appeared before this committee in recent years has indicated how a tax increase could promptly moderate the present inflation.

The prime element in the cost of living is food. Would this tax increase reduce the rise in the cost of food? Of course not. It won't even reduce the demand for food. Those in tax brackets that might curtail their diets because of this tax increase are exempted from the tax. Others are hardly going to cut back food purchases because of this tax increase.

Will it reduce the cost of housing? Housing is the second large item in the cost of living. Will the tax increase cut the demand for housing, for new homes? Of course not. We are assured that a principal reason for this proposal is to ease the mortgage market so that the need for housing can become effective demand, and housing production can soar. Without this tax increase, we are told, housing may become depressed.

Will the tax increase slow down the rise in the price of automobiles? It may reduce the demand; but the price of autos went up last year in spite of vast and increased productive capacity and productivity, and in spite of inadequate demand. This Nation's mighty auto industry could increase auto production immensely without any cost pressure on facilities that would raise prices.

Will the tax hike cut the price of appliances—refrigerators, toasters, TV sets? Of course not. These are in roughly the same position as autos: Capacity availability great and growing; effect of demand increases; a reduction of cost.

Will it reduce the rise in price for the fastest rising element in the cost of living, medical services? Once again, obviously not. The demand so far outpaces supply in this area for nurses, doctors, hospital facilities that no diminution in demand—certainly not one this modest—will permit demand and supply forces to come into balance in the near future.

What prices will be moderated by the tax increase? Name one.

Wrong Time for the Increase

But what makes this tax increase especially suspect is its timing. The administration is asking that it go into effect on April 1 for individuals and be made retroactive to January 1 for corporations. But we all know that final passage—enactment into law, short of some kind of national military catastrophe, will not take place until late spring. July 1 would be an early date for it to become effective.

And yet, most economists concede that while the economy may be buoyant in the first half of 1968, it will be much less so in the last half. And with good reason. Forward buying for steel is a clear and significant element in the economy's current buoyancy. That highly stimulating element will work in reverse after July 1. Either there will be a steel strike that will certainly slow the economy—and seriously—or there will not be a strike and steel buying will slow to a trickle for months while the heavy inventory stocks are worked off.

There is no economic analysis in the report of the timing effect of the tax increase even after it might go into effect, although we know that the effect of the tax increase in reducing consumer spending is sure to be both partial and gradual. And timing is of the essence in curtailing the current inflation. The need is to stop the rise in prices now, not at some later date when all may agree the economy is receding.

Some part of the tax increase will affect not a reduction in spending but a reduction in savings, even if the taxpayers maintain their present rate of saving after taxes are increased.

Tax Increase Won't Slow Consumer Spending

But what is much more likely on the basis of experience, the taxpayer will be likely to maintain his spending and simply save a little less. If, for example, the taxpayer should revert from the 7.1 percent of income saved last year, partway back to the 5.9 percent of income he saved in earlier years, the tax increase would have no effect on consumer demand at all. And, at any rate, it is likely to be a matter of months and perhaps years, if ever, before spending is reduced to accommodate the tax increase.

Here is a prime reason among many why a reduction in Federal spending will be so much surer and more effective than an increase in taxes. Federal spending can be cut back with the enthusiastic cooperation of the Congress if the President leads the way. What is equally important from my pro-growth bias is that spending can be restored promptly when the economy falters.

Is this true of the proposed tax increase? The Council asserts the tax can be promplty repealed if the economy does not need it. But, can it?

Tax Hike Will Linger On

How many taxes have been repealed before their expiration? I can't recall any, ever. Why would this tax be an exception? Is it not hard to list the taxes that have been continued on after their expiration and through recessions. In fact, it's hard to recall a tax that expired on its first expiration date.

If, by July 1, 1969, the economy is suffering 5-percent unemployment and 5-percent inflation, will Congress permit the tax to die? You may think it should; but will it?

And, of course, what makes the tax increase most unfortunate of all is the price that will have to be paid for it. The administration favors the tax increase. I favor spending reduction. I am convinced that most Members of the Congress will only buy a tax increase if they can get both. And that, I am convinced, would be an economic catastrophe; a real overkill.

Tax Hike and Spending Cut: Overkill

I hope you and other witnesses will address yourself vigorously to this overkill possibility. Congress may well commit it. Two of the ablest Members of the Senate have readied amendments to a bill that will soon be on the floor to cut spending back to the $176 billion of last year and to increase taxes substantially at the same time.

Where's the Boom Coming From

Meanwhile, where is the stimulation for the economy coming from? I can't find a word about this in the President's Report or in that of the Council. The big stimulation in the present long expansion of the economy, after its initial recovery, came from three sources: First, the massive tax cuts of 1964 and 1965; second; the extraordinary escalation in Vietnam from early 1965 to, but not through, 1967, through 1966, that the escalations reported to have increased jobs directly and indirectly by 3 million; and, third, the remarkable and unparalleled increase in the accelerator, i.e., business investment in plant and equipment that took place in the 3 years 1964 through 1966 inclusive.

None of these—not one of them—will be working to stimulate the economy this year unless we suffer a military catastrophe.

It is true that the Report indicates a possibility of increase of 5 percent in business plant and equipment; but, as I understand it, although this is because of the expected increase in the price of the equipment that will be purchased, the physical increase will be very small, if any.

No Inflation Deterrent Without Unemployment Hike

Consider what this proposed tax increase must do to accomplish the kind of incisive stemming of inflation that the President has claimed for it. To do this, it would have to increase unemployment substantially. And in this cost-push—or wage cost-push atmosphere—that unemployment increase would have to be big and sharp to retard wage increases. And if it does succeed, and I doubt very much that it will, it could very well reduce revenues, not increase them.

After all, I have yet to meet an economist who did not claim that the 1964 tax cut surely increased revenues, although it decreased tax rates. Why is it not possible, conversely, for this tax increase to reduce revenues. In such a case, of course, the tax increase would not reduce the deficit at all. It would increase the deficit, slow inflation, but at a terrific cost in employment and growth.

Will Not Raise $10,000,000,000

Now, I do not think this tax increase will accomplish anything of the kind, at least not for quite some time. It won't reduce revenue and it won't increase the deficit. But it will certainly not, indeed it cannot if it slows the economy at all—and this is its object—if it slows the economy at all it cannot raise the $10 billion the report claims the surtax will raise.

Most likely it will raise some, a little, perhaps $3 or $4 billion. It will slow growth some and it will have some effect, sometime down the line, not this year, but perhaps in late 1969 or 1970, in slowing inflation—a very little. And, of course, by that time the effect of the tax increase may be seriously perverse. It may be retarding growth and promoting unemployment.

Federal Spending Cut Option

Finally, there is a good clear option to a tax increase. First, a pinpointed cut in low priority Government programs: the space program by a billion dollars; public works can and should be cut by $5 or $6 billion. Four of our six military divisions should be withdrawn from Europe at a saving of $2 billion. The supersonic transport should be postponed. With the exception of troops in Europe, most of this spending can be swiftly restored when the economy can take it.

Wage-Price Guidelines Needed

And meanwhile, it is time for us to take a hard, clear look at the real cause of this inflation that occurs so sharply when so much of our resources are idle. This cost-push inflation can be met with a program that recognizes that with productivity up 1½ percent last year, and wage settlements running over 6 percent at the end of last year—the Ford settlement was specially setting a precedent—we need far more than a Cabinet committee which will look into the causes of inflation, but will not—in the President's words—become involved in specific current wage or price matters.

It seems to me this kind of prescription means this is a prescription for nothing. This nothing prescription is compounded by a flat refusal of the administration to come up with a specific guideline figure: 4.5 percent, 5 percent, 5.5 percent—something. Because of the overriding importance of this issue, this Joint Economic Committee last week undertook a 1-day hearing at which a panel of experts testified. There was unanimous agreement, no exceptions, that if we are going to adopt a policy of keeping prices as low as possible consistent with high employment, we must have a figure, a number as a wage-price guideline. General invocations are useless and that's all this Economic Report provides.

Excellence of Council of Economic Advisers

Let me say this, however, there is no one I would rather explore these difficult questions that are before us, than the group that is before us today. Mr. Ackley, this is very likely your last appearance before this committee, and I would like to take this opportunity to tell you how appreciative and grateful we are for the excellence of your presentations and performances before this committee. Some of us may have disagreed with you from time to time on specific matters, but our great respect for you has never diminished. I know that my colleagues join me in expressing pleasure at the fact that you are remaining in the public service in so important a capacity as that of the Ambassador to Italy.

Mr. Okun, you have been a most able Council member and we are pleased and reassured to know that you will take up the chairmanship now.

Mr. Duesenberry, you, too, are well known to this committee—for many years as a distinguished university economist whose testimony has helped us, and more recently, as a most capable member of the Council.

I am happy to know that you are being joined by another very noted economist, with a splendid background, who has great wisdom; Dr. Peck, is appearing before our Senate Banking and Currency Committee now, and I know as soon as the hearings have been held for his confirmation, he will come before this committee.

Once again, with apologies for taking 15 minutes of the committee's time, I yield to the distinguished ranking minority member of the committee, Congressman Curtis.

Representative CURTIS. Thank you, Mr. Chairman.

Let me say that I think probably it is a good format for the members of the committee to present concisely a general point of view before the witnesses are interrogated.

In the past, of course, we have had to try to get a contrary point of view across through asking lengthy questions, which were really statements. I think it served a proper and worthy purpose.

In that spirit, the minority members have met, and prepared a statement. I want to read this statement on behalf of myself, Senator Javits, the ranking Senate minority member, and, indeed, all of the minority members.

Let me point out that, essentially, this statement relates to the President's part of the Economic Report [1] that has been transmitted to the Congress; namely, the first 28 pages, which are largely, and I think anyone would agree, a political document, not an economic document.

These hearings and what we will write in our minority views on the President's Economic Report, will relate to the report of the CEA; the 200 pages and tables truly constitute an economic report in line with the tradition.

One point I must emphasize, in light of the chairman's statement. It is with regret I note that nowhere in the 28 pages of the President's message is there any reference to the impact of war on the economy. The boasting, and I regard this as boasting, of prosperity, ignores that there is a war that lies at the base of the economy. This boasting even carries over into the pages of the Report itself. The choice of dates in referring to how the economy did from 1948 to 1953, and from 1965 to 1967, points this up. The Council might as well have added the period of 1940 to 1945, to show this same kind of increased economic activity which results from war. I think this omission is a very serious political and economic reporting flaw.

The second general criticism, and this goes certainly to the full statement of the 200 pages, is that there has been no reference to what I regard as an achievement of the years from 1953 to 1960 in stemming the psychology of inflation. To a large degree, I believe this administration, which began in 1961, was able to capitalize on the very difficult economic job that had been achieved by its predecessor in stemming the psychology of inflation.

Certainly, that theory deserves consideration on the part of Congress and the people. Yet, it is not even considered in this Report's historical account. The boasting of what was achieved economically relates initially to political dates. This makes the document, as an economic report, weaker.

Now, if I may, Mr. Chairman, I will read the statement.

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[1] Economic Report of the President together with the Annual Report of the Council of Economic Advisers, February 1968. H. Doc. 238, 90th Cong., 2d sess. Available from Superintendent of Documents, U.S. Government Printing Office.

OPENING STATEMENT OF REPRESENTATIVE THOMAS B. CURTIS, RANKING MINORITY MEMBER OF THE JOINT ECONOMIC COMMITTEE

This Nation and its economy are in trouble and the American people know it.

The plain fact is that the administration has lost the initiative. It is not solving problems; it is stockpiling them. It is failing in the primary task of leadership. It has neither maintained the confidence of the people nor shown the capacity to rally the country behind hard but necessary actions.

The President has tried to reassure us that his policies are moving the Nation "toward new and better shores." An anxious and concerned public knows better. The American people are aware that—

The purchasing power of their dollar is dropping at an accelerating rate;

Long-term interest rates are at cruelly high levels:

The administration has lost the power to control the Federal budget;

The dollar is under attack from abroad;

The stability of the world monetary system itself is threatened;

Our cities are seething with discontent and the possibility of civil strife;

Our rural areas are struggling under the worsening cost-price squeeze on agriculture;

Our so-called full employment has been bought by the heavy manpower requirements associated with the Vietnam war and by swollen Federal payrolls; and

The possibility of other military involvements overseas looms large.

Can we take pride in this record? Are these the fruits of wise and prudent leadership? Haven't the American people the right to expect more from an administration that promised creation of a Great Society?

The reluctance of the American people to pay higher taxes does not stem from indifference to the needs of our poor, the crisis in our cities and rural areas, or the demands for better education and health, clean water and air, and improved transportation services. The public lives daily with these problems and, if anything, is eager to get on with the job. And so are we.

But the public is not willing to underwrite vast new Federal expenditures on top of an already swollen, often ineffective and outmoded structure of existing Federal programs. The American people demand more than lipservice to the urgent need to establish a new order of priorities in domestic spending.

Nor is the public ready to recognize that the Federal Government is the only, or even the best, agent of social change in our society. Again, more is demanded than mere lipservice to the concept that our private institutions and our State and local governments must be given new incentives and mobilized to play the key role in meeting our public problems.

The administration has failed to appreciate the depth of feeling which exists on these questions. Its words embrace priorities, private initiative, and creative federalism, but its deeds retain its commitment to the State solutions of the 1930's.

The President's talk about establishing priorities and making sacrifices is nothing but that—just talk. The 1969 budget, which has already been made obsolete by the rapid pace of events, is a case in point. Contrary to the administration's pretentions, the budget is neither tight, frugal, nor stringent. It does not reflect a realistic sense of our national priorities.

By what stretch of the imagination does the administration call this a tight budget?

At existing tax rates, and even based upon unrealistically optimistic economic assumptions, the 1969 budget will show a massive minimum deficit of $20 billion for a second year in a row. New obligational authority would increase by nearly $18 billion compared to an increase of $7.4 billion in the current year. Total budget authority would increase by over $15 billion, compared to less than $4 billion in the current year. Net obligations incurred would increase by $15.7 billion, compared to $10.8 billion in the current year. Employment in the civilian agencies would increase by over 40,000 in fiscal 1969.

A budget is more than a blueprint for a single year; it is a plan for future spending as well. On this basis, the President's new budget is sowing the seeds for yet another spending explosion.

We continue to pay a high price for the administration's refusal to bring Federal spending under firm control. The reason the administration has met resistance to its request for higher taxes is that it has not made a real effort to reduce domestic spending and set hard priorities among domestic programs.

Last year it announced with great fanfare budget cuts in the current fiscal year. Yet, even after these cuts, total administration budget expenditures will rise by nearly $3 billion above the January 1967 estimate. This was in spite of the fact that the bipartisan majority of the Joint Economic Committee last year recommended a $5 billion cut, not a $3 billion increase. And while it asks for more new taxes, the administration conveniently overlooks the fact that payroll taxes have already been increased and will yield an additional $3.3 billion in the coming fiscal year.

To back up its plea for higher taxes, the administration preaches voluntary restraint to labor and business. There has yet to be any recognition of the need for the Federal Government itself to exercise restraint or of the Government's primary responsibility for our present economic problems. If the administration continues along this route, we would not be surprised if it eventually tries to impose mandatory price, wage, and credit controls on the American people. Its balance-of-payments policies offer an instructive and disquieting parallel.

Its emergency balance-of-payments program is shortsighted and self-defeating. Its analysis of the problem is completely contradicted by its proposed solutions. With one stroke, the administration has reversed our postwar policy to free international trade and payments from restrictive and crippling controls. It hopes to buy some immediate gain in our balance of payments while it undermines the value of the U.S. dollar as a fully convertible and stable reserve currency. In the long run, the resort to disguised devaluation will lead to larger gold outflows, reduced confidence in the dollar and a weakening of the entire free world economy.

The administration apparently regards all overseas travel as mere pleasure seeking in spite of the fact that much is related to education, essential Government activities, and business purposes related to the expansion of exports. It is curbing the freedom of our citizens without having made a real effort to increase foreign tourism to the United States. The administration delayed the appointment of its travel task force for over 11 months and finally acted only a month before it pushed the panic button.

The administration has yet to come clean with the American people about the economic effects of the Vietnam war. Private studies conducted at the University of Michigan show that the Vietnam buildup between the first quarter of 1965 and the last quarter of 1966 was responsible for a total rise of $32 billion in annual gross national product and for, roughly, 3.2 million additional jobs. According to the study, without Vietnam spending, output in the final quarter of 1966 would have been almost 4 percent below that reported, while unemployment would have risen to a recession level of 7.7 percent of the labor force.

American agriculture is also in serious trouble. Farm parity prices are the lowest since the depression days of the thirties and costs of production are steadily rising under the administration's inflationary policies. Farm debt has reached the danger point.

There is no disguising the difficulties before our country by a long and weary statistical recital of our economic achievements. The wonder is not that we have made economic gains but that, having made those gains, the administration has failed so completely to marshal our vast resources effectively to solve our growing agenda of urgent and critical problems.

For our part, whether collectively or individually, we have consistently advocated that at high employment, the avoidance of inflation required a more moderate pace of monetary advance and a Federal budget somewhere near balance. Time, I think, has proved that judgment correct.

As long ago as 1963, the minority members of this committee proposed a nonpartisan Commission on Federal Expenditure Policy to establish priorties in public spending and to identify those activities which could be better performed and with superior effectiveness by State and local governments and by the private sector. We repeated that recommendation in 1964 only to have it rejected outright by the administration in both years.

For years, we have advocated less reliance on aggregate spending to eliminate hard-core unemployment and more emphasis on manpower training in the private sector through devices such as the Human Investment Act. We have urged the formation of a public-private Economic Opportunity Corporation, new machinery to combat emergency strikes, a plan to promote and assist in providing homeownership among low-income families and better methods to increase the revenue sources of State and local governments.

In 1963, long before the administration finally acted, the minority foresaw the coming world financial crisis and introduced a resolution calling for reform of the international monetary system and parallel action to drastically reduce our balance-of-payments deficit. Had the administration assigned a high priority to the solution of these problems years ago, we would not now be experiencing our staggering balance-of-payments deficit and gold outflow.

We regret that most of these and other recommendations which we have made through the years were received by the administration with indifference or outright hostility. This applies as well to our belief that before a tax increase could be of benefit to the economy it would have to be tied to a package of significant reductions in nonessential spending. Only such a package would slow inflation below the 3-percent increase which the administration appears content to tolerate this year and enable a reordering of priorities so necessary to help solve our unmet domestic problems.

Although time is growing short, and our problems are mounting, we are confident that our people still have the will and the capacity to overcome them if given wise, effective, and courageous leadership.

Thank you very much, Mr. Chairman.

Chairman PROXMIRE. Thank you, Congressman Curtis.

Congressman Bolling?

Representative BOLLING. Mr. Chairman, I would like to hear Mr. Ackley.

Chairman PROXMIRE. Are there any other statements?

Senator JAVITS. No, thank you, Mr. Chairman.

Chairman PROXMIRE. Mr. Ackley, once again I apologize for detaining you. You have a fine statement, as usual, and you may go right ahead with your presentation.

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

Mr. ACKLEY. Mr. Chairman and members of the Joint Economic Committee, may I begin with a slightly personal note. This is the sixth year that I have appeared with my Council colleagues before this committee at its annual hearings on the President's Economic Report, and it will be, as you noted, my last such appearance.

Each year I have very much appreciated the opportunity to participate in your important considerations, and I surely do so again in 1968.

The Council and the Joint Economic Committee have not always been in full agreement, as you indicated. But I do hope that our discussions have been helpful to you, as they certainly have been to us.

In 1968, as in every year, the President's Economic Report and the Annual Report of the Council of Economic Advisers place primary emphasis on the goals of high employment and growing and sustainable prosperity. This year, however, other goals must share the forefront, especially because they bear heavily on the prospects for an enduring prosperity over the longer run.

To protect the future of our expanding economy, we urgently need, in 1968, to make progress toward restoring price stability and to achieve notable improvement in our balance of payments. The two reports that are before you discuss many policy actions that have been taken, and many others that are proposed, to deal with these and other objectives.

The Tax Surcharge and the Outlook

First and foremost among the policy recommendations is the proposed surcharge on individual and corporate income taxes. We should like, once again, to outline briefly for the committee the key propositions underlying this recommendation.

First, even with the President's stringent expenditure program, if there should be neither a tax increase nor monetary restraint, Federal economic policy would be inappropriately stimulative, given the present and prospective strength of private demand. The expenditures of the Federal sector would continue to outrun receipts by, roughly, $13 billion—national income accounts basis—in 1968, essentially the same wide margin as in 1967, and an almost unprecedented margin at high employment.

The persistence of such an extremely large deficit, in combination with a monetary policy that was not highly restrictive, would threaten strong inflationary pressures, unless there were a marked, abrupt, and quite implausible weakening of private demand. Such a weakening would have to involve a substantial further increase in the saving rate from its recent unusually high level, a major shift of investment plans, or a disappearance of the fundamental strength of the demand for new homes—any one of these not offset by unexpected strength of demand in another sector.

We obviously cannot guarantee that the basic strength of private demand will not weaken significantly in 1968: we can tell you that a careful and objective review of the evidence gives no basis for thinking that this is probable. A further delay in stabilization policy can be justified at this time only if one is prepared to forecast such a marked weakening as the most probable development.

Second, although additional monetary restraint could hold the economy in check, it would be far less desirable than fiscal action. Tight money—raising interest rates to unprecedented levels for the United States—would bear down unevenly and harshly on homebuilding, mortgage-financed nonresidential construction, small business, and State and local capital projects.

A policy of monetary restraint would, in effect, levy a tax that would be far less equitable and less efficient than the President's proposed surcharge. Tight money could also jeopardize the stability of financial markets, with unpredictable effects on the economy. Yet some further monetary restraint is what we must expect if we do not have fiscal restraint. Our present choice is not whether to apply economic restraint, but rather what kind of restraint we prefer—fiscal or monetary.

Third, we cannot and should not count on major cutbacks in Federal expenditures to do the needed job of restraining aggregate demand. Important cuts have already been made by the President in submitting his budget. In light of our defense needs and our social priorities, and a realistic evaluation of the appropriations process, we cannot believe that the President's budget is going to be drastically slashed by the Congress. Indeed, it will require an unusual degree of restraint to implement the reductions and reforms proposed by the President.

Fourth, the tax increase will have significant and welcome effects on prices, interest rates, and our balance of payments. To be sure, it will not solve these problems all by itself, nor will it exert its full effects immediately. But the tax increase is essential to our objectives of decelerating price increases, and of improving our world trade position during 1968—objectives which are going to be difficult to accomplish at best.

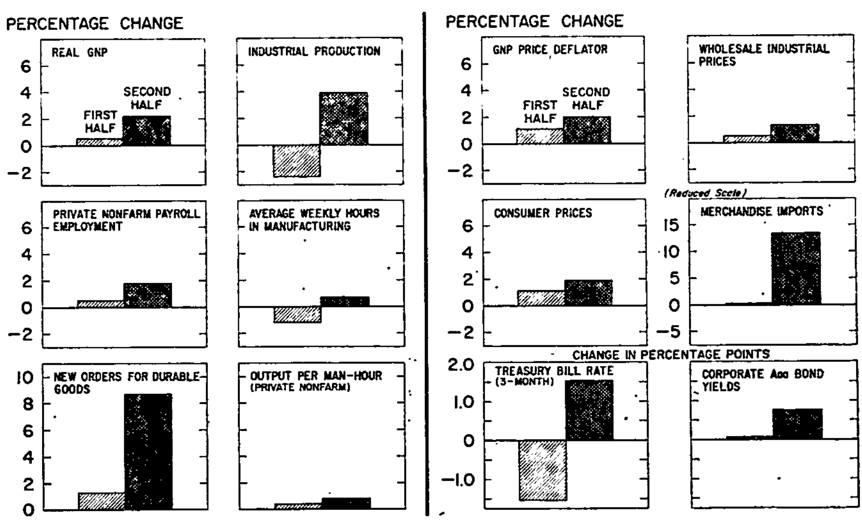
The Tax Surcharge and Prices, Interest Rates, and Imports

Considerable interest and attention have been paid to the question of how much and how soon the tax increase can improve the performance of prices, interest rates, and our international trade position. The tax increase clearly will moderate the growth of aggregate demand. The question then is, really: How much difference does the overall pace of the economy make to our performance in these areas?

The evidence of 1967 offers some clear-cut answers to this important question. Let us look at the facts of our recent history.

The attached chart, which I have a larger version here, Mr. Chairman, shows a number of the major contrasts in economic performance between the first and second half years of 1967. The six blocks on the left side of the chart record the speedup of economic activity during the second half, in contrast with the sluggishness of the first half.

CHANGES IN SELECTED ECONOMIC INDICATORS DURING THE FIRST AND SECOND HALVES OF 1967



NOTE: BASED ON SEASONALLY ADJUSTED DATA FOR ALL SERIES EXCEPT WHOLESALE AND CONSUMER PRICES, TREASURY BILL RATE, AND BOND YIELDS.
SOURCES: COMMERCE, LABOR, TREASURY, FEDERAL RESERVE, AND MOODY'S.

In the case of quarterly data, the changes are measured from the fourth quarter of 1966 to the second quarter of 1967, and from the second to the fourth quarters of 1967. In the case of monthly data, the changes are measured from December 1966 to June 1967, and from June to December 1967.

Industrial production and the factory workweek, which declined from December 1966 to June 1967, rebounded strongly from June to December. The annual growth rate of real GNP picked up from 1 percent in the first half to 4½ percent in the second half of the year. Private nonfarm jobs grew by 1 million from June to December, nearly four times the gain in the preceding half year. Durable goods orders, which had already recovered markedly by June, were 8½ percent higher in December. And, although productivity lagged all year long, it, too, showed signs of improvement in the second half.

The right side of the chart shows the equally striking contrast between the performance of prices, interest rates, and imports during the first and second halves of the year.

Both the GNP price deflator and the Consumer Price Index slowed to an annual rate of increase of slightly more than 2 percent in the first half; but both advanced at an annual rate of nearly 4 percent in the second half. For wholesale industrial prices, the step-up was from a 1-percent to a 2½-percent annual rate of increase. Our merchandise imports in June were barely above their level of December 1966; but in December 1967 they reached an alltime record at 13½ percent above the June level. Short-term interest rates at midyear were far below their levels at the start of 1967; but by the close of the year, they were back to where they had started. And corporate bond rates, which were already back to January levels by midyear, climbed to far higher ground by December.

We submit that it is no coincidence that the acceleration in economic activity during the second half was associated with a marked speedup in the rate of price increases, a major turn-around in interest rates, and a new upsurge in imports. The pace of demand was a key factor in these results. And the pace of demand will continue to determine how we fare in 1968.

We hasten to add that the first half of 1967 was not a satisfactory period of economic performance. The economy should grow more rapidly than that, and it will—with the tax increase the President has proposed. On the other hand, the pace of activity during the second half of 1967 was excessively rapid. To be sure, the 4½-percent rate of growth of real GNP was not significantly above the target we consider appropriate. But that rate was significantly held down by the unusual volume of work stoppages during September, October, and November, most notably the strike at the Ford Motor Co. Adjusted for strike effects, the real growth rate in the second half of 1967 was much closer to 5½ percent. And that is too fast for safety. And so is the nearly 8 percent annual rate of growth of industrial production from June to December as well as the 1 million increase of private nonfarm employment.

Of course, price increases reflect cost increases as well as the state of demand. But cost increases, too, are not independent of demand—especially in a slightly longer run. And the extent to which cost increases are reflected—or pyramided—in prices is strongly influenced by demand conditions.

Of course, interest rates reflect monetary policy as well as the pace of the economy and the size of Federal borrowing. But the difference between the behavior of interest rates in the first and second halves of 1967 was not the result of any change in monetary policy.

Whether or not there is a tax increase in 1968 will make a big difference in the growth of demand. It will thereby also make a big difference for prices, interest rates, and our trade surplus. And that is precisely why we need the tax increase.

A Three-Pronged Defense Against Inflation

The contribution of the tax surcharge to a healthy pace of economic expansion is one element of a three-pronged defense against rising prices. It is an essential element because an excessive growth of demand would thwart any other policy measures to curb inflation in a free economy.

But the surcharge must be complemented by vigorous efforts in two other directions. First, utmost restraint on the part of those who have discretion in price and wage determination is more important than ever. Second, we must work to improve the structure of our economy so as to remove as much as possible of its inflationary bias.

A limited number of businesses and labor groups exercise a substantial influence on the overall movements of wages and prices. When demand is rising excessively, prices and wages will advance too rapidly even if those with market power behave responsibly. But in an environment in which demands and supplies are generally well balanced, their decisions can exert a crucial influence. The price and wage decisions of those with market power are directly significant; and—even more important—they affect other decisions, and thus extend their influence throughout the economy.

If we are to move back toward price stability in a high employment economy, it is essential that businesses and unions exercise restraint in their price and wage decisions. Progress toward price stability can begin in 1968 only if the average of new union settlements is appreciably lower than the 5½-percent average in 1967, and only if business firms avoid any widening of their gross margins over direct costs and indeed absorb cost increases to the extent feasible.

In pointing to the need for restraint, the Council is certainly not seeking to force any particular pattern of price or wage behavior on any group. Rather, we are asking for the full cooperation of private groups which exercise a significant influence in an important area of national concern. They have a responsibility to recognize that their decisions affect the whole Nation, as well as their own businesses and their own memberships.

Given the complexity of price and wage problems, responsible behavior cannot be described by a simple formula—especially during a period of generally rising prices. But the direction in which we must move is clear—it is toward smaller wage and price increases in 1968 than in 1967. And it is equally clear that we have a long way to travel. A full return to price stability will be achieved only when average wage increases once more conform to the growth of productivity, and when prices reflect fully the stability of average costs which would then result.

We will not get there in 1968. But it is crucial that we begin to travel in that direction. With both the tax increase and responsible wage and price behavior, we can expect the rate of price increase to decelerate by yearend to an annual rate of 3 percent, or even less. Without both, the tax increase and responsible behavior, the rate could accelerate to 4 percent, or even more. This would not make much difference in the rate of price change from the average for 1967 to the average for 1968. But in the one case, we would be heading into 1969 with the clear prospect of moving back toward reasonable price stability. In the other case, the wage-price spiral would be turning faster, and the prospect of restoring reasonable price stability—other than through a severe recession—would be remote.

The Council's report discusses the many sources of inflationary bias which tend to push prices up even when total demand does not strain the supply capabilities of the economy. Market power on the part of labor and management is only one element. There are, in addition, in some of our markets and industries, "structural" features which impede efficiency and impair competition.

Although the efficiency of the American economy today is unparalled, there are nevertheless areas of stagnant technology, weak management, firms of inefficient size, poorly functioning markets, restrictive labor practices, and inadequate methods for training and recruiting workers. Some of the problems may actually be aggravated by Government policies that unintentionally impair incentives and opportunities to economize. Indeed, efficiency and costs are substantially influenced by a wide range of Government policies, extending to procurement, international trade, competition and trade practices, technology, and many others.

This administration has been constantly engaged in efforts to promote efficiency and price stability; many agencies have participated individually and cooperatively. But there is need for improvement in the machinery of Government to bring the objective of overall price stability more clearly into focus and to give it a high priority in the formulation of Government programs across the board.

To achieve this needed improvement, the President has established a Cabinet Committee on Price Stability. The committee will not become involved in specific current wage and price matters. It will focus on the long-term issues that have challenged the best efforts of every free industrial economy to reconcile price stability with high employment.

In conclusion, we should like to just mention several other issues that play a prominent role in economic policy for 1968, and which are stressed in the President's Report, as in our own. Chapter 4 of the Council's Report is devoted to a discussion of the problems of poverty, as they are affected by structural changes in the American economy and by the increasingly urban character of our society. The discussion points to the very high priority of Federal programs that can contribute significantly to the economic opportunities of disadvantaged Americans, both urban and rural. Chapter 5 of our Report discusses the specific measures required to deal with our balance of payments, the need for international cooperation in trade and payments, and potentialities for strengthening the world monetary system. The success of measures in both areas depends on our ability to maintain a sound and healthy overall prosperity. And that requires prompt enactment of the President's tax program.

Chairman PROXMIRE. Thank you, Chairman Ackley, for your usual superlative Report. We appreciate it very much.

As I understand it, the proposal for the tax increase is designed to raise $10 billion and decrease the deficit by roughly that. This leaves out of account the other tax increases or tax measures the President proposes, sustaining the excise and speedup of corporate income tax. We would get $10 billion from the surtax, roughly, by itself. It also, as I understand it, is designed to slow down price increases, reduce the interest rate, cut imports and expand exports and, at the same time, maintain employment and growth.

You made a very strong statement here about the unlikelihood of Congress being able to reduce spending below the President's requests. In view of what the Congress did last year in cutting both expenditures and appropriations, in cutting expenditures roughly $4½ billion and appropriations by about $9 billion, isn't it perfectly possible that given the mood of Congress and the expression of very powerful and able people like Wilbur Mills and others that the Congress is likely to cut spending this year? I am not saying that it is good or bad. I am saying that Congress is likely to do it.

Mr. Ackley. Mr. Chairman, it was perhaps inappropriate for us to comment on what Congress is likely to do. However, our reference was referring to the fact that the budget, as proposed by the President, is already one which incorporates substantial cuts. Taking off from the cuts, that you referred to, that occurred last year cooperatively by the administration and by the Congress——

Chairman Proxmire. You are quite right.

What I am trying to say is, Isn't it a possibility, a real possibility, that Congress may do this year as it did last year? What I am really addressing myself to is what could be economic overkill, supposing we do adopt the amendments that are suggested by able Members of the Senate to cut back spending to $176 billion and also increase taxes substantially—do both. There is a great deal of sentiment for this on both sides of the aisle. It may or may not pass. It is a real possibility and I would appreciate it very much if you would give us your economic expertise of what this would do to the economy?

Mr. Ackley. Certainly, Mr. Chairman, the possibilities of overkill always exist. If the Congress were to cut expenditures by $10 billion and were at the same time to impose a $10 billion tax increase, the possibilities of overkill would be very strong. Indeed there has been a strange proposal lurking around the Congress which suggests that the larger the cut in expenditures, the larger the tax increase that the Congress might be willing to vote. This seems to me to be quite an inappropriate kind of economic reasoning. Rather, to the extent that expenditures are cut the tax increase needs to be smaller to achieve the same result.

Chairman Proxmire. I think that is a helpful observation. I think we need it said, because this is exactly the atmosphere we are in, that the argument will be that if the President will cut spending we will give him a tax increase and if he won't cut spending we won't give him a tax increase. This, it seems to me, is the worse prescription, and I am glad you concur in that.

What you are saying to us, as I understand it this morning, is that the best judgment by you and your other members of the Council, is that we can reduce demand by increasing taxes by $10 billion, surtax by $10 billion, or we could have a similar effect—I don't think it is the same, I think it is much more intensive, have a similar effect—by decreasing Government spending. But if we do both it will be too much, it will substantially increase unemployment and it will slow down the economy and it could abort the 7-year growth in our economy. Is that correct?

Mr. ACKLEY. Mr. Chairman, if I could comment just briefly, in this correction, on your opening statement. With respect to this proposition, it seems to me that, begging your pardon, you have put forward some rather contradictory propositions. You suggest first, that the economy doesn't need any restraint, and indeed that a tax increase would by itself perhaps end the prosperity, throw us into a recession and put an end to the 7 years of expansion; the economy is too weak to stand the tax increase. Yet you propose expenditure restraint instead.

Likewise, it seems to me——

Chairman PROXMIRE. If I can address myself just momentarily to that, since we have turned this around a little bit, may I say that when I say that the economy doesn't need restraint, what I am trying to stress as much as I can is the very, very great uncertainty under which all of us labor at the present time and the very great importance of adopting economic policies that can be put into effect promptly, and enforced promptly.

Mr. ACKLEY. Right, Mr. Chairman.

Chairman PROXMIRE. In 1966, the President cut spending, as I recall, about $3 billion. He made the cut effective the day he made the decision to do so. He restored it 3 or 4 months later. The very day he decided to do it. It is true that a more substantial cut in spending might take more time but certainly not the months or years that this tax increase has taken, and the effect of the spending cut is likely to be swifter, and the restoration of the spending it seems to me would be easier. That is why it may not be inconsistent for me to argue that whereas I don't think the economy may need restraint 6 months from now. At the moment the economy is blooming and going very well; temporary spending reductions can restrain the economy for now and be restored as quickly later. The tax hike and cut will take longer to enact and repeal.

Mr. ACKLEY. Mr. Chairman, I was going to add, it seems to me, that many of the points you make about the ineffectiveness of a tax increase in affecting consumer expenditure and prices and so on would apply equally to fiscal restraint secured through expenditure control, expenditure reduction. Indeed, so far as I am aware, the effects on prices, on employment, on interest rates, on international trade, of restraint through expenditure cut, are essentially the same as from taxes.

Chairman PROXMIRE. I think that is right. I think my statement would have been clearer if I had put even more emphasis on the timing than on this other aspect of it. I put some emphasis on the timing aspect of it. How about addressing yourself to that angle.

Mr. ACKLEY. I was about to come to that.

Chairman PROXMIRE. Would you agree that it is possible for the President to reduce spending, as he did in the past, promptly, and restore it rather promptly?

Mr. ACKLEY. The President can take action or the Congress can take prompt action which, over a period, will have, a substantial effect on expenditures. But in terms of action that will have a quick effect, I think it has been the unanimous judgment of every economist who has ever studied this question, that tax changes can be effective much more rapidly and flexibly than expenditure changes.

A tax increase, if it were enacted now and became effective in terms of withholding on April 1, would immediately begin to remove from the stream of income and the resultant spending the full annual rate of the tax increase.

Chairman PROXMIRE. It would immediately reduce income by the full amount of the tax increase; but would it reduce spending? That is the effective thing.

Isn't it also true that many economists, perhaps most economists, argue that consumers take some time to adjust their spending patterns?

Mr. ACKLEY. There is——

Chairman PROXMIRE. They might very easily reduce their proportion of savings, increase their proportion of spending, and the effect might neutralize the tax increase. Isn't that perfectly possible?

Mr. ACKLEY. Anything is possible, Mr. Chairman.

Chairman PROXMIRE. Not only possible, but isn't it likely?

Mr. ACKLEY. You suggest on the one hand the possibility there would be no effect on consumer spending and on the other hand that consumer spending might boom and go back to 5½ percent?

Chairman PROXMIRE. What I am saying is that consumer spending might be affected over a considerable period of time while the consumer adapts himself to the tax increase; in other words it won't come in July and August of 1968, but perhaps come in a later period, perhaps as I said, in 1969 or 1970.

Mr. ACKLEY. In our judgment, Mr. Chairman, the tax increase effective April 1 would have an appreciable effect on the second quarter's results as well as on the third and fourth quarters' results. Indeed, the fact that there is some lag is one reason why the administration was very anxious to have this tax increase enacted last fall, last summer, indeed.

But again, let's get back to the relationship of expenditure changes and tax changes. Do you think that if, say, Federal employees are thrown out of their jobs by an expenditure cut that the lag in the adjustment of their spending to that is different from the lag of consumers whose incomes are curtailed by a tax increase? Or that business firms whose sales are reduced because of a reduction in sales to the Government will react differently, more slowly, more quickly, than they will react to a change in taxes? I really don't see the basis for that, Mr. Chairman.

Chairman PROXMIRE. My time is up. I would be happy to answer that question and simply say, I do think that, as Senator Paul Douglas used to argue, you have a more complete effect by reducing spending or increasing spending than you do by reducing or increasing taxes because of the savings factor. You would have the immediate effect in a cut in spending.

So far as throwing people out of work is concerned, we know on the basis of what happened last year that that isn't at all likely; and we also know that when you cut back construction contracts and others, without having an effect of throwing Government employees out of work you have a terrific demand for specific items.

My time is up.

Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I am happy to pursue this line of thinking and I might say the manner in which Mr. Ackley phrases his response "to throw Federal employees out of work," reveals a bias. Actually, all you have to do is not fill all the vacancies that just in the ordinary process of turnover occur.

But this business of cutting expenditures, I suggest, may require that the economists talk to the political scientists a bit to learn whether programs can or cannot be done immediately. When we started World War II there was almost a complete cessation of public works and certainly we have seen frequent demonstrations when the Executive wants to cut expenditures, of his doing so promptly. He is the one who spends money, not the Congress. Congress merely gives him the power to spend. He has the judgment on setting the level of spending.

So, from an economist's standpoint, I think we need to direct attention to a question that I directed to the panel of economists who appeared before the Ways and Means Committee last fall. As far as hitting at the inflationary forces, what is the impact of a $1 billion cut in Federal spending compared to an increase of $1 billion in revenue? With the exception of one, I think there were eight panelists there of all variety of economic thinking, they all said that cutting expenditures has a much greater multiplier effect in stemming these forces of inflation.

Would you tend to agree or disagree with that observation?

Mr. Ackley. Yes.

I think it is correct that there is a somewhat larger effect on total spending in the economy of $1 billion of expenditure reduction than $1 billion of tax increase. It is not a matter of large magnitude but there is some difference.

Representative Curtis. But many of the panelists thought it was of large magnitude. My own judgment is: I do think, of course, you have to then go in and consider what kind of spending you are going to cut. You must go into details because the kind of expenditure program cut makes a difference.

Let me say this, that these same economists, with the exception of one, said that in effect, and I hope I am not misquoting them, that cutting expenditures was absolutely necessary, and then, even after cutting expenditures, it still would be necessary to have a tax increase to hit at these inflationary forces. My own judgment is somewhat along those lines, although I worry about what the chairman said lest there be overkill. But, I believe, even cutting expenditures and holding them at the level of last year, although I think they even should be cut below that, but even doing that, it seems to me it probably would be necessary to think in terms of a tax rate increase. But here is where the discussion, I think, from an economic standpoint must start, and then move into the area of a dialog of where expenditures might be cut.

Now, regrettably that dialog has never developed. I have given my list of over $15 billion expenditure cuts, and I would be happy to examine them to see what economic support they would have, but we have got to get over the first hurdle of agreeing to discuss expenditure cuts of this kind of magnitude.

Your statement says: "Even with the President's stringent expenditure program."

What I would like you to do is to match that rhetoric with the arithmetic of the budget. The word "stringent," how does it fit the figures that you have on page 54 of the Economic Report? On page 65, instead of figures there is this statement: "It is a budget consistent with a program of fiscal restraint." That is just begging the question.

On page 54 you say—

> Federal expenditures in 1968 are expected to rise by about $15 billion, considerably less than the $21 billion increase of last year.

Well, I would say $6 billion less, rather than "considerably" less; $15 billion increase is not descriptive by the word "stringent," particularly as you pile this increase on top of increase, year after year. If you go back to fiscal 1960, using the administrative budget we were at a $77 billion expenditure level. Expenditures in the budget for 1969 are projected on up to over $150 billion interpolating for the administrative budget. Would you comment on how you arrive at such a term "stringent" in light of the actual figures?

Mr. Ackley. I think discussion of the budget should be based on the budget document rather than on the Economic Report, since the budget document goes into it in much more detail.

As the budget document points out, however, the $10.4 billion increase for fiscal 1969 on the new budget concept basis is explainable entirely in terms of defense, pay increases voted by the Congress, social security.

Representative Curtis. Mr. Ackley, may I interrupt just a moment? We are dealing in aggregate, not in components. I understand this.

I am asking, though, in the aggregate how can you call this a stringent expenditure budget when it is $15 billion more than a budget that was $21 billion more than the preceding one which, incidentally, was about $10 billion more than the preceding one in context of a previous historical increase of about $5 billion a year, in the expenditure level? That is the crucial thing.

Yes; I want to get into this other aspect, too, of the details. But, first let's admit, please, that this is not a correct use of the word "stringent."

Mr. Ackley. My reference to stringent, Mr. Curtis, related to the rather difficult decisions the President had to make and did make to cut back a number of programs—programs that have a lot of support in the Congress and the country.

Representative Curtis. Let me interrupt to ask, Isn't that the usual budgetary process? It is always difficult to cut back on programs, because every program has its advocates, and most programs have merit. This is no more than a description of the budgetary process.

The question of stringency, I would argue, to try to develop this dialog, relates to what your aggregate comes out to. If your aggregate is $15 billion more than a previous one, which was $21 billion more in context with increases that have been averaging around $5 billion, how can you use such a term? Don't go back and defend by recounting the difficulties involved in making up any budget. Your results are there for us to inspect.

Mr. Ackley. I think the matter of what terms we use are choices which each of us will have to make. I believe those who participated in the formulation of the budget for fiscal 1969, regard it as one which required unusually difficult decisions—both the effort to cut back programs which, as you say, are good programs and have a lot of support, and, second, to refrain from increasing other programs in the face of very urgent social problems of our cities, of housing, and of poverty, and all the rest. I continue to regard the result as a stringent budget. I recognize that others may characterize it in other ways.

Representative CURTIS. Well, I see my time is up. Just one comment. The President talks in his 28 pages of "The role of fiscal restraint." It is one of the subheads. Well, all the discussion there and the bulk of the discussion in the other 200 pages in the Economic Report, deal with new restraint on the people by paying more taxes.

Now, I look at fiscal policy as twofold: One, expenditures which I want to discuss, and the administration refuses to discuss. What would the economic impact be if we cut back on particular expenditures? The discussion in the Economic Report is solely on the restraint that would be imposed by increasing taxes. This I regard as simply transferring decisionmaking power over spending from the private sector to the public sector. I would like to get into the question of whether in specific areas of the public sector, the Government, the Federal Government, actually spends money for specific programs more effectively than does the private sector. This lies at the base of what I think should be the debate in regard to how we correct what we all agree is the economic problem; namely, the size of the deficit. The size of the deficit creates the problems. Some think that the primary way to cut the size of the deficit is by cutting Federal expenditures, not cutting the level below previous years, but not increasing them to the tune of $15 billion on top of a $21 billion increase the year before. Yet, here we are again. We went through all this discussion last year. The Joint Economic Committee said it felt expenditures was the hub of the problem. The administration witnesses have been before the Ways and Means Committee, constantly, and never have they been willing to discuss this question of expenditure control in aggregate or in these kinds of details. They simply use adjectives such as "stringent," to avoid the discussion, or "well, we have cut hard and we have cut deep." I submit that these adjectives, this rhetoric, is not matched with the arithmetic.

Chairman PROXMIRE. Congressman Bolling?

Representative BOLLING. Mr. Ackley, I am tempted to make some sort of facetious remark that the committee ought to adopt procedures so that the witness can have equal time. I will restrain it.

Would you review for me very quickly, just give me the date and the amounts, starting in January of 1966, the administration's series of recommendations with regard to tax policy?

Mr. ACKLEY. Mr. Bolling, in the January state of the Union message Economic Report, and budget message, the President made some recommendations with respect to excise taxes, a graduated withholding system for personal taxes, and a speedup of corporate taxes.

Representative BOLLING. This is January 1966?

Mr. ACKLEY. Yes, sir.

Representative BOLLING. All right.

Mr. ACKLEY. Those recommendations were, I think, generally accepted by the Congress and put into effect some time in the spring.

In the January 1966 budget and economic messages, the President referred to the possibility that additional restraint might be needed during the year, and said that if it appeared that it should be necessary, he would make further recommendations.

The Joint Economic Committee, in commenting on the 1966 Economic Report, indicated that it felt that further fiscal restraint might be required, and indeed recommended, as I recall, that the Congress actually pass tax legislation which would be kept in suspense and later activated when necessary.

In September 1966, the President, as you will recall, did conclude that further restraint was necessary, and he withheld some $3 billion of appropriated funds. That, of course, didn't mean an immediate $3 billion reduction in spending—rather, an action to withhold appropriated funds which otherwise would have been spent over many subsequent months—and he asked for the suspension of the investment tax credit, which again happened fairly promptly.

In his January 1967 Economic Report, budget, and state of Union message, the President indicated that although the first half of calendar 1967 would see an economy which would not be vigorous because of the inventory adjustment which was obviously going to be necessary, that in the second half of the year the economy would require additional restraint. Thus, he proposed a 6-percent surcharge on income taxes, to be voted and effective somewhere around midyear.

In August of 1967, the President sent a message to the Congress repeating his recommendation for a tax surcharge, but lifting the proposed rate of surcharge from 6 to 10 percent; and at that time asked for the extension of excise taxes that would otherwise expire on April 1, 1968, along with a further speedup in corporate taxes.

The proposal at that time was that the individual income tax surcharge should become effective on October 1, and the corporate surcharge as of July 1, 1967.

In January 1968, the President again, in his budget, state of the Union, and economic messages, repeated his proposal for surcharges, for the extension of the excise taxes, and for the speedup of corporate income taxes. Recognizing that time had passed, he proposed effective dates of April 1 for the individual surcharge and January 1 for the corporate.

Representative BOLLING. Only one question, to be sure I understand. My memory is that the request that was made for the suspension of the investment credit met with very prompt action in the House of Representatives and then was slowed down very substantially in the U.S. Senate. So that actually the Congress reaction was relatively slower than that proposed by the President.

Mr. ACKLEY. I think that is essentially correct, Mr. Bolling, although I believe that the President proposed that the suspension of the investment credit be made retroactively effective to the date on which he proposed it and Congress did later make it retroactively effective, although not to the extent that he proposed.

Representative BOLLING. The recounting of this history merely leads me to reiterate what I have said many times before. It seems to me clearer and clearer and clearer that the Congress should give to the Executive, within very specific limits, the rights to raise and lower tax rates, income tax rates. It seems to me that this is the great blank in the cooperative endeavor between the Congress and the Executive, because Congress repeatedly proves its inability to act very promptly.

Now, in whatever time I have remaining, I would like to see if you have available what cuts the Congress, with all that noise last year, actually made, in appropriations and in expenditures.

I hesitate to refer to this, but I have been here long enough and through enough different sets of economy drives to note a very curious fact that there is usually a great deal more rhetoric and oratory than there is actual cutting. We have a very convenient procedure called supplemental appropriations and sometimes we find another way to obtain the money for the programs that are popular. I just wonder if you have available now or if you do not now have available, if you could supply for the record, some analysis of what actual cuts up to this date appear to have been made by the Congress that were effective?

Mr. ACKLEY. Mr. Bolling, my recollection is that, the Congress, in dealing last year with the budget for fiscal year 1968, reduced appropriations by something in the neighborhood of $4 billion or $5 billion, which would have reduced expenditures by $1.6 billion, and that the President then, later in the year, proposed a formula which was eventually adopted by the Congress which cut another $2.7 billion from estimated expenditures for fiscal 1968 for a total reduction in expenditures of $4.3 billion, and a total reduction in appropriations or other expenditures authority of close to $10 billion. Now, while all these reductions were being and are being put into effect, other elements of so-called noncontrollable expenditures—programs for which the administration has no authority to influence the rate of expenditure—were also increasing. So that, I believe, the present estimate of expenditures for fiscal year 1968—on the old administrative budget basis—will end up about $2 billion higher than the budget originally submitted.

This doesn't take away from the fact that there were substantial cuts of expenditures legislated by the Congress in cooperation with the President last year. But they were offset, and more than offset, by unanticipated increases in such things as medicaid, medicare payments, public assistance, and agricultural payments—all under existing legislation.

Representative BOLLING. One final point. It is my impression that both during the period of the last 2 years and also during the period of the Korean War the Congress had an almost infinite power for not acting promptly on the gross overall recommendations of the administration. The situation developed that the Congress, not as a group, but as a group of groups, set up different alternatives, none of which were possible, in order to avoid acting on an alternative proposed by the Executive.

For example, on the tax increase today we have a school of thought which says, "Well, we really should have a tax increase"—and, of course, I number among each of these groups many of my friends—"we really should have a tax increase, but we won't stand still for a tax increase unless we get massive tax reform to restore equity to the tax base."

Then we have another group that says, "Well, we will have a tax increase only if we have substantial expenditure cuts. But those expenditures must come in programs like the poverty program, and programs of that sort, which some others, perhaps a majority of the Congress, find unacceptable."

And then there is a third group to which I tend to belong—I am living in a dreamworld temporarily. This group believes that we ought to cut the programs that are very popular, particularly among conservatives, which deal with public works. These things are unkindly described as "pork barrel" and often have something to do with the success of a Member being continually reelected. I know sometimes I feel that the large Federal office building in my district is more important in my reelection than some of the more worthy endeavors that I have been engaged in. I guess this is shared generally so that the administration is faced with a series of wonderful alternatives, none of which is practical. And all I can say is that every President with whom I have served, starting with President Truman, in this field, in fiscal matters, including President Eisenhower, President Kennedy, and President Johnson, have my deep sympathy in trying to outtalk the Congress in this kind of thing.

Thank you.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Dr. Ackley, the country is indebted to you, whether we agree with you or not, for the labors which you and Mr. Duesenberry and Dr. Okun give to the public weal. The academic groves are much calmer and you don't have to take the beating you do here. But you have a sense of the public good and you do contribute to it by laying bare the situation with which we must deal, and I would like to join the chairman in expressing our thanks to you—insofar as I do represent at least 10 percent of the people of the country—for what you are doing.

I notice with great interest, the absence—almost complete absence—in your testimony of any reference either to the Vietnam war or to the balance of payments. But I notice that you put your whole case for a tax increase on reduction of demand, and I think there our behooved chairman can give you a real challenge.

But I think if you put this on the basis of the Vietnam war, which is costing $20 million in money for war, plus an estimated equal amount, the best estimate we have is about 65 percent, in additional civilian expenditures, accounting for almost all your increase in GNP both for 1967 and 1968. Everywhere that I went in Europe very recently, at the very gracious suggestion of the Chair, the one thing that the bankers said will relieve the demand for American gold and on the American balance of payments is a tax surcharge—they make it as specific as that—I think we are going to have a lot better case before the American people. Before you comment, may I tell you this about my own attitude? I am thoroughly with you on the fact that you have got to have a tax surcharge and you have got to have reduction in expenditures and you have got to have reforms in closing tax loopholes. I think you need all three; and I think we have to do all three and I think we are in a very bad spot in this country, where we, unhappily for us, can't make one lean on the other.

If I were the administration, I would cause a 2-to-1 ratio to exist in a a tax surcharge as between corporations and individuals. But I would—because I didn't want you to feel I was hostile to you in any way—want your comment upon this very grave question of not laying this at the door of Vietnam at all, let alone the balance of payments.

Mr. ACKLEY. Well, Senator Javits, I apologize if our brief statement this morning, which we tried to keep very brief, gave inadequate recognition to either to the balance-of-payments problems, or to the significance of the Vietnam hostilities in creating our present problem.

Certainly in our Economic Report we emphasize very much, as we did a year ago, the major role that Vietnam expenditures have had in creating the kind of economic situation in which we find ourselves. Indeed, the difference in economic performance prior to mid-1965 and subsequent to mid-1965 was repeatedly emphasized both in our Report this year and our Report last year.

Likewise, the importance of the balance-of-payments problem cannot be overemphasized. We did make some reference to it this morning, Senator Javits, in pointing to the fact that our imports of goods and services are highly sensitive to the level of demand in the economy, as illustrated even by the difference between the first and second halves of last year. In the first half, when the economy was sluggish; imports barely increased at all. In the second half they increased very substantially, in large part as a result of the faster pace of expansion of the economy.

I think it is of major importance for the balance of payments that a tax increase be enacted so as to restrain the rapid rise in imports which would otherwise occur, which would be a serious detriment to our efforts to bring the balance of payments into equilibrium.

Senator JAVITS. My colleague, Congressman Curtis, calls to my attention in 28 pages of conclusion in the Economic Report, this is all you have to say about the Vietnam war and its impact and its being really the basis for what is a war tax, and this is what you say at the bottom of page 27, "Today the war in Vietnam is costing us 3 percent of our total production. That is a burden a wealthy people can bear. It represents less than 1 year's growth in our total output." That is it.

Now, is there a conscious effort by the administration to disassociate the tax surcharge from the cost of the Vietnam war and are you a party to it?

Mr. ACKLEY. I think there is no such effort, Senator Javits, and I don't believe I could be a party to it if there were.

In the President's report, at the bottom of page 9, he does refer to defense outlays in connection with the Federal fiscal problem, the current fiscal situation. He said:

> The cost of our commitment to freedom in Southeast Asia was steadily rising. As a result the Federal sector account plunged into deficit $12½ billion in calendar 1967.

At the bottom of the page:

> Federal spending has not been growing rapidly since mid-1967, nor will it increase rapidly over the next year and a half. But because of the already high level of defense outlays, total Federal expenditures are too large to be piled on top of normal private demand without overheating our economy.

Mr. Chairman, with your permission I will submit for the record a selection of Presidential statements connecting the fiscal program to the problems imposed by the war in Vietnam.

(The following excerpts were later submitted by the CEA:)

> "If left untended (the) deficit could cause . . . an unequal and unjust distribution of the cost of supporting our men in Vietnam. . . ." (Message to Congress, Aug. 3, 1967.)
>
> "For three out of every four American families, the burden of this increase will be between a few cents and $9 a month. That is a small burden, a small incon-

venience compared to what is borne by our men in arms who put their lives on the line in Vietnam." (Message to Congress, Aug. 3, 1967).

"A failure to raise taxes would not avoid the burdens of financing a war. For these burdens are inescapable. But, instead of sharing those burdens equitably and responsibly . . . as an income tax surcharge would do . . . inflation, tight money and shortages would tax the American people cruelly and capriciously. . . . Some may hear in this message a call to sacrifice. In truth it is a call to the sense of obligation felt by all Americans." (Message to Congress, Aug. 3, 1967).

"I know it is not a popular thing for a President to do . . . to ask anyone for a penny out of a dollar to pay for a war that is not popular either. . . . We believe, on the best information we can get from every source, that as unpleasant as this is that both of these things must be faced up to." (Remarks to FHLB System officials, Oct. 6, 1967).

"I know it doesn't add to your polls and your popularity to say we have to have additional taxes to fight this war abroad. . . ." (News Conference, Nov. 17, 1967).

"The war in Vietnam is costing us about $25 billion and we are asking for about $12 billion in taxes. . . ." (State of the Union, Jan. 17, 1968).

"It is not the rise in regular budget outlays which requires a tax increase, but the cost of Vietnam. . . ." (Budget Message, Jan. 29, 1968).

"Our *ability* to act as a great nation is not at issue. It is our *will* that is being tested. Are we willing to tax our incomes an addiional penny on the dollar to finance the cost of Vietnam responsibility?" (Budget Message, Jan. 29, 1968).

"The American people are giving their sons and brothers to fight for freedom abroad. At home we must support their sacrifice by preserving a sound economy. I believe the American people will accept the cost of doing that by paying an extra cent of each dollar of income in taxes. . . ." (Economic Report, Feb. 1, 1968).

Senator JAVITS. Isn't it fair to say, Dr. Ackley, if you didn't have a Vietnam war you wouldn't need a tax surcharge?

Mr. ACKLEY. I think that is entirely correct.

Senator JAVITS. Well, I think, as I say, the administration thinks it may be making the people not very conscious of the Vietnam war and its cost by minimizing the whole thing, playing it down in terms of lesser percentages and of the GNP, et cetera. In my judgment if you really want it—if you really want the tax surcharge—and it is really as critical and vital as you make it to be, and I agree with you, then you had better lay it right on the line for what it is: to wit, that you can't fight a war unless you increase your taxes and that is the way to support our men in the field, not Fourth of July speeches.

Would you care to comment on that?

Mr. ACKLEY. I fully agree, Senator Javits. Without the war in Vietnam we would not need a tax increase. It is so clear that it almost needs not to be said. Perhaps it should be repeated, however.

Senator JAVITS. Well, I just say, Dr. Ackley, that when you read this report and what you fellows said about it, I think it very much needs to be said.

May I just ask you one other question before my time is up? I notice with great interest that you speak about the essentiality of progress:

Progress towards price stability heavily depends upon new union settlements in 1968.

And you then go on to make clear what we all know; to wit, the tremendous market impact of certain key sectors of the economy in terms of the wage-cost like steel and automobiles, et cetera.

Yet, although the Chair has called for guidelines, and I would like to express my support of Senator Proxmire in that, when you get down to what you fellows are going to do about it, it sounds—I don't like to say anything like that about a Presidential message, so I won't—but it sounds like pretty small stuff. Here is what you are going to do—page 11:

To achieve this needed improvement, the President has established a Cabinet Committee on Price Stability. The committee will not become involved in specific current wage and price matters—

A strange aloofness, I might add, and then to go on with the quote:

It will focus on the long-term issues that have challenged the best efforts of every free industrial economy to reconcile price stability with high employment.

Now, Dr. Ackley, are you going to get hit hard with inflation by the wage-price settlements on a long term or are you going to get hit in 1968, and you have to do something about it, and is that really the essence of the economic testimony?

Mr. Ackley. Senator Javits, the purpose of the Cabinet committee is not, as we tried to make very clear, to get involved in specific current wage and price matters. I don't think those are effectively dealt with by a committee. Perhaps we should have made clearer than we did that the Council of Economic Advisers, which has borne most of this burden in the past several years, will continue, as it has in the past, to meet frequently with and discuss with businesses and unions wage and price matters in precisely the same way as it always has.

The purpose of the committee is something quite different, which is to deal with the longer range structural problems more effectively, the Government programs which affect economic structure. However, the committee is, as the President described it, also asked to—as indicated on page 21 of the President's Report—

The Committee will work closely with representatives of business, labor, and the public to seek ideas and initiatives to correct persistent structural problems that cause prices to rise and to inform them of the consequences of irresponsible wage and price behavior. It will not, however, become involved in specific current wage or price matters.

And there is a fuller discussion of the committee which appears in the council's report where it is made clear it will meet with industry and labor, with the purpose of calling attention in more general terms—not in terms of next week's wage increase or last week's price increase—to the importance of restraint and responsibility in private wage and price decisions.

Senator Javits. May I tell you, Dr. Ackley, that you have to do a lot more than that, otherwise you are going to have the same kind of panic that you had in the balance of payments which suddenly hit you, and with the travel situation which suddenly hit you. At the very least you need guidelines, and my guess is you probably need more than that in fairness to American labor which will suffer much more from a runaway cost of living than from anything it is likely to get. It is going to be running behind that bus instead of up to it or in front of it.

Thank you, Mr. Chairman.

Chairman Proxmire. Mr. Moorhead?

Representative Moorhead. Thank you, Mr. Chairman.

Mr. Ackley, I remember your coming here last year to give us what has been a very brilliant prediction of the course of the economy—a slow first 6 months and then increasing expansion in the latter half of the year—I think that your prediction would have been even more dramatic and accurate if there hadn't been some work stoppages—the Ford strike you mentioned and others.

The chart which you show us today certainly emphasizes that you were absolutely right in what you said a year ago.

I wish that this chart showed what you predict for the coming year. As I read your report it seems to indicate almost the opposite of that chart; a rather rapid expansion, maybe too rapid, in the first half of 1968, and then a flattening out in the second half of 1968. Am I reading your report correctly?

Mr. ACKLEY. I think not entirely so. There will be a bulge in the first half, which is a worrisome problem because very little can be done by tax action that the Congress might take now that would have much effect on that first half bulge. However, we are not talking about a sluggish second half—of the kind we had in the first half of 1967. However, we see progress at a slower rate in the second half, but nevertheless a solid rate of progress.

The increase of gross national product that we see for the year as a whole, something over 4 percent in real terms for 1968 as a whole over 1967 as a whole, is roughly paralleled by the expected increases from the fourth quarter of 1967 to the fourth quarter of 1968. There will be a somewhat more rapid—a too rapid—pace of advance in the first half, but for the year as a whole, an adequate and healthy rate of advance, and during the second half a healthy advance.

Representative MOORHEAD. You convinced me last year, and last year I would have voted for a tax increase had we been given that opportunity. But this year, I fear—and this is what worries me—that because the tax increase won't really bite until about the first of July, if it moves as rapidly as we can possibly predict through the Congress, it may hit just at a time when things are flattening out. Some people say this will tend to overkill or push us downward at a time when we have reached a proper equilibrium in the second half of this year. I wish you could persuade me to the contrary.

Mr. ACKLEY. I think what you have referred to emphasizes the importance of the promptest possible action on the tax increase so that we may get its benefits during the first half of the year when the advance will be particularly strong. But we will take the tax increase anytime we can get it and we will need it whenever we can get it, in my judgment.

Representative MOORHEAD. The chairman of this committee, the senior Senator from Wisconsin, says in his statement that public works can and should be cut by $5 billion or $6 billion.

Recognizing the political difficulty that Congressman Bolling mentioned, but just as an economic matter, can public works be cut by $5 billion or $6 billion this year?

Mr. ACKLEY. I think that question really ought to be directed to the Director of the Budget when he appears here, and I am sure he knows in more detail what the possibilities are. I think they can surely not be cut by $5 billion or $6 billion for the fiscal year unless contracts were canceled and work on partially completed projects were stopped. Whether, even then, the cut could amount to that much I wouldn't be able to say. I think you should address that question to Mr. Zwick.

Representative MOORHEAD. Now, Dr. Ackley, you speak about progress toward price stability beginning in 1968:

> Only if the average of new union settlements is appreciably lower than the 5½ percent average of 1967, and only if business firms avoid any widening of their gross margins over direct costs.

If wage settlements this year don't go below 5½ percent but actually go above 5½ percent, would you expect to recommend direct wage and price controls?

Mr. ACKLEY. No, sir, I would not so recommend. I believe that under the kind of economic conditions that I foresee for 1968, the damage to our economy that would be done by direct controls would even outweigh the damage that would be done to our economy by continued excessive wage increases and price increases of the kind you describe. I think we have a choice among evils, and, in my book, direct wage and price controls are the worst of the evils.

Representative MOORHEAD. Thank you. I share your opinion about wage and price controls. Thank you very much, Dr. Ackley.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Dr. Ackley, in your prepared statement you made no mention of the request of the President in his message to take prompt action to free our gold reserves so that they can unequivocally fulfill their true purpose to insure the international convertibility of the dollar to gold at $35 an ounce. I come from a Western State that depends largely on its mining economy for a great share of its industry, and numerous questions are put to me with respect to the proposal to remove the gold cover, the effect it would have, and so on. I would like to propound some of those same questions to you.

I think we agree that there are presently about $43 billion or $44 billion worth of gold held by the free nations of the world; is that not so?

Mr. ACKLEY. I think that is about right, Senator.

Senator JORDAN. Shortly after the war in 1947, largely by reason of trade transactions during the war, the United States had accumulated a sizable share of that total free world gold, probably as much as 55 percent. I think our holdings at the end of World War II were about $24 billion; is that approximately correct?

Mr. ACKLEY. I think so; yes.

Senator JORDAN. Since that time, our reserves have declined to less than 50 percent of what they were in 1947. At present they stand at a figure of less than $12 billion; is that about correct?

Mr. ACKLEY. I think so; yes, sir.

Senator JORDAN. Now, how much, Dr. Ackley, of that $12 billion, is required as a backup for Federal Reserve notes?

Mr. ACKLEY. Senator, with your permission, I would like to turn the microphone over to my colleague, Mr. Okun, who is our real expert on international and monetary matters.

Senator JORDAN. Very good.

Mr. OKUN. The reserve requirement today is, as I recall, approaching $10 billion, sir.

Senator JORDAN. Approaching $10 billion. Leaving, therefore, a free balance above the amount required for backup of our domestic currency, of something less than $2 billion?

Mr. OKUN. About that amount.

Senator JORDAN. So, you say, the only real purpose the United States will hold a gold stock is to insure the international convertibility of the dollar?

Mr. OKUN. That is correct.

Senator JORDAN. That was your statement in your report?

Now, Mr. Okun or Dr. Ackley, upon removal of the gold cover, do you expect a gold run to develop and persist until our gold reserves are exhausted and, if not, why not?

Mr. ACKLEY. I would think, Senator, to the contrary—that the purpose of removing the gold cover requirement would be to avoid any possibility of a run on gold which might arise because of incorrect expectations on the part of others that our gold stock was not fully available.

The purpose of removing the reserve requirement is not so that you can pay out the gold, but so that we won't need to—to make it clear to the world that there are $12 billion of gold there which would be available and, therefore, make it unnecessary for anyone to ask for it.

Senator JORDAN. How many outstanding obligations are there held by foreigners that are redeemable in gold?

Mr. OKUN. I believe official holdings of——

Senator JORDAN. In value.

Mr. OKUN (continuing). Of dollar assets today are on the order of $15 billion. Obviously the U.S. commitment is such that private holdings of dollars abroad can be turned into official holdings and these, in turn, could become claims on our gold stock.

Senator JORDAN. Then, there are, presently, demands held by foreign governments and others—foreign banks and governments—that can be converted into gold to the extent of $16 billion against an overall U.S. gold reserve, including the backup for Federal Reserve notes of less than $12 billion?

Mr. OKUN. That is correct. We really——

Senator JORDAN. You do not anticipate a run if the gold cover is removed, you do not anticipate there would be a run, to take advantage of that gold cover removal and cash in on those foreign-held securities?

Mr. OKUN. Well, any single holder today is free to come in to get gold for his dollar.

Senator JORDAN. Not any holder; just a foreign holder?

Mr. OKUN. Yes, of course, any official foreign holder.

Senator JORDAN. Yes.

Mr. OKUN. But the removal of the gold cover will, as you are suggesting, not change that situation. Anyone who is now entitled to gold for dollars if he so chooses will remain entitled to it. Anyone who is not directly authorized will not obtain an authorization through the removal of the gold cover.

It is hard to see why anyone who today prefers dollars to gold, should have any reason to change his preference with the gold cover removed. Indeed, as Mr. Ackley suggested, there are reasons why people who might feel that under present circumstances with the amount of free gold relatively small, that they might have an incentive to come and get it while the getting is good. Once the gold cover is removed they would feel more relaxed about it, recognizing there are the $18 billion gold stock available for conversion purposes.

Senator JORDAN. Isn't it true that during the month of December alone the stocks of gold held by the United States diminished by $900 million in 1 month?

Mr. OKUN. Yes.

Senator JORDAN. Following the devaluation of the British pound?

Mr. OKUN. Yes, indeed, and as you point out, this was an unusual circumstance, one of unusual turbulence in world financial markets associated with the devaluation and the various rumors and conjectures and speculation that were associated with it.

Mr. ACKLEY. However, that $900 million was not in the largest part a matter of conversions by official holders. Rather, it was our portion of the losses sustained in supporting the price of gold on the London market.

Senator JORDAN. I see.

In your Report on page 16, you say:

> Speculation generated by the strains on the international monetary system has caused further drains of gold from international reserves—much of it from our own.

What percent would you calculate of the $900 million withdrawn in the month of December went into the hands of foreign speculators rather than into reserve accounts or banks?

Mr. OKUN. I don't have the exact figures offhand, but by far the bulk of it went to private holders. The extent to which some of them were speculating, the extent to which they were setting aside stocks for ultimate industrial use, is something that one can't exactly determine. But certainly, speculative factors were a major, perhaps the overwhelming, factor in the gold purchases by private buyers during the month of December.

Senator JORDAN. It is true, is it not, that the maintenance of a gold reserve acts as a discipline, perhaps too rigid a discipline, against the expanding of currency?

Mr. OKUN. Certainly our monetary authorities have shown a sense of discipline, I believe, in a period in which the gold requirement was not strongly pressing on them, and I think you can rely on them to show discipline, to show a sense of what the American economy needs in the way of money in the future.

Senator JORDAN. You think that that discipline will be exercised even after the gold cover is removed and that discipline, actual statutory discipline, is no longer there?

Mr. OKUN. I think one can be confident of that; yes, sir.

Senator JORDAN. My time permits but one final question: What evidence do you have that the removal of the gold cover would strengthen the dollar or establish confidence in the dollar?

Mr. OKUN. There have been reactions in the gold market since the President's recommendation for repeal of the gold cover which point in that direction, which do show that this was a reassuring factor. We have heard reports from central bank officials abroad, who have commended the President for this proposal, and reaffirmed their view that it does show the commitment and dedication of the United States to supporting the international convertibility of the dollar, and maintaining gold equally with the dollar as a basis for international reserves. All the evidence we have so far suggests that this is a move that adds to confidence.

(Mr. Okun later submitted this additional statement on the relationship between U.S. gold losses and the gold cover requirement:)

The United States has a commitment to buy gold from official holders and sell gold to them at $35 an ounce. This commitment legally arises from the obligation we assumed in the International Monetary Fund; and it is not limited by the existence of the gold cover requirement for Federal Reserve notes. In the event that our gold holdings became insufficient to meet the gold cover, either because of gold sales to foreigners or because of an increase in Federal Reserve note circulation, the Federal Reserve Board under existing legislation could suspend the gold cover requirement under a specified procedure. Because of this legislation, our gold stock has, in fact, stood fully behind the international convertibility of the dollar.

Foreign governments have held dollars rather than converting them to gold because they have confidence in the dollar; not because our gold cover requirement has prevented them from converting. The removal of the gold cover would in no way alter our commitment to convert dollars into gold. Since some foreigners may still doubt that the United States would be willing to let our gold stock dip below the cover requirement, removal of the requirement will add to confidence in the dollar and its convertibility. In short, the removal will make it less likely that holders of dollars will wish to convert to gold. Since the gold cover does not serve a useful domestic monetary function, its removal would not hinder domestic monetary policy.

Senator JORDAN. Thank you.

I have further questions, but my time is up, Mr. Chairman.

(Senator Jordan subsequently submitted these questions to the Council of Economic Advisers and received the following replies from Mr. Okun:)

Question 1. You have said that you do not expect or believe that a gold run will follow should Congress remove the gold cover. Do you think that the United States should remain a free market in gold at $35.00 per ounce so foreign speculators can acquire and hoard gold on the chance that devaluation of the dollar will bring them windfall profits?

Answer. Because of gold's importance as a monetary metal, a price in the principal gold market—in London—that deviated very far from the monetary price for gold would create uncertainty regarding the official price. Particularly when the monetary system is under strain, a rise in the London price would be regarded by some as a challenge to the maintenance of the official price. Such uncertainties could also lead a number of monetary authorities around the world to present dollars to the Treasury for conversion into gold, thus causing a drain on our gold reserves. These dangers were illustrated by our experience in 1960 when the open market price of gold rose far above the official price. For these reasons, the support of the London gold price is justified as part of the general undertaking of the United States to maintain the official $35 price of gold.

Question 2. Since, as you have stated in your report, our gold supply primarily serves the international monetary system, and, if the gold cover is removed, our gold stock will then be entirely divorced from our *domestic* monetary system, what objections, if any, would you have to eliminating the legal impediments which now prevent American citizens from possessing and owning gold, particularly if such a possession is confined to new gold production?

Answer. With the removal of the gold cover requirement, gold will continue to maintain an important international monetary function. If gold was sold to American citizens for speculative purposes, less gold would be available for the world's official reserves.

It is true, of course, that citizens of some other nations are permitted by their governments to speculate in gold. This is a matter in which each nation obviously must make its own judgments and decisions. We do not believe that Americans are disadvantaged by not being able to speculate in gold. Gold is a sterile asset that earns no return and gold speculation could divert some funds from being invested in productive capital. Americans are able, of course, to purchase gold for legitimate artistic and industrial uses. In this context, we see no meaningful distinction between newly mined gold and gold previously mined, since both types have the same effect on world monetary reserves.

Question 3. Since the IMF (International Monetary Fund) special drawing rights plan has not been accepted by the other nation members, and if it is so accepted the pressure on gold for use in the international monetary system will be eased, why would it not be prudent to wait until the SDR (Special Drawing Rights) proposal is an accepted fact before taking the drastic step by removing our gold cover and exposing our entire gold stock to loss?

Answer. Prompt action to approve and to activate the special drawing rights plan is highly desirable and will become even more urgent with the correction of the United States deficit. Nevertheless, a year or two may elapse before the first issuance of special drawing rights is decided upon. In the meantime, no one can predict with assurance that sales of gold, in addition to the steady growth in the domestic note issue, will not bring our gold reserve below 25 percent of the value of the note issue.

The adoption of the special drawing rights plan should help to convince speculators that their operations will not be profitable. But we must be able to deal effectively with the possibility of net private acquisitions of gold through the operations of the private market. Moreover, official conversions into gold may take place from time to time as countries modify their policies with respect to the composition of their reserves. While the special drawing rights plan should contribute to reserve policies that will make conversions into gold less frequent, in the future, we must be able to carry them out when called upon to do so. The primary reserve asset of the U.S. is gold, and the introduction of special drawing rights will not alter the need to provide assurance that our full reserves stand ready to defend the dollar internationally.

In short, we regard both the removal of the gold cover and the special drawing rights plan as highly desirable, and do not consider them to be organically linked together.

Question 4. In the absence of absolute proof that we will *not* lose our gold stock by removal of the gold cover entirely, why not reduce the 25 percent cover to 20 percent and thereby bring about a gradual rather than an abrupt removal of the gold cover? Would not such procedure reduce the risk of losing all our gold reserves?

Answer. Much of our introductory statement is applicable to this question. Since a gold cover requirement serves no useful purpose, a 20 percent cover is no better than a 25 percent cover. Furthermore, a reduction of the cover rather than its removal may well increase the risk and actuality of gold losses. Speculators might be misled into believing that a cover of 20 percent represented the absolute limit below which we will not permit our gold stock to fall. Such a misunderstanding would encourage speculation. As the President has said repeatedly, all of our gold must be available to defend the international convertibility of the dollar and no one should be misled into thinking otherwise.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Chairman Ackley, you have suggested that the responsible thing for Congress to do is to pass the surtax.

Mr. ACKLEY. I certainly do feel that way.

Representative REUSS. Now, I notice that in discussing loophole-plugging tax reforms—this is largely on page 86—while you said that they are long past due and necessary to bring some equity and efficiency into the tax structure, because of the time that Congress has to take to enact a loophole-plugging tax reform and because of the time it would take before they would be fully effective, loophole-plugging tax reform won't do as an answer to our immediate problem. Is that a fair statement?

Mr. ACKLEY. It is indeed.

Representative REUSS. Well now, in view of the fact that I and a number of other Congressmen have been saying for a long time—and saying particularly in the last year—that we don't propose to vote for an increase of taxes on the moderate income taxpayer unless the administration is willing to come up and lay on the line before the Congress a loophole-plugging tax program, and in view of that very clear legislative prehistory, wouldn't the responsibile thing for the administration be to bring up such a loophole-plugging tax reform program and to table it before the Congress with an indication that it would hope for action on that as a matter of priority after the temporary surtax had been enacted?

Mr. ACKLEY. I am sure that after the temporary tax surcharge is enacted, as I hope it will be, that the administration will be ready to discuss with the chairman of the Ways and Means Committee a schedule for the consideration of tax reform proposals.

Representative REUSS. Yes. But how would people like myself who object to increasing the tax on my secretary who makes $8,000 a year, by a hundred dollars a year, which is what the surtax would do, how do people in that frame of mind have any assurance that the administration ever will back a tax reform program? We have been waiting for years for it now.

Mr. ACKLEY. I think, Mr. Reuss, that the administration has made very clear its interest in tax reform over the years. It made a number of proposals several years ago which were placed before the Congress and very few of which were enacted. And it stands ready with further proposals if and when the legislative calendar seems to permit their consideration.

Representative REUSS. But what you are telling me is that the administration will not bring in a tax reform program as evidence of its seriousness prior to the House vote on the 10-percent surcharge?

Mr. ACKLEY. I don't know, Mr. Reuss, that I can speak for the administration in that respect. The administration has not, as you recognize, presented specific proposals and I believe it does not propose to before the surcharge matter is out of the way.

Representative REUSS. But you don't think it would be irresponsible of the administration to refrain from bringing up such a tax reform package?

Mr. ACKLEY. I really think that the questions on strategy with respect to the timing of any such legislation ought to be addressed to some other official of the Government than those who are before you today.

Representative REUSS. Turning to another subject, we all note that the rate of individual savings has continued to go up. In fact, in the period of 1959–64 it was 5.5 percent of income, and in 1967 it had climbed to 7.1 percent. Many people are, as you are, putting their minds on this as to what would be the cause. You devote some pages to it, and I am wondering if an important cause isn't one that you don't mention at all.

As you know I am very hipped on these tax loopholes because I think the revenue collector not only losses a lot of necessary revenues from them, but also I think they tend to skew the distribution of after-tax income. One big loophole now is the exemption of appreciated securities held until death from the capital gains tax. That gyps the tax collector of $2½ to $3 billion a year and in addition it means in a period when incomes are going up, and the stock market is going up, the amount abstracted by this tax loophole also goes up.

I will now come to my question. Couldn't it be that the reason savings are going up alarmingly is because these tax loopholes mean that a lot of income gets into the pockets of people who spend it neither on consumption or on useful real capital investment?

Mr. ACKLEY. I might make a couple of comments on that, Mr. Reuss, and see if my colleagues have further comments. In the first place the provisions to which you refer are, of course, not new. They have been in effect for a long time. They were associated with the lower saving rates earlier and equally with the high savings rates most recent——

Representative REUSS. But as GNP and income climbs, the amount abstracted by the beneficiaries of the loopholes increases.

Mr. ACKLEY. Yes, but the GNP climb in 1967 was a modest one. I don't think that you can find any correlation between the saving rate and whatever capital gains might have been. The more important fact is that income, as we compute it, is exclusive of capital gains. To the extent that people are making capital gains and somehow feeling that they are better off for that reason, one would suppose that they might be more ready to spend freely out of their current incomes.

Representative REUSS. Of course, capital gains is just one of a dozen loopholes which I use for illustration. You can take any of the others.

I am a little disturbed, too, at the fact, as you say in your report, that savings in 1967 greatly exceeded real investment. I think it would be most useful if you and this committee and everybody who has the time to do it, took a look at our distribution of after-tax income, because it could be that you have such a Swiss-cheese type of tax system there is not sufficient effective demand in the economy in any one period to take off the market the goods and services produced in that period. That would be the classic case of oversaving which has preoccupied economic philosophers over a hundred years, and I certainly wouldn't want that to sneak up on us as a result of a tax system which had becomee overfilled with loopholes. What do you think about that? Are you prepared to rule out that possibility now?

Mr. ACKLEY. I would certainly not rule out the possibility that in the longer run the tax structure has something to do with the amount of saving relative to the amount of investment but it seems to me not plausible to suggest that the high saving rate in 1967 is somehow associated with that.

Representative REUSS. Well, did you break that down between different income levels? You give us a gross figure. You say that everybody saved 7.1 percent of their income. Well is that everybody? Does that include the poor devil at the bottom of the economic scale? Was he saving more than usual?

I would like to have a breakdown of that. Have you got one?

Mr. ACKLEY. I think we all would like to have more detailed data on savings and income distribution than we in fact have.

Representative REUSS. You don't have any breakdown of that figure, that 7.1 figure?

For example, for all I know, it simply shows that people at the top of the income scale were saving a lot more. If so, that would tend to prove my thesis that loopholes are bothering us, but, as you say, if we can't break it down we don't know.

Mr. ACKLEY. We can't for 1967, that is clear. As you suggest, such data as are available of saving by income classes do show that savings are higher at higher incomes and tend to be nonexistent or even negative at the lowest income levels.

Representative REUSS. The question is though, Has it accelerated? We don't know whether it has or not.

Mr. ACKLEY. We don't know too much about income distribution in 1967. I think some of the things we know would not suggest that it had. The most rapid wage gains were by the lowest income workers. Profits as a share of income declined. Farm income did not keep pace with other incomes in 1967, and farmers are high savers, very high savers. Dividend income rose only slightly, less than most other incomes. So I think it is very difficult to make an a priori case that there was a redistribution of income in 1967 which favored those who had higher savings propensities, and that this accounted for the high overall saving rate.

Representative REUSS. It isn't just 1967. I keep raising this subject, as you know, every year when we have these hearings, and my suspicion remains.

Mr. ACKLEY. Mr. Duesenberry has some comments. He wrote one of the best books on saving that was ever written.

Mr. DUESENBERRY. A long time ago. But it is only in 1967 that we had the sharp rise in the saving rate. There are a number of factors which may explain it, although—since we don't have adequate data on the detailed distribution of savings—we can't make an exhaustive account. We did draw attention in our report to two factors. One is that automobile sales were off in 1967. This in the past has, in the short run, been accompanied by a corresponding movement in savings. I think if you compare the big automobile years with weaker automobile years you usually find some associated change in savings.

The second factor we mentioned is the possibility that medicare may have relieved some older people of heavy medical expenses which they otherwise would have paid for by drawing down their savings account and other assets. Being relieved of that burden didn't make them go out and spend a corresponding amount of money, so that this factor may have played some role in 1967.

Now, in addition, just because the productivity gain was low in 1967, the overall increase in real income for an individual worker at any level of income was relatively small; and this is after a number of years in which individual income increases have been quite rapid. So that it may be that that slowdown has had some effect on a variety of expenditures, including the automobile slowdown.

It may also affect the fact that while spending on non-automobile durable goods has been rising as a share of disposable income in the past few years, it leveled off in 1967. It didn't decline but it leveled off, so that change in the pace of growth of income may have had some influence on the overall rate of saving during the year.

But we don't see anything that we can put our finger on in terms of income distribution which would account for it. The only thing connected with income distribution that I would point to is that we did have a rapid increase in the number of women in the labor force in 1966 and in 1967. It may be that some of these second workers in the family are maybe saving a somewhat larger proportion of the added income than would occur if you had the same total income increases spread over a larger number of workers. That may be accounting for a part of the rise in savings due in 1967.

Representative REUSS. You are talking about before-tax incomes; aren't you?

Mr. DUESENBERRY. Yes.

But we don't see any factor in the after-tax income that changed from 1965 to 1966 to 1967. It is true that the loopholes to which you point surely have some influence on the overall distribution of income. But we don't see that there has been any notable change which would account for the rise from 1966 to 1967.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

First, I would like to ask unanimous consent to include in the record at this point some editorials and an article. The first editorial from Life magazine, dated January 19, 1968, "L.B.J. and His Soft Dollar." Next, an editorial in the New York Times, January 30, 1968, entitled "Budget Priorities." The next, from the Washington Post, "1969 Budget, Resources and Priorities," January 30, 1968. The next one, the New York Times, February 2, 1968, "New Diagnosis, Old Cure." And, the final, an article by Hobart Rowen from the Washington Post, February 4, 1968.

Chairman PROXMIRE. Without objection, so ordered. They are all fine articles and editorials.

We are glad to have them in.

(Above editorials and article appear at close of day's proceedings, p. 58.)

Representative WIDNALL. Mr. Ackley, how would reducing the disposable income of consumers and business through a tax increase help reduce pressure on interest rates?

Mr. ACKLEY. I think the connection between interest rates and the tax increase is fairly clear and direct. By reducing the growth of disposable incomes of consumers and thereby the growth of spending by consumers and the rate of advance in the economy, private demands for credit would be eased. At the same time, by paying for a larger fraction of total Government expenditures through taxes, the Federal Government's demand on credit markets would be eased, having the effect of reducing the total demand for credit, relative to the supply of credit, and thus easing interest rates.

Representative WIDNALL. But won't the individuals and the businesses attempt to maintain their spending by reduced savings?

Mr. ACKLEY. This is certainly a possibility. However, the experience is pretty clear that tax cuts do increase consumer spending and tax increases do reduce consumer spending, and that the major impact of changes in disposable income is on spending rather than on saving.

Representative WIDNALL. It is my feeling that reduction in Federal demands for funds will be just about offset by the reduction of supply of private savings to the financial market. Do you feel strongly the other way?

Mr. ACKLEY. Yes.

There is obviously some offset in the fact that some part of a change in disposable income in either direction goes to change savings. But the magnitudes are such that the effect on spending is far greater than the effect on saving.

Representative WINDALL. While the administration has retained the validity of the guidepost principle it fails to state a precise guidepost figure. What would the guideposts be today were it to be calculated? Would it be lower than the 3.2 percent which was used for several years?

Mr. ACKLEY. No, Mr. Widnall, our view is that the trend of increase in productivity in the economy is still about what we estimated it several years ago, roughly 3¼ percent a year. That trend of productivity is obviously the factor that has to be put up against the rise in wage and fringe benefits to find out whether unit labor costs on the average are stable or are rising.

Representative WINDALL. It is quite clear at this time 3.2 is not the figure in mind as a safe figure by the administration. It seems to me it is nearer 4.5 or maybe 5 percent.

Mr. ACKLEY. I don't know what you have reference to as to the figure we have in mind. We clearly recognize that it would be useless and inappropriate—and probably counterproductive—to take a position that wage increases in 1968 ought to be held to 3.2 percent on the average. We have not specified another, higher figure.

Representative WIDNALL. Why have conditions changed so from a couple of years ago when the administration was insisting that this should be done and labor and management were called in on it? Now, it seems to me they are now being given free rein and we could have unbridled inflation as a result.

Mr. ACKLEY. We hope they are not being given free rein. Our effort will continue to be to seek the maximum degree of restraint on wages and prices that we can possibly achieve.

I think it ought to be clear to this committee that the Council of Economic Advisers, of all people, is the strongest and stanchest supporter of the guideposts. I hope there is no assumption that the Council of Economic Advisers has changed its view as to the importance of wage and price restraint, as to the importance of achieving a situation in which wage changes are on a par with productivity gains. Also, I think, in addition to being the strongest supporter of the guidepost principle, we are also those who have had the most experience in trying to apply them.

We think that a numerical guidepost of 3.2 percent actually did help in the period between 1962 and 1965 to restrain wage, excessive wage increases and rising prices.

After about mid-1965, it became clear to us, and I think to a great many other people, that the effort to hang on to a 3.2-percent wage guidepost was not a useful effort any longer. There were, as you recall, some highly publicized violations, if you wish, of the guideposts, the automobile industry in the fall of 1964, the New York transit workers in 1965, by the airline mechanics and others in mid-1966.

There was a general excess demand that developed after mid-1965 and which raised nonunion wages substantially more than the 3.2 percent, making employers willing to grant larger wage increases. There was a rise in the cost of living which, in part, resulted from the extra large wage increases through the violation of the guideposts principle by businesses, and, unfortunately, by a sharp rise in prices in the cost of living, including the cost of food.

Under those circumstances, it did not seem advisable for us to try to insist on or try to persuade unions they should restrict their increases to 3.2 percent.

We did not feel it would be useful either to suggest a higher figure. That, too, in our view, would discredit the guideposts by giving some kind of Government blessing to inflationary settlements which would be bound to result in price increases.

But our interest in the guideposts principle is no less than before. We think that a guidepost policy, to be effective, must rest on some kind of a social consensus on the part of business and labor and Government, and the public generally, as to what is an acceptable policy for wages and prices.

We have tried informally and in an exploratory way to see whether the basis for such a consensus did exist today, and our explorations did not suggest that it does.

Under those circumstances, we think our best efforts should be devoted to encouraging whatever restraint we can effectively get, but not to either reinstate a 3.2 guidepost or to suggest a higher one.

Representative WIDNALL. Do you feel that the cost-of-living index accurately reflects the large increase in cost of services? I ask that as one who through my life have contracted for services in my own home. I am aware of the very abrupt changes that have occurred, far more than 3-, 4-, or 5-percent changes.

Do you believe that the items that go into the daily cost of living of the average family is adequately reflected in the cost-of-living index?

Mr. ACKLEY. I am sure that the Consumer Price Index is not perfect. I think it may very well understate price increases in some areas, and overstate them in others.

I do not know any reason to suppose that the extent to which the index reflects price increases for services is on the whole, any less adequate than its reflection of price increases for commodities.

If there is any difference, I would think, perhaps, it was the other way around—that the improving quality of services, particularly of such things as medical services, cannot be measured even as accurately as the quality of goods. Many services are better today and more effective than they were earlier, and the fact that the price increase does not take account of that improvement may give rise to some overstatement of increase in service prices. I think this is particularly true in the case of medical services.

Representative WIDNALL. I hate to think of what the cost of hospital care would be like today if they had to pay all the volunteers in the United States to keep all of the hospitals going. There are thousands of people volunteering services that are keeping the costs from being far greater at the present time.

My time is up. Thank you.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. Dr. Ackley, I would simply like to join my colleagues in expressing deep appreciation to you for your service to your country. I wish this were a testimonial dinner rather than a hearing.

In the perspective that you have had on our budget problems and fiscal affairs of the country, and of our economy, wouldn't you say that one of the greatest mistakes that we have made over the last 4 or 5 years has been to assume that we can have both guns and butter? How can we possibly carry forward, continuing our commitments abroad and increasing those commitments, escalating our domestic programs—some of which we cannot even estimate in terms of their ultimate cost—and not to have a good deal of sacrifice in one way or another in terms of an unbalanced economy?

Mr. ACKLEY. Well, it is a very large question, Senator Percy.

I think that if there has been a mistake made in the fiscal planning of the Government, it has been its failure to recognize the unwillingness of the Congress, and apparently the people, to tax themselves to pay for the things that the Congress and the people want, including both the prosecution of the war in Vietnam and the civilian programs.

Clearly, if we have the will to do what is required in the way of taxation, our economy can provide guns and butter, if you will.

But, of course, if the public is not willing to pay the costs, and what is being sought is a tax increase that will yield less than half of the total cost of Vietnam, then clearly, the economy is going to reflect that unwillingness in an unacceptable rate of price increases, in tight money, in possible damage, again, to our housing industry.

Senator PERCY. Why do you suppose it is that, when it is so clear to you and the administration what must be done, that the administration is not able to convince either the Congress—and they are reasonably patriotic people here—or the country that these steps are necessary? What has to be done?

Mr. ACKLEY. I think one real difficulty is the fact that although the Federal tax burden is substantially lower than it was 4 or 5 years ago, State and local taxation has continued to rise, reflecting the needs of State and local governments to spend a lot of money meeting the very difficult problems of an urban society facing difficulties of transportation and pollution and congestion and crime.

States and local governments have had continually to raise their tax rates and this, I think, affects people's attitudes toward Federal taxes. Even with the tax surcharge, Federal tax rates on individuals would, on the average, be something like 10 percent less than they were before 1963.

I do not completely despair that we have not yet succeeded in convincing the country that fiscal restraint through a tax increase is required. I do recall it took us over a year to convince the country that we ought to reduce Federal taxes, and I suppose one should expect that it would take even longer to convince people that it was necessary to raise them.

Senator PERCY. Dr. Ackley, what do you estimate is the direct and/or indirect effect of the Vietnam war on employment—including both civilian and military personnel? What percent of the increase in GNP that we have experienced would you attribute to the direct and indirect effect of the Vietnam war?

Mr. ACKLEY. Well, my colleague, Mr. Okun, is reputed to be a very quick man with numbers on the back of an envelope. I will give him an envelope and see if he can give you a quick answer and, perhaps, supply a better one for the record.

Mr. OKUN. As you know, our expenditures for Vietnam represent about 3 percent of our gross national product, and it would be a fair assumption that it probably represents about 3 percent of the employment in the economy, including the military and civilian activities that produce the equipment and supply the personnel directly involved.

If one merely looked at the indirect effects of that total, and supposed there would be no difference in our Government expenditures or taxes or our monetary policies in the absence of the war, one might conclude that perhaps something like 2½ times that $25 billion is the effect of the war, direct and indirect—something over $60 billion of our gross national product.

But I would hasten to add that obviously if we were in a peacetime situation lots of other things would be different. We might well be coming back here today to talk about tax reductions rather than tax increases. We would not have had a monetary policy in 1966 that created a housing depression. Indeed, we would have had a very strong homebuilding sector throughout this period, I think.

We might well be doing more on the civilian expenditure side. Certainly it would not be as though those dollars disappeared and nothing else came to take their place. I think in asking questions about the impact of the war, one does have to ask, what else would have happened? And the studies of the University of Michigan that were cited in the statement by Mr. Curtis really did merely ask what happens as a result of these expenditures, everything else being equal. But everything else would not be equal.

I think that, if one goes back to mid-1965 and looks at the state of our economy, and recognizes how well we were doing, that we had already surpassed in length and strength every previous peacetime expansion, I would feel confident in reiterating our strong conviction that the war has been a source of problems and complications to economic policymaking, an unwelcome rather than a welcome phenomenon.

Certainly, the United States does not need the prop of military spending in order to support growing prosperity. I think this is evident when you look at the way our budget has evolved during that period. We have had nondefense spending use roughly half of the normal fiscal dividend associated with economic growth over this period. We would have had the other half essentially to distribute in the form of either added civilian spending or further tax reductions.

Senator PERCY. I share with Senator Javits the concern that in giving the country and the Congress a true economic picture of what is transpiring now, there has been an undue deemphasis on Vietnam in this report.

I read through it carefully, and I was really shocked to find that the only direct reference to it was an attempt to minimize its effect. I have had the feeling that all through the economy there has been a considerable effect. A 3-percent stimulus or a 3-percent depressant has a tremendous effect on our economy, I think, and I feel that we might face up to some of these problems better if we called a spade a spade and said we need a tax increase for the war.

This war is causing great difficulties in our economy, and we should clearly outline it as such. I think we would be making more progress rather than just this talking about the inflationary situation and the need for the tax as a depressant. As Senator Proxmire has shown, you can punch a lot of holes in an argument like that. That argument has not motivated the Congress. It has not motivated the country, really. And it would seem to me if we want to really put the tax increase across—it is important, and I am willing to do it as well as to cut expenses—I think we have to call the tax increase what it really is: an attempt to finance a war that has gone way out of bounds so far as what we thought originally the expense would be.

The Council's Report attacks wage and price controls in very strong terms, and goes so far as to call them repugnant. Why do you not feel the same aversion to the administration's program of balance-of-payments controls?

Mr. ACKLEY. I think we would all be much happier, Senator Percy, if we could be in a world in which complete freedom could exist for capital movements and tourist movements, and so on.

I believe there is some difference between the kind of program of restraint that is called for in the international program and the kind of detailed wage and price controls that sometimes have been suggested for the domestic economy.

Each corporation is allowed freedom under the program to allocate its investment expenditures wherever it wishes, within very broad limits, by types of countries, and to finance its investments abroad if it wants to go beyond those limits.

It is not the kind of detailed control that I think would be most inefficient and unfortunate. I believe an effort has been made to give the balance-of-payments controls an overall character which does leave to private enterprise the choices to make within very broad target.

Senator PERCY. Mr. Chairman, if I can make one closing comment, outside of welcoming a very able successor to Dr. Ackley, I did have occasion one time to ask a Soviet official what the underlying reasons were that Mr. Khrushchev fell.

He said one of them was an economic reason. Khrushchev just did not have the sophistication to understand that, in a modern technological economy, you do not increase productivity by exhorting the workers to produce more. You have to pay them more, and invoke what he referred to as "sophisticated Socialist incentives."

I have almost the same feeling when I get to the punchline in the message this morning, in the President's economic message, that the big thing we are coming up with now is a Cabinet Committee on Price Stabilization.

I do not know how different this is from the Eisenhower Cabinet Committee on Price Stability that was created in 1959 and 1960. It issued reports and made studies.

But it is an unsophisticated thought that you can exhort labor leaders, in the face of tremendous demand because of increased costs, to reduce wage demands because it is in the national interest. It is equally naive to suppose that you can tell businessmen to stop raising prices when they have tremendous cost pressure underneath them, and terrific dividend and profit pressure from stockholders, because to do so is not in the national interest. This is especially true when the real cause of all of this is a fiscal and monetary policy established by the U.S. Government and this administration which is really irresponsible now.

In retrospect, I think this voluntary restraint program is just pie in the sky; these are just pious hopes and dreams, and they have no relationship to reality.

You can pull out a few steel and automobile companies and force them publicly to maybe push down prices. But when we consider that thousands of pricing decisions are made every single day all over the country by companies you cannot focus and put attention on, it illustrates that you cannot control and regulate in a free economy, such as we have. So I repeat, I just do not think that it amounts to a hill of beans; it is most unrealistic, and I think unsophisticated.

Mr. ACKLEY. May I make just two observations? One, obviously, that jawbone effort, persuasion, cannot be effective in the face of a fiscal and monetary policy which is creating excessive demand. We try to be very clear on that. Guideposts are not a substitute for a proper fiscal and monetary policy.

Second, despite the obvious difficulties of persuading people to do things that are against their interest, their narrow, immediate, and apparent self-interest, in fact, a great many companies, not only those with whom we have been in contact directly, but many others, and labor unions, as well, have, I think, done things differently because there has been a national policy and a statement of an objective which has led them to take account of the national interest in their decisions.

While it may be marginal, and while it certainly cannot fight an inflation that is due to too much demand, it does have a useful impact, and it is worth pursuing.

Chairman PROXMIRE. Chairman Ackley, with all due respect—and you have a lot of respect coming because you are a mighty able economist—I think we have been letting you get away with murder on some of your assumptions on the tax increase.

Let me ask you some questions about this.

First: Where is the boom coming from? You do have some reference to business investment in plant and equipment on a dollar basis. It may come from the Vietnam war.

I think if the President comes in with a big escalation and a request for a tax increase, he will get it, and I think that is part of what the minority members of this committee have been saying this morning.

But, short of that, where is this boom which you seem to feel, and so much of the questioning seems to accept, coming from?

Mr. ACKLEY. I think it is very easy to see where it is coming from, Mr. Chairman.

It is not a defense boom, it is not a consumer boom. It is not a plant and equipment boom. It is just a very strong economy all across the board, one which produced an increase in gross national product in the second half of 1967 of $32.5 billion. That is a $65 billion a year increase, which would have been even larger absent the strikes.

It is a rate of unemployment which was 3.7 percent in December. It is a situation in which, although there are not the kind of acute labor shortages with which we were confronted in 1966, and in which, for example, you just could not find machinists, it is a situation in which our basic labor force is fully utilized.

Let me point out, if one takes the adult male labor force—males between the ages of 25 and 54—the unemployment rate for adult males in December 1967, was 1.7 percent.

There were 2 months during the Korean War, I believe, when it got down to that level. But that was a lower rate of unemployment of our adult male labor force than at any time during 1966.

Chairman PROXMIRE. You could have said the same thing, only with more emphasis last year in January 1967, virtually the same thing.

Mr. ACKLEY. We did.

Chairman PROXMIRE. But there was no boom. You were wrong. You see, what gets me is we have had 7 years of extraordinary prosperity, unprecedented prosperity. We have not had 7 years before—even in wartime we did not have 7 years. In 3 of the last 4 years, we had an enormous increase in business investment in plant and equipment meeting our productive capacity. Our capacity to meet the demand has greatly increased and increased; it increased at a compounded rate in 1965 and 1966 over the great increase in 1964. In 1967, it leveled off, but it was still a tremendous expansion of plant and equipment but, at the same very high rate that had been achieved in 1966, so all this seems to indicate to me that we may be in a position where we can produce a tremendous amount. We have increased our productive capacity up until this last year when it began to cool off some.

The work force is increasing at a million and a half a year, and it seems to me, absent any of the stimuli which did give the economy its length and breadth from 1964 on, I just do not see where, by simply saying we had a strong economy in the last half of the year, where a tax and a fiscal policy program that is supposed to have its primary impact at the end of this year and next year, has any basis in economic analysis.

At any rate, what you are saying is that you are relying on a strong economy at the end of last year.

Mr. ACKLEY. We had a strong economy at the end of 1967. We have a strong economy today, and one which continues to increase at a rate which is not sustainable.

Chairman PROXMIRE. Let me ask you this question: What prices would this tax act moderate? I went through a list of the principal prices which, in my view, it would not affect. It would not cut the price of food, it would not cut the price of housing. In my view it would not cut the price of automobiles. It would not cut the price of many appliances.

It probably would not moderate the price of the medical services. What would it moderate?

Mr. ACKLEY. I think it would cut the price in all of these services.

Chairman PROXMIRE. Do you think it would cut the price of food?

Mr. ACKLEY. There would be less demand.

Chairman PROXMIRE. People won't eat as much; less demand?

Mr. ACKLEY. To some extent.

Chairman PROXMIRE. You mean, in view of those brackets which are exempt, those who have $5,000 or less, who have a family, would not have to pay more taxes?

Mr. ACKLEY. The expenditure on restaurant meals certainly would be affected. There is a positive elasticity of demand, income elasticity of demand for food, and the more rapidly incomes rise the more expenditures on food rise. It is relatively low, not as much as for other kinds of commodities, especially, durable goods.

Chairman PROXMIRE. In view of the fact that a very large proportion of the population—I do not know how much, but perhaps half, considering those who do not pay taxes, and those whose incomes are so low they would be exempt—would not be affected by the tax increase, and certainly since high-income groups would not reduce their diet, it is hard for me to see that this will have any serious effect on the price of food.

People might not eat out quite as often, but in terms of half a percent or a fraction of a half a percent, I just cannot see it.

How about housing?

Mr. ACKLEY. I am reminded, Senator Proxmire, by the discussions we used to have back in 1963 about the effect of a tax cut. We were told it was cigarette money for any individual, particularly the low-income individual, so small an effect on income he would not see it, he would not spend any differently.

It seems to me we are talking about an effect at the margin which is significant, and which can certainly make a considerable difference in price levels. You asked me about the price of housing——

Chairman PROXMIRE. Let me say, I have not heard you or any other economist argue that the 1964 tax cut increased prices.

Mr. ACKLEY. No, sir.

Chairman PROXMIRE. If it did not, why would it then be true that the proposed tax hike will slow down the price rise?

Mr. ACKLEY. At that point, we had large unutilizied resources. We had an unemployment rate——

Chairman PROXMIRE. We had a percentage of plant utilization that was almost precisely the same as it is today, 85 percent, when we cut taxes in 1964.

Mr. ACKLEY. I do not think you have heard us suggest that plant capacity is today a limitation on the ability to increase output. Certainly, the labor supply is.

Chairman PROXMIRE. And they were working about the same number of hours, maybe a little more, in plants than they are today. So that it is possible today to expand manpower resources by simply having people work a little longer hours.

Mr. ACKLEY. That is right.

Chairman PROXMIRE. Well, at any rate, how about the housing end?

Mr. DUESENBERRY. There is a very direct effect even this year in the difference in mortgage costs on the cost of housing.

Chairman PROXMIRE. I agree with you. But isn't that going to result in people buying more housing, with the result that demand will not diminish because the taxes go up. But your argument and the argument of the Council is that the demand will decrease.

Mr. DUESENBERRY. The mortgage rate goes into the cost of living for all people who buy housing. In addition, there is certainly an effect which we observed in 1966 of the difference which taxing of people makes on the expansion of commercial and industrial construction, which does have an impact on what is still a very tight labor supply in construction and on the cost of construction material.

Chairman PROXMIRE. So what you gentlemen are telling us is that by increasing demand for housing and increasing activity and increasing jobs in housing, which a tax increase presumably will do because of lower interest rates, you are going to reduce the cost of housing?

Mr. DUESENBERRY. What I am saying is that it will shift the composition of output toward housing and away from some other things. And it will reduce interest costs because it will reduce other types of demand for credit and make room for the demand for housing, instead of having the two of them fighting for the available credit and driving up interest rates.

Chairman PROXMIRE. Along the same line, then it seems to me you are doing two things: No. 1, you are saying that you are going to reduce jobs and activity in the economy by slowing the economy down.

Mr. DUESENBERRY. No, sir. We are saying——

Chairman PROXMIRE. Well, I have a letter from Chairman Ackley in which he says this tax increase is going to cut GNP by $7 billion in the calendar year, $14 billion in annual rate by the end of this year, and it will reduce it by 150,000 jobs, during the calendar year presumably 300,000 jobs for the full fiscal year. So it will slow the economy down.

But then, at the same time you are saying that it will also increase the economic activity, increase production in housing. It seems that is almost as contradictory as you allege I have been in my analysis.

Mr. DUESENBERRY. We have said any number of times that there is a question of the mix of activity, as well as the total amount of activity. In the case of housing, what we are saying is that we will have more housing by virtue of having less of something else.

Now, what we say about our estimate of the employment effect is correct. There has to be some employment effect. We would not describe it as slowing down the economy, but keeping the economy from speeding up excessively.

Most of those additional jobs, at least a large proportion of them, would be jobs obtained by additional women coming into the labor force, as happened in the previous period of rapid expansion.

Let me make one point about prices, if I may, that we all agree that there is a so-called cost-push element. Because of what has happened to the cost of living, there are pressures on negotiated wage rates. But those wage rates are not the whole story. Given the employment situation Mr. Ackley pointed to a few minutes ago, the additional pressure on the labor market will cause wage increases throughout the economy, quite outside the negotiated segments, and those will be affected quite directly by the change in demand, as was clear in 1966 when wages began to go up outside the negotiated sector several months before there was any real rise in the level of union settlements. So there is an effect on prices over a very wide range through that impact on the condition of the labor market.

Chairman PROXMIRE. Thank you. My time is up.

Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I am going to get back, if I may, to the expenditure policy.

Chairman PROXMIRE. May I just interrupt to say that we are 5 minutes to 1, and if it would be all right with you gentlemen—and I have checked with some of the members, the remaining members of the committee—we would prefer to go right through for a few more minutes rather than come back at 2 or 2:30, if it is all right with you.

Mr. ACKLEY. Whatever you wish. We have a number of additional points we hope we will have a chance to make in response to your questions.

Senator JAVITS. Mr. Chairman, would Congressman Curtis yield very briefly? If I am called to the floor, may I have leave to make two or three requests that will be replied to?

Chairman PROXMIRE. Oh, yes, indeed, Senator. Senator Jordan made the same request. He has some questions he would like answers to.

Mr. ACKLEY. We will do our best.

Chairman PROXMIRE. Yes.

Representative CURTIS. During the colloquy that Mr. Okun had with Senator Percy with reference to this expansion as the longest peacetime expansion, I do not think this was just a Freudian slip, because it gets right back to the points that many of us are trying to make. There is a great deal of the expansion which is related to the Vietnam war expenditures.

Mr. OKUN. If I may——

Representative CURTIS. Just a minute. Let me develop the thought fully.

I have never denied that war did not increase economic activity. Indeed, of course, it does; and the reference I previously made about your report of the period when you were discussing how you took care of poverty and unemployment, and you picked these periods when we had economic activity increased as a result of the war. But the question I think we must get on with is, Does that increased activity create new wealth or eat into the wealth we already have? And this requires a careful analysis of what the money is spent for, not just the fact that it is spent.

Yes, you wanted to respond?

Mr. OKUN. I merely wanted to repeat my earlier statement to Senator Percy. I said that, as of mid-1965, which was before the Vietnam war became a major economic factor, we had already achieved the longest and strongest peacetime expansion in the history of the United States.

I think that is an accurate statement of fact, Mr. Curtis.

Representative CURTIS. Well, as long as you choose some cutoff date, because again this must be related to the periods that are mentioned throughout your report, which are political periods, rather than economic periods.

The Korean War, of course, ended right around 1953, and for so much of the data, the takeoff date is used as 1953 or 1952, right up at the height of the Korean War, and notably a similar group of politicians, who are economists, referred to the recession of 1954, without referring to the fact that here we had shifted from an economy based on war to one that was based on peace, when there is bound to be a considerable adjustment.

Just take manpower: We take 1.2 million people out of uniform and probably 2.5 million out of the munitions plants.

All I am saying, all I am seeking to do here, is to try to direct attention to the economic impact of expenditure policy and what it constitutes.

If I may move to another problem. When Mr. William McChesney Martin appeared before the Ways and Means Committee last fall, advocating a tax surtax—but also advocating expenditure cuts—in his statement he developed the details of where he felt the tax increase should come, specifically. But when I began to interrogate him about where the expenditure cuts should come, he stated that he was essentially an authority in the monetary field, and this was not his area of expertise.

My observation was that I appreciated that, but that was true also of the tax field, that was not monetary policy, that was the other aspect of fiscal policy, and I was very happy to get his views on the revenue side of the economic impact, but I was equally anxious to get his views on expenditures.

We have had a similar situation develop here, as I understand it. You have gone into some depth as to where you recommend tax increases, and so forth. But when I sought to direct your attention to the economic effect of the expenditure policy, either in aggregate or in detail, you wanted to refer me to the Director of the Bureau of the Budget.

Of course, I want to talk to him, too. But I am most anxious to have economists zero in on this.

When we had the business panel before the Ways and Means Committee, they, too, said there should be a tax increase and expenditure cuts.

When we sought to go over with those gentlemen where the expenditure cuts might be made, this is something they sought to avoid.

Congressman Bolling, I suppose, would like me to defend the last session of Congress or these Congresses that have been controlled by members of his party with respect to appropriations. Of course, I cannot, because I have been and have felt opposed to the points they were making.

Again, I think his criticism of the Congresses is just that they have not zeroed in on the problems involved in the economic impact of expenditures and how we might move in on this.

I do not know whether we can go forward here in light of what has been said about expenditure policy.

Take, for example, foreign aid, not just the AID program, but Public Law 480, food and tobacco and cotton for peace—or freedom, I guess it is now—which generates as much expenditure as does AID, and related also to the so-called loans which are just a euphemism for what I would regard as grants, but they also generate expenditure policies.

We are talking in terms of probably around $5 billion or $6 billion annual expenditures, not the level you had given of around $3 billion.

I have suggested that the level ought to be probably around $1.8 billion, and I favor the theory of foreign aid to get nations on their economic feet, but no dialog develops.

Congress has defaulted on this, I feel the administration has defaulted on this, and I feel the private sector has defaulted on a discussion of this.

Move to this question of whether or not we should cut back the divisions of troops in Europe. Many military authorities have suggested this as wise. This bears on expenditure policy.

Public works, as I pointed out, in World War II, we did do, Mr. Ackley, what you said could not be done, cut back all public works. It is not a question of whether it can be done, because, of course, it can be done. It is a question of, what are the consequences, and what judgments need to be made.

When I was driving to the Capitol this morning, I passed a project that is now going on, to put that road underneath Pennsylvania Avenue, or Constitution Avenue, I guess. Most of those signs usually say something like "This project is your tax dollars at work." I was thinking to myself there could have been this sign, "This project has been temporarily suspended to put purchasing power back in the dollar."

I think we have got to start treating things in this way if we really feel that this deficit is too great, the cumulative deficit, and start not using just words, saying, a "stringent" budget. I do not want to quarrel with you about it, but in the aggregate, when it goes up $15 billion over a $21 billion increase the year before, which again was over a $10 billion increase over the year before, and a pattern of an increase that has been averaging, or had been averaging, about $5 billion, maybe. But what I want to know, what I would like to have been able to examine into, is expenditures, the economic impact of these expenditure cuts.

I notice my time is up, so what I want to do is to completely pose the problem, and the record will be open so that if you would care to submit for the record your judgment of what the impact of the ones I have mentioned is, but I want to go on and mention a couple of more.

We spent $17 billion on research and development. I have suggested that, important as this is, probably there should be a level of $14 billion.

I have suggested, in fact introduced a bill, to remove the present farm price supports of about $2 billion worth, which is on the assumption of paying people to produce less, and I am anxious to get increased purchasing power into the hands of the farmers. But I think this is an area.

Many of us have suggested that the supersonic transport be deferred. In my area, the McDonnell aircraft company is very vitally concerned about space programs, and yet I have said that the level of $5.1 billion, in my judgment, is entirely too high in these circumstances. It probably should be around $3.5 billion.

This has an economic impact, it would have an economic impact in my district. I would like to see the figures used of $9 billion on public works. Well, of course, that includes the highway program. That is financed, as we know, through the trust funds, so I relate it to the $5 billion public works.

I am satisfied that with proper economies, because of this situation, we could cut that back $2 or $3 billion, and not only would the Congressmen whose districts would be involved go along if the proper leadership were shown, but certainly the people behind them would.

I have listed here briefly what would total over $15 billion of expenditures.

This committee, all 20 members, after listening to the Economic Report last year and reviewing the budget, recommended instead of an expenditure level of $135 billion that it be reduced $5 billion, to $130 billion. That is $5 billion more than the previous fiscal year.

Instead of that—and this is getting rid of the rhetoric and getting to the arithmetic, the expenditure level, as we read in the Economic Indicators, is at a level of over $140 billion, talking about the actual expenditures to date, and then projecting that out.

I was told by the Director of the Budget that the last half, the last 6 months, or this half, will be about $1 billion more, so I do not think I am in error in using the figure.

I think a factor that would reconcile the figures that the administration has of $138.7 billion expenditures, is how one treats the sale of these participation certificates.

I point out, and I am happy the new budget shows them to be debt financing, they are not a cut in expenditures. These are simply one of the ways we pay for increased expenditures.

But, to conclude, I have put forward a package to you in general terms of expenditures, and if you can and would comment on the economic impact, how it would cut back on inflation. I know it is not that easy because they have other effects, economic effects, that we have to consider.

But this kind of economic exercise has not been engaged in. There has been no committee set up to review priorities, as has been recommended by this committee and many other people; indeed, Chairman Mills put in a bill to establish a commission to get into this question of expenditure priorities.

So if you care to supply an answer for the record before we go to write up our report on the Report, I would be happy to receive it.

Mr. Chairman, I have exceeded my time, but rather than let it rest, if you care to comment at all on what I have just said, you may; if not, please prepare something.

Chairman PROXMIRE. By all means.

Mr. ACKLEY. Mr. Curtis, I have a great deal of sympathy with your point of view here.

The Federal budget is a very vast thing, and it has all kinds of things in it. It is obviously a question of priorities as to how the funds should be spent, and which things should be increased and which things cut back.

I think all of us feel that the Federal budget is so vast that it is very difficult to deal with it in any simple way.

There is, of course, an appropriations process in the Congress in which the individual items are studied. It may be that there is inadequate machinery within the legislative branch, at least for judging relative priorities.

Within the administration, there is the machinery of the budget process in which efforts are certainly made to try to weigh expenditures in one line against those of another, and I think those efforts are becoming increasingly intelligent and, I think, scientific. The PPB system does make an effort to look at the expenditure program, line by line, and across the board in terms of priorities.

I think on an overall basis, when we are talking about the economy as a whole, we do almost have to talk about the aggregate and leave the question of the individual priorities to the budgetary and the appropriations process.

I think I would, perhaps, only comment that in my view it would be a strange set of national priorities which would suggest that the entire increase in the cost of the war should necessarily come out of the civilian programs of the Government.

In fact, what we are talking about here is a tax increase which would take half of the cost of the war, roughly, out of the taxpayer, and the other half out of the civilian programs of the Government.

We are not talking about a $25 billion tax increase, nor are we talking about a program of civilian expenditures which automatically expands to use up the entire fiscal dividend from a growing economy.

The kind of program which is proposed here is one which does make a reasonable effort, in part, to restrict the growth of private expenditures. In part, it has also involved a substantial restriction in the proportion of the national product which is being used for the Federal civilian programs.

Chairman PROXMIRE. I would like to continue, Chairman Ackley, along a line that may seem very critical of you, but it is only because your job is so enormously difficult, and I know it is, and I think you have done—as everybody here has said you have done—a fine job.

But you just said a few minutes ago it took a year to convince the country that we should reduce taxes and, therefore, it is not surprising that it takes perhaps more than a year for you to persuade the country and the Congress to increase taxes. I think that is a very wise observation, and it is the heart of what I have been arguing this morning. Tax changes are a very awkward and a very slow, and a very unsatisfactory method, it seems to me, of operating fiscal policy, however attractive they may seem theoretically, largely because the political process is so slow. We know it is slow, and we know it is going to continue to be slow.

Now, in this connection, what we have to have, I feel, is a policy that can be put into effect as rapidly as possible, whether it is spending reductions, whether it is an incisive and effective guidelines system, or whatever it is. The reason I say that is because these forecasts are inclined, as you know, to be so limited and so inaccurate, and this is the critical part of it, the critical point I want to make to you, and I would be interested in your reply. Richard Janssen did quite a job, as you know, in the Wall Street Journal recently, in which he seemed to dispute the implications of what Congressman Moorhead said when he talked about the brilliant forecast last year.

He said the Council of Economic Advisers—

Foresaw a 1967 gain of "more than $30 billion." Outcome: A gain of less than $26 billion. Disregarding inflationary price increases, the "real" gain in consumer purchases was envisioned as equaling the $20 billion of 1966; instead, this major measure of living standards mustered only a $12 billion "real" advance.

CONSUMER SAVINGS

The forecast was that people would be saving about 5.2 percent of their after-tax income, "a little below the average of recent years." Outcome: A surprise surge to 7.2 percent (highest since 1958), including a 14-year high of 7.5 percent in the final quarter.

TRADE SURPLUS

The gain from exporting more than we import was seen swelling by about "$1 billion over 1966's disappointing $5.1 billion total." Outcome: An even more disappointing $5.0 billion, including a thudding drop in the last few months.

BALANCE OF PAYMENTS

The goal—this was the estimate, the forecast—was "to come closer to equilibrium than in 1966, when total international transactions expanded foreign-dollar holdings by about $1.4 billion." Outcome: A 1967 deficit alarmingly estimated at two or three times that much.

REAL OUTPUT

The physical volume of goods and services was foreseen rising "nearly in line with the 4-percent growth in potential." Outcome: A gain of only 2.5 percent, weakest since the 1960–61 recession.

PRICES

"The price record should improve," the Council predicted. Outcome: From a 2.7-percent rise in the overall price level in 1966, and acceleration of inflation to a 3-percent pace for all 1967, including a 4-percent annual rate in the final quarter.

Probably the poorest forecast of all occurred in the Council's own backyard. The Federal Budget deficit on the "national income accounts" basis, which includes trust funds, but excludes lending operations, was to be "more than $5 billion" at a seasonally adjusted annual rate in 1967's first half, slacking off to $3 billion in the second half. Instead, the first-half deficit averaged a staggering $13.3 billion, and the second half (for which not all the returns are in) started off at about the same rate.

Anyhow, this seems to me to be a very, very serious indictment of the forecasting record of last year, and once again I certainly do not mean to imply any criticism of you. I don't think anybody could have necessarily done better.

My point is that if we are going to rely on this kind of forecasting to make policy, that policy should be, No. 1, easy to put into effect quickly and, No. 2, reversible, and we all know that to get a tax increase off takes a long, long time.

Mr. Ackley. Well, I would not try to dispute Mr. Janssen's numbers. I think we have never tried to make any secret of the fact that we were surprised at some aspects of the 1967 performance.

We do not claim perfection in this art of forecasting at all. I think it is important to recognize that one does have to forecast to make intelligent policy, and one ought to do the best he can.

I am not either going to apologize particularly for our forecasting record. It might have been off in some of the components, but I think on the whole it was not too badly off.

But the point which seems to me essential here, and which I would like the record to be very clear on, is my view, that, which I think most economists share, that tax changes can be effective much more promptly and repealed more easily than expediture changes.

Certainly, the record of the difficulty of manipulating the expenditure side of the budget seems to me abundantly clear. You talk about tax increases once enacted being difficult to take off. Expenditure programs, once put into effect, are also difficult to take off.

Chairman Proxmire. It is true on the upside, but it is not true on the downside. Once you reduce spending, it is pretty easy to restore it. Once you postpone it, it is pretty easy to resume it.

Mr Ackley. It is pretty easy to write the instructions and say, "OK, now turn this program around." But it does not happen that way. It takes a long time to get purchase orders out, production begun.

Chairman Proxmire. How long did it take last March or April to restore the roadbuilding program? The President postponed that by $3 billion, which was a very decisive and significant element.

Mr. Ackley. The rate of expenditure on highway development did not fluctuate in proportion to the change in spending authority.

Chairman Proxmire. Was it not relatively swift? It certainly was prompt in comparison to the effect of the President conceiving a notion he would like a tax increase and communicating that to Congress and getting congressional committees to act on it, getting the House committee to act on it, getting the Senate committee, and getting the House and the Senate to act on it, and than having an effect on the American people.

Mr. ACKLEY. I suggest that expenditure changes also have to go through the Congress, and that the appropriations processes are lengthy.

Chairman PROXMIRE. No. There are a number of things the President could do, as you know. The December cuts in public works were engineered without any congressional action. I submit to you he can hold back a substantial amount of expenditures.

Furthermore, in this expenditure atmosphere, if the President requests that we limit spending of this kind, I would anticipate that the Congress would act promptly; certainly, much more promptly than it has in the tax field.

Mr. ACKLEY. I certainly hope the Congress will act promptly to approve those expenditure reductions which require legislation, which are set forth at some length in the budget document.

Chairman PROXMIRE. Let me ask one other thing. There are an awful lot of questions, as you know, we could ask, and we could go on all afternoon, but I know you are tired and hungry, and so am I. But let me simply ask: in view of the fact there has been, as you have conceded, to some considerable extent, a cost-push inflation, in view of the fact that productivity only went up 1.4 percent last year, and in view of the Ford settlement between 6 and 7 percent, which seems to set a pattern in the minds of many labor leaders I have talked to, who say they have to do as well or close to as well, or they are in trouble with their membership, under these circumstances, how heavily would a tax increase have to hit the economy, how much unemployment would it have to provide, how much retardation in employment would it have to exert to have an influence on wage settlements significant enough to affect prices seriously on the basis of the past experience we have had?

Mr. ACKLEY. I think it is clear, as you suggest, a good deal of the rise in prices over the past year has been a cost-push variety.

I would like to make a couple of points. The distinction between cost-push and demand-pull inflation is a very useful one to make for analytical purposes. I think to understand what is going on in the economy it is very helpful to make this distinction.

But, I think, in practice, we have to recognize that these two are not separate. They work together, they interact.

I think the chart which we have here this morning indicates so very clearly that the rate of price change is, in fact, sensitive to the rate of change in economic activity. I do not know any other explanation for the fact that the rise in industrial wholesale prices more than doubled between the first and second half of last year.

I do not know any other explanation for the fact that the rate of increase in machinery prices in 1967 was half that, or less than half that in 1966.

Now, you can call the price increase cost-push. There are cost factors involved. You can call it demand-pull. The fact is the rate of price increase is sensitive to the rate of advance in the economy.

What we call cost-push in 1967 largely stemmed from wage increases that were substantially in excess of the growth of productivity. But where did that pattern of wage increases get established? It got established in late 1965 and in 1966 when we did have excess demand, and we are still living with that wage increase pattern. It will take a long time to get back away from it.

It seems to me that it is absolutely essential that we avoid another burst of demand that will give us another step-up in the rate of increase in wages, which will haunt us for a long time to come.

You are quite right, it will take a while to affect the pattern of wage increases through a tax increase. But it will not take very long for the absence of a tax increase and excessive demand in the economy to step up that rate of wage increase in a way that will haunt us for a long time to come.

Chairman PROXMIRE. But aren't you making the assumption that the Phillips curve is a fixed entity? In other words, that you cannot do very much, at least very much in the short run, about a situation which you have been describing consistently today, as one in which if unemployment is low and employment high, you are inclined to have inflation?

The whole point, as I understand it, of the wage-price guidelines is to create a situation in which you can have reasonable price stability at a lower level of unemployment.

Now, this Report on the policies of the President is all foursquare with the notion we are not going to try to do much about this Phillips curve this year. We are not going to really try to do very much about getting wage settlements down, holding down wage settlements, to such an extent that we can moderate this impact on prices.

It seems to me this is the essence of solving our problem. If we are going to grow, if we are going to have stable prices with maximum growth, we should adopt a wage-price guideline or wage-price system. We should fight hard for it, certainly, the administration should, and the Congress will agree that the administration should, that will enable us to keep prices as stable as possible, consistent with—let me put it the other way—would keep unemployment as low as possible, and grow as high as possible, consistent with price stability.

What are you going to do about that?

Mr. ACKLEY. I do not think there is any conflict between us in terms of our objectives. I think our objective is, and ought to be, to obtain the highest possible degree of growth and employment consistent with reasonable stability of prices. And we ought to try to reduce the rate of price increase associated with any rate of real growth.

It is, as you suggest, a slow business. What are we doing about it? Well, we are trying to do a lot of things about it. Our whole manpower training program is an attempt, if you will, to shift the Phillips curve, so as to make our total manpower resources more available for production, adapt them more effectively to the composition of the demand for labor.

The guideposts effort is a marginal effort to try to reduce——

Chairman PROXMIRE. But you proposed no guideposts. You walked away from a specified figure, and without a figure there is no guidepost. The guidepost is a figure, it seems to me, if it is anything, and if you oppose any compromise guideposts above productivity—if you are going to say that to favor such a compromise would be to give your blessing to inflationary wage settlements by settling, say, for a 5-percent wage-price guidepost or 5½ percent or around that area, all that I can say is you assure us of having settlements between 6 and 7 percent, following the Ford pattern.

Mr. ACKLEY. Well, let me only repeat that you are talking to the converted when you tell us about the usefulness of guideposts.

Chairman PROXMIRE. That is why it is so discouraging when you come up and indicate you know that you just cannot have a guidepost this year. There were none last year, and it was a big source of our inflationary problems.

I think you feel that way. You feel it was impossible, you feel you could not have one, but that is where we differ.

Mr. ACKLEY. If you cannot have one that will work, then there is very little use in trying to have one that won't work.

Chairman PROXMIRE. May I say we had four of the outstanding experts we could find on guideposts at our hearing 3 or 4 days ago, including Professor Sheahan of Williams College, a very able man who has just written an excellent book on this; all of them specialists in this area. They said that we have to have a figure, a compromise figure, that would work.

Mr. ACKLEY. I think the real problems with guideposts is what you do when it is widely violated. It does very little good to have a low guidepost figure that no one respects.

Chairman PROXMIRE. It is tough, painful; it is unpopular. You succeed in making labor and management mad at you.

Mr. ACKLEY. I think we have succeeded very well, and I think we have had some impact. It is our judgment that numerical guideposts on wages would not be productive in reducing the size of wage settlements in 1968. This is the judgment of others who have had to face up to the problem in the hard terms of what happens if you do it, and what happens if you do not. It is our judgment that a numercial guidepost would not be a useful thing to have in 1968.

It would be if there were a consensus in the labor movement and in business that this is something that we ought to try and we ought to do our best to live with.

That consensus does not exist. I do not think you create it by having the Council of Economic Advisers publish in its Report a statement that "We think wage increases in 1968 ought to be 3.2 percent or 4.5 percent, or any other number." That does not make it so. It may be that you would like to have it, but it just does not happen that way.

Chairman PROXMIRE. If Congressman Curtis will just permit me 1 minute, there was no consensus in 1962. Business certainly did not go along with Kennedy's crackdown on steel, no consensus at all. Labor was very critical of these guideposts all throughout these years, as you know far better than I do. You were at the center of this, and you know they were most uncomfortable with it. They complained to me, and I am sure they complained to you.

This is something you have to do whether they like it or not, and not expect a consensus, but go along with, it seems to me.

I yield.

Representative CURTIS. Just two things, please.

One, in this question that I posed for an answer for the record, it has to do with your expenditure policy again, but on page 66, in your report where you talk about the tax reduction in 1964, again, I think this misstates what actually happened.

The argument at the time, because I was right in it, was whether or not we would exercise expenditure restraint, and by that, I meant real expenditure restraint, that you did not increase the expenditures in the next fiscal year.

We actually had a motion to recommit in the House to hold expenditures to $97 billion for fiscal 1964, $98 billion for fiscal 1965. Chairman mills substituted that for exhortation that said the same thing.

But the figures in retrospect now show that they did exercise expenditure restraint, $97.7 billion level of expenditures for fiscal 1964 were a little higher, but fiscal 1965, the figures were $96.5 billion. Now, this has to do with expenditure policy.

I call attention to the fact that the tax cut of 1954 was in the same context of expenditure restraint. The tax cut in 1948 was in the same context, and these were in the depths of a recession, and I think you can go back to 1927.

So again, in discussing expenditure policy. I am anxious, as you said—you are more suited to discuss it in the aggregate—and I am anxious to discuss it in the aggregate, but also in detail because I think we need economic judgment on it.

But I would hope your answer would be in the context of not this new experiment in 1964 of a tax cut, because that experiment contemplated continuing increasing the Federal spending rates, not cutting back. That is what the administration fought us on and did not succeed.

Now, the other detail was, you had a list of improvements that you thought were necessary in our economic statistics, and I was very interested. But I was most disappointed to not see listed there the statistics on jobs available which really, in my judgment—and this committee held hearings on it—is an essential tool to make any manpower training program most effective.

I understand the cost is about $2.5 million, and I just think it is distressing that apparently it is the influence of the people in the AFL-CIO who are opposing it—their influences with the Secretary of Labor—that prevents this from moving forward.

The administration has not requested it. Again, it was defeated in Congress, but I can assure you it was done with the knowledge and, I argued, the connivance of the administration. Chairman Fogarty, who was chairman of the Appropriations Subcommittee, and the Republicans were trying to get the thing through, and we are trying to get it through, and this, I am satisfied from the hearings we held a couple of years ago, demonstrated both the feasibility of this and the essentiality of it to have any job training program work.

So, would you care to make your comment for the record, if you care to comment now?

Mr. Ackley. Mr. Okun might make some comment on it.

Mr. Okun. Just this comment, briefly. We fully share your feeling on the value of job vacancy statistics, and we recognize and appreciate the fact that you and other members of this committee have supported it.

But, as you point out, this has been beaten down twice when proposed by the administration. The Labor Department is currently reviewing the program in an effort to devise something that will be acceptable to the Appropriations Committee, and does not feel it has something that has a hope of passage at this time, and it is working on devising a program that might be——

Representative Curtis. I can assure you of Republican support because I have taken the trouble to get our people to agree. I think it is that important, and if the administration has been pushing this in any way they sure have not been making much noise about it, I must say.

Mr. OKUN. I know Commissioner Ross has worked very hard to——

Representative CURTIS. I know Commissioner Ross has, but it does not come out as policy, and I have never heard the President, in all of his talk about the need for job training and so forth, even refer to the fact that the Job Corps and every other vocational program and training program is hampered badly because of the lack of these series of statistics that could be brought about.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Well, gentlemen, we thank you. It is 1:30. I think you have broken all track records for testimony before this committee, and you have done a fine job.

I, once again, apologize if questions were asked which have been a little more abrasive than usual, but I think you have stood up to it very well, as always.

Tomorrow, the committee will hear the new Budget Director, Dr. Zwick, who will be our witness, at 10 a.m., in this room.

(Whereupon, at 1:35 p.m., the committee adjourned, to reconvene at 10 a.m., Feb. 6, 1968.)

(Inserts which follow placed in record at request of Representative Widnall:)

L. B. J. AND HIS SOFT DOLLAR [1]

No sooner had the economists got through predicting another record year in 1968 than President Johnson, on New Year's Day, announced a basic change in U.S. economic policy. Its consequences, which bear on our foreign trade and investment, are as yet unforeseeable, but it is a change for the worse. Johnson decreed measures sharply limiting the uses to which American citizens can put their dollar abroad. He has installed exchange controls on capital movements, something new for this country in peace or war, and he also proposes to discourage private travel outside the Western Hemisphere. In so doing, Johnson was forced to admit that the dollar, by other nations' standards, has become a soft currency.

What softened the dollar? Ten consecutive annual deficits in our balance of payments. What precipitated Johnson's action? Not the warnings of experts, who have been vainly telling him for years that the dollar was heading toward a crisis. Instead it was his sudden discovery that the deficit for 1967's fourth quarter was an unexpectedly scary $2 billion or so, bringing the full year's deficit close to $4 billion. To prevent a recurrence of the speculative panic that cost us nearly $1 billion in gold in December alone, Johnson had to take drastic action.

His action, an attack on symptoms, has given the dollar a breathing spell. But unless it is now followed up by more basic remedies, he will eventually have left the dollar weaker than before. Such has been the postwar history of the British pound. Such is the fate in store for any world currency whose managers share an inflationary bias they cannot or will not control.

The value of the dollar should become a prime political issue in 1968. It is not just the internal value of our currency that is at stake (though that has been declining at about 3% a year); the whole world monetary system has been put in jeopardy. The bulwark of this system has for 24 years been the free convertibility of dollars held by other governments into gold, as agreed on at Bretton Woods in 1944. Under steady U.S. pressure and example, the survivors of World War II gradually followed the U.S. lead into multilateral currency convertibility and trade liberalization, thus building an expansive dollar-based world market which Johnson could call "the greatest economic miracle of modern times." But now he has brought this most creative of U.S. policies to a halt.

Well, Johnson had to do something and we are stuck with his decision. It can enable us to resume our forward progress, provided: (a) Americans cooperate and (b) the government applies the more basic remedy required of a world currency

[1] Editorial reprinted from Life, Jan. 19, 1968.

that has been living beyond its means, i.e., disinflation. In order to make itself really scarcer abroad, the dollar must also become scarcer at home. Rigorous priorities on the use of our resources will have to replace Johnson's guns-and-butter policy.

He has not made the dollar any scarcer. Instead, he has chosen to restrict its usefulness. Foreign investment by U.S. corporations and foreign lending by U.S. banks had risen so fast that they have been under "voluntary" restraint since 1965. Now the limits are mandatory and more arbitrary and discriminatory as well. For example, new U.S. private investment in continental Europe is barred entirely except for Greece and Finland; in the U.K., Canada, Australia, Japan and oil countries it is held to 65% of the 1965–66 average; but in Latin America, Africa and most of Asia, the ceiling is 110%. All this is the very essence of discrimination, against which the U.S. has been the No. 1 world preacher for a generation.

The new investment and lending controls are aimed to reduce our balance-of-payments deficit by $1.5 billion. Another $500 million is hoped for from restrictions on U.S. travel outside this hemisphere; if this is done by law, its Iron Curtain overtones would make it an unpopular law indeed. Another $500 million improvement is hoped for from a new export drive, and the same amount from a new program to reduce U.S. government expenditures overseas. This last is the only one of the Johnson measures in which government, whose expenditures are chiefly responsible for the chronic deficits, will share the deprivations of "the private sector," whose foreign transactions earn us a surplus.

Nobody likes these decrees, including the officials who drew them up. Leading bankers, whose business will suffer but who understand the President's dilemma, reluctantly but patriotically promised to cooperate. So will everybody who realizes the seriousness of the dollar problem—for a while.

But they are a stopgap of strictly temporary usefulness. As Rudolph Peterson, president of the Bank of America, remarked, "We still need to develop a long-term balance-of-payments strategy." Johnson has not described one.

[Reprinted from New York Times, Jan. 30, 1968]

Budget Priorities

President Johnson's budget for fiscal 1969 is presented in an entirely new form covering all Federal receipts and expenditures. Unlike the three different budgets that proved so confusing and misleading in the past, the new unified form provides a reasonably comprehensive picture of the Administration's economic plans and expectations.

As a step toward restoring stability in the economy, the projections show a hold-down on spending and a rise in revenues that will reduce the over-all deficit from almost $20 million in the current fiscal year to $8 billion in the next. A swing of this magnitude would not only curb the danger of overheating but could conceivably threaten to cool things off too much.

The new budget, like the old, is far from a precise blueprint of things to come. Even in the most stable of times, it is difficult to make firm plans eighteen months in advance. The times and the budget are anything but stable now. With an escalating war in Vietnam, uncertainty in Korea, unrest at home and a national election approaching, the budget must be regarded as more of an exercise in optimistic impressionism than the sober realism that is unquestionably needed.

Certainly there is a lot of wishful thinking in the Administration's estimates of incoming revenues. Mr. Johnson is counting on a boom in the economy along with Congressional approval of his tax surcharge proposal and new "user" taxes. These are debatable assumptions since Congress is clearly reluctant to raise taxes and the economy has not been accelerating at the feverish pace that the Administration has predicted.

The spending estimates also are suspect. Mr. Johnson has contrived to keep the increase in outlays to $10.4 billion, a sizable reduction from the rise of over $17 billion expected in the current fiscal year. But that reduction has been managed by a number of dubious techniques for limiting military spending and it makes no allowance for further escalation in Vietnam, for fresh outbreaks of trouble elsewhere, for stresses in the cities or strains in the economy or for hyperactive Congressional logrolling of the kind that is standard with an election in the offing.

The President insists that he has made hard choices and that the budget is "a program to meet our responsibilities compassionately and sensibly." Yet it is hardly the lean and frugal budget demanded by a nation at war in Vietnam and fighting poverty at home. There are still too many appropriations for nonessential items while those projects vital for poverty and other social purposes are either shortchanged or stretched out.

In proposing adoption of the unified budget, the Presidential commission that examined the entire subject also suggested that the Administration make available its revisions of its original estimates and urged Congress to conduct a thorough review of the budget's composition. Both of these recommendations must be followed. The unified budget represents an advance, but it is a big and unwieldly package that requires the most careful and searching scrutiny if its economic impact is to be measured and understood.

A comprehensive picture of the budget's over-all impact can, in fact, be gained only by a thorough review of its separate parts, with particular emphasis on the innovations—and the gimmickry—entailed in its spending estimates for nonessential programs. After two years of runaway outlays that have made for damaging dislocations and excessive inflationary pressure throughout the economy, priority must be placed on confining expenditures to those programs that will meet the nation's necessary defense and social objectives.

[Reprinted from the Washington Post, Tuesday, Jan. 30, 1968]

The 1969 Budget: Resources and Priorities

There is a widespread impression that domestic welfare is being sacrificed on the altar of war. And perhaps, by some tests it is. For defense certainly is accounting for an inordinately large part of our resources. But a comparison of the actual spending trends for defense and social welfare does not sustain the charge that the former is rising while the latter is going down; they are rising hand in hand. The question raised in President Johnson's 1969 budget is whether welfare spending is rising fast enough, and whether other less useful, nonmilitary civilian programs could not have been more sharply curtailed.

Even the President's budget rhetoric is misleading. In January 1965, before the beginning of the expansion of the war effort in Vietnam, Mr. Johnson said that his budget had begun "to grasp the opportunities of the Great Society." Indeed, there were four references to the Great Society on the first page. In January, 1966, the Great Society was mentioned only once; in January, 1967, not at all. And yesterday, in presenting his budget for the fiscal year 1969, the President, after cataloging the more urgent domestic problems said that "we would be derelict in our responsibilities as a great Nation if we shrank from pressing forward toward solutions * * *." "But," he said, "faced with a costly war abroad * * * we had to set priorities. And 'priority' is but another word for 'choice.' We cannot do everything we wish to do. And so we must choose carefully among competing demands on our resources."

Taken alone, the abandonment of the Great Society slogan and the statement about the need to set priorities, would imply austerity, a reduction of welfare programs in favor of those relating to defense. But the figures simply do not support that impression. In fiscal 1969, according to the new, unified budget, national defense outlays—spending and lending—will rise by $3.3 billion while health, labor and welfare outlays will rise by $5 billion. Nor is the picture much changed if a longer time span is taken. From 1962 to 1969, defense outlays are scheduled to rise by $28.8 billion, those for health, labor and welfare by $28 billion.

The broad generalization that welfare has been sacrificed in the interest of defense simply will not wash. Indeed, if the $3.5 billion increase in Federal outlays for education, scheduled over the period 1962–69, is taken into account, the charge becomes weaker. Why then is there likely to be dissatisfaction with this budget?

One answer, of course, is that the increase for welfare and other nonmilitary programs will be regarded by many as insufficient, especially since Congress is much more likely to practice economy on these items than on spending for the war. It can be argued, for example, that expenditures for housing and urban developments should be higher than the $1.43 billion budgeted for 1969, that expenditures for economic assistance to underdeveloped countries should exceed $2.33 billion or that outlays for the Office of Economic Opportunity should exceed $1.99 billion. But it does not follow that the total budget has to be larger or that the defense budget, which accounts for about 43 per cent of the total, has to be smaller in order to achieve a higher rate of spending for welfare. Another way to do this is to reorder the priorities in nonmilitary spending by cutting back pure and simple pork barrel projects and other less urgent programs in favor of funds for more pressing social problems.

Attempts were doubtless made to accomplish that objective, but the results are not impressive. Recommendations for reductions in budget authority—authorization to spend through appropriations or other means—amounted to nearly $12.5 billion as against $26.5 billion in recommended increases. But in perusing the reductions, one finds few very deep cuts and no programs that have been completely phased out. Yet if the Administration were serious about priorities they would be urging Congress to undertake a ruthless pruning of programs that confer small benefits upon the taxpaying public. And they would urge special fees or user charge for programs that are of benefit only to small, special interest groups.

Several examples might be cited. The Office of Business Economics in the Department of Commerce, the agency that prepares the national income estimates, the balance of payments accounts and other vital economic statistics has a recommended budget authorization of $3.31 million. Yet the Business and Defense Services Administration, whose work is far less useful and less widely used, has a $6.48 million budget. Is there any reason why patent applicants and holders should not bear the cost of the $43 million needed to run the Patent Office? Why should the public pay $990,000 for the Office of Oil and Gas in the Interior Department when the mandatory oil import program which it conducts confers such enormous benefits on a single industry?

Much was said in the Budget about efforts to economize, and the public is assured that the $12.9 billion it is being asked to pay through income tax surcharges will not be used to sustain a rapidly growing level of expenditures after 1969. But those claims are difficult to reconcile with the published information. Federal civilian employment is scheduled to rise by 46,000 in fiscal 1969, the only reduction being 300 from the Selective Service System.

Total Federal outlays are scheduled to rise by only $10.4 billion in 1969 as against more than $17 billion in 1968, but that slowdown will prove ephemeral. Net obligations incurred—the budget authority that will be obligated by commitments to spend—are scheduled to rise by $15.7 billion in 1969 as against only $10.7 billion in 1968. So while spending will be slowed in fiscal 1969, it will, if Congress accepts this budget, spurt forward in subsequent years.

The economic implications of the budget—its impact upon income, employment and prices—will be surveyed after the President makes his Economic Report. But an examination of the first budgetary function—that of allocating Federal resources among various programs—is disappointing. No real effort appears to have been made in restructuring programs. Indeed the image of the Federal establishment that emerges from the budget is one of a great glacier. It may be possible to speed up or slow down its rate of advance. But sharp changes in direction, however desirable, are very difficult to accomplish.

[From the New York Times, Feb. 2, 1968]

NEW DIAGNOSIS, OLD CURE

President Johnson takes a much more sober and more candid approach in his new economic report than he did in the palmy days of untroubled expansion. Instead of the suggestion that the secret to permanent noninflationary prosperity had been found, there is a humble admission that the Administration's policies "have not been perfectly executed nor perfectly coordinated," together with renewed warning of the danger of an inflationary spiral at home and of the threat to the stability of the dollar abroad.

This chastened note also appears in the supplementary study prepared by the President's Council of Economic Advisers. They, too, confess to "shortcomings in our policy record," and indicate that the "fine tuning" of the economy that they once had thought possible demands much better forecasting than the "new economics" has yet achieved. Their difficulties, they point out correctly, have been compounded by large and unforeseen defense expenditures as a result of the escalating war in Vietnam.

These welcome and disarming comments are not accompanied by a major change in the Administration's prescription for the economy. The report contains some constructive new proposals but it refuses to consider an alternative to its major drive for a tax increase that has faced stubborn resistance in Congress.

Nevertheless, there are useful new recommendations in some areas. Mr. Johnson plans to set up a Cabinet Committee on Price Stability in order to emphasize the vital importance of combating wage and price inflation. His committee will serve to coordinate efforts to keep prices and wages from rising faster than advances in productivity, although he specifically rules out any involvement in wage and price negotiations that could be construed as a form of control. Moreover the President frankly states that he does not expect a return to stability in 1968; but the priority he is now giving to this objective may succeed in winning greater cooperation from management and labor.

Mr. Johnson also proposes new measures to bolster the hard-hit housing industry. He wants to sustain his program for rebuilding blighted urban areas and he will be taking fresh steps to assure greater availability of mortgage credit. In addition, the Administration is planning a creative partnership with private industry to speed the training of the poor who are without skills or opportunities.

But these enlightened 'inovations are not the core of the Administration's economic policy. Despite the more searching diagnosis undertaken by the President and his advisers, there is still too much of a business-as-usual tone to their main prescription when it is clear that conditions are anything but usual. The mounting costs of the war in Vietnam that have put the economy under so much strain at home and that have aroused suspicions about the dollar abroad demand much harder choices and a sterner set of priorities on spending than the President has been willing to make.

[Reprinted from Washington Post, Feb. 4, 1968]

Economy in Trouble, Answers Elude LBJ

(By Hobart Rowen)

For all the affluence of American middle-class and upperclass families, the U.S. economy is in trouble, and the Johnson Administration appears to be bankrupt of ideas to avert disaster.

In two major reports to Congress this past week—one on the budget and the other on the economic outlook—the President has properly stressed the danger of a rip-roaring inflation in 1968.

But his proposals to control it are limited to a reiteration of his request for a tax increase, and a toothless appeal to management and labor to behave themselves.

In the international arena, we are faced with a balance of payments and gold crisis—but while we blithely let gold leak to speculators by the hundreds of millions through the London gold pool, we're concentrating our efforts on stopping Aunt Minnie from spending more than $5 a day in London or Oslo.

The United States Government is happy to give the impression that it sells gold only to foreign central banks at $35 an ounce. But the fact is that the London market sells to anyone, especially speculators—and 59 per cent of the gold sold by the pool comes from the U.S. stockpile at Fort Knox.

ECONOMIC IMPACT

In December alone, U.S. gold stocks were reduced by $900 million. Almost none of this went to central banks, which means that almost all of it went to speculators, who are assured against any loss by the bull-headed determination of U.S. officials to support the buying price of gold at $35 an ounce.

As for the tax surcharge problem, Johnson made the necessary budgetary concessions that make it feasible for Congressman Wilbur Mills—if he chooses to do so—to support a form of tax increase.

The tip-off came from exiting Budget Director Charles L. Schultze, who told a group of suburban Democratic women here the other day that "it will take some pulling and hauling, and some further compromise with Wilbur on spending, but my best guess is that we now can get a tax increase, maybe not everything the President has asked for, by the middle of the year."

Thus, after shaving down the former "Great Society" programs, the only possibility of getting even a 6 or 7 per cent surtax will be by yielding further to Mills' fear of Big Government. If and when Mills agrees to a tax increase on this basis, it will be a triumph for the Southern Democrat-Republican coalition.

There is something else in the mix of things that now suggests the likelihood of tax action: military spending for Vietnam and Korea is doubtless going to rise again, whatever the official assurances to the contrary may be.

The evidence of Vietcong strength in Saigon and other cities, as well as the unexpected developments in Korea following the capture of the Pueblo suggest it is good policy to be skeptical of Administration assurances that defense spending has "peaked" or will level out.

Every dollar added for war, and every other dollar that Mills can squeeze out of the budget will mean that much less for the civilian side of the economy.

The truth is that the war in Vietnam is now pervasive and dominant. Most of our troubles are traceable to it, and it is therefore terribly misleading for the Administration to trumpet the fact, as it does at every opportunity, that Vietnam is costing only 3 per cent of the Nation's output.

That's only part of the story. In the first place, total defense spending is $80 billion a year, three times the amount chalked up to Vietnam. Who is to say how much more of the balance is really for Vietnam?

But even taking the lesser figure, the Council of Economic Advisers points out that Vietnam has absorbed 25 per cent of the Nation's growth in real output since 1965.

Including the monies in the new budget, Vietnam has so far, by the President's own figures, cost more than $75 billion. Measure that against the small amounts spent for the poverty and slum programs.

Is it exaggerating to say the economy is in trouble? The President himself reported:

"The American city is in distress, plagued by poverty, unemployment and slums; hobbled by inadequate public services, inefficient transportation, pollution, and congestion."

Yet, we can't do better by the cities because we are in a war. We may be coming close to the point where economic controls are needed. Administration officials throw up their hands in horror at the suggestion. Wage and price controls? Repugnant thought, says the CEA. Sure it is.

But when the Administration admits that even if it gets a tax increase, it will be powerless to halt a wage-price spiral, such self-confessed impotency is not a pleasant thought, either.

Much of the economy's present problem stems from President Johnson's failure in 1966 to propose an increase in taxes to match the rising cost of the war. He shoved the problem under the rug, promising guns and butter.

Presumably, he was relying on the advice of his Joint Chiefs (which proved to be wrong) that the pesky North Vietnamese could be dealt with quickly and effectively. That was a bad guess, and spending in Southeast Asia zoomed out of sight.

Now, the President is temporizing again. It's an election year, and he wants to deal softly with business and labor. He even rejected a plan for turning a Government spotlight, through an "incomes policy" board, on wage bargaining or pricing decisions that seemed greedy.

The prospect of strikes this year in key industries against the background of excited charges that the supply lines to the Asian fronts are being affected is a real one. It will be a long, hot, uneasy summer in many ways.

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 6, 1968

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

The committee met at 10:05 a.m., pursuant to adjournment, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Talmadge, Javits, and Percy; and Representatives Bolling, Reuss, and Moorhead.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

Our witness this morning is the new Budget Director, Mr. Charles J. Zwick.

Mr. Zwick, you have been before us before, and you have always done an outstanding job. We know of your competence and of your dedication to the job.

I might say that you succeed one of the finest Budget Directors in the Nation's history, in my view, Charles Schultze, a very able man. And while we regret to see him go, we are delighted to see that he is succeeded by such a competent and able person.

You may go right ahead with your statement, Mr. Zwick.

STATEMENT OF CHARLES J. ZWICK, DIRECTOR OF THE BUREAU OF THE BUDGET, ACCOMPANIED BY SAMUEL M. COHN, ASSISTANT DIRECTOR FOR BUDGET REVIEW

Mr. ZWICK. Thank you very much. I appreciate your remarks. And I am, of course, quite aware that I am following a very competent person in Charles Schultze.

Mr. Chairman and members of the Joint Economic Committee, I am pleased to have this opportunity—my first as Budget Director—to discuss with you the fiscal policy and program plans encompassed in the 1969 budget. In their appearance, yesterday, the members of the Council of Economic Advisers set forth the economic outlook on which the budget policy for fiscal year 1969 has been based. To conserve time, I will at this point merely say that I associate myself with their view that recent and foreseeable trends in the economy clearly indicate the need for the additional taxes the President has proposed, coupled with the expenditure restraint incorporated in the budget. I will, of course, be happy to answer any questions you may have on this subject.

In my statement this morning I would like to describe, first, the fiscal implications of the new budget and then discuss briefly its program emphasis. Before I do, however, I will take a few minutes to explain the new budget presentation adopted in line with the recommendations of the President's Commission on Budget Concepts.

The New Budget

The new budget, as you know, resulted from a Presidential Commission which was established last March to review the concepts, format, and presentation of the Federal budget, with the objectives of improving and clarifying the budget itself and increasing public and congressional understanding of this important document.

The Commission was made up of 16 distinguished citizens, including the chairmen and ranking minority members of the Appropriations Committees of the Congress. This is the first time that a Presidential Commission has reviewed the basic concepts underlying the budget since passage of the Budget and Accounting Act of 1921.

The report of the Commission was presented to the President last October. Shortly afterward, the Subcommittee on Economy in Government of this committee held hearings, during which a number of expert witnesses indicated their generally favorable reaction. At that time, the Chairman of the Commission, David Kennedy of the Continental Illinois National Bank & Trust Co. of Chicago, outlined for the subcommittee the major recommendations of the Commission. We have incorporated those recommendations in the 1969 budget, as follows:

First, a single unified budget format is used in place of the three different concepts highlighted in the past—the "administrative," "cash," and "national income accounts" budgets. For comparability purposes, the detailed budget data for 1967 and 1968 have also been compiled on the new basis and summary budget information has been carried back to 1958, using the new concept.

Budget data consistent with the national income accounts framework have also been calculated and will continue to be useful since they tie directly into the gross national product statistics of the Department of Commerce. However, the NIA data are not presented in the basic budget summary; they are shown in Special Analysis B toward the back of the budget document. In addition, during this period of transition to the new concept, we have provided in the budget information on the old administrative and cash budgets, also in a special budget analysis—A.

Second, the new budget stresses comprehensive coverage of all programs of the Federal Government, including the receipts and expenditures of the social security, medicare, highway, and other trust funds. Outlays of the trust funds in fiscal 1969 are estimated at about $47 billion, thereby raising significantly the level of the new budget compared with the traditional administrative budget.

Third, the new budget is *divided between an expenditure account and a loan account*, in recognition of the difference in economic impact between these two types of transactions. When the Federal Government makes a repayable loan, and exchange of financial assets is involved. When an outright expenditure is made, on the other hand—for military hardware, or a bridge, or retirement benefits, or a grant to a State—this is a direct addition to the income of the recipient. Accordingly, the Commission on Budget Concepts recommended—and the 1969 budget shows—that "spending" be separated from "lending." Also following the Commission's recommendation, the budget shows a separate calculation of the deficit on expenditure account totals alone, in addition to the overall budget deficit which includes net lending.

I should note that certain loans are included in the expenditure account rather than being treated as "lending"—again, in line with the recommendations of the Commission. These comprise: (*a*) foreign loans made largely on noncommercial terms, such as those of the Agency for International Development, and (*b*) other loans where the terms of the loan contract make repayment in certain cases contingent rather than mandatory.

Fourth, the new budget *offsets against related expenditures certain receipts* of the Government, these are primarily from businesslike or market-oriented activities, in order to highlight the *net* cost to the taxpayer. This eliminates the inconsistent treatment of these receipts in the old administrative budget, but does not alter the deficit since it affects receipts and expenditures equally.

Finally, sales of participation certificates are no longer treated as an offset to expenditures, but are handled as a means of financing the deficit, similar to Treasury securities.

Two other major recommendations were made by the Commission for later adoption. These are, first, the adoption of an accrual basis for accounting for expenditures and revenues, and, second, a separate identification of the interest subsidy element in Federal loan programs in the expenditure account. These changes involve major adjustments in the Government's accounting system. They are now being undertaken, but it will be a few years before they can be put into effect.

There are several aspects of the new budget which take getting used to, in addition to the higher levels arising from inclusion of the trust funds. The simple combination of Federal funds and trust funds inflates some of the figures because there are a number of transactions between these types of funds. For example, the Treasury pays interest to the trust funds on the securities they hold; payments go into the supplementary medical insurance trust fund out of general revenues. Therefore, before arriving at budget totals, these sizable intragovernmental transactions must be deducted to avoid double counting.

Some of us are also finding it a little difficult to get used to using the term "budget outlays" which is the name we selected for the sum of "expenditures" and "net lending." However, I am sure this problem will disappear in time.

In the valuable hearings of this committee several years ago on "The Budget as an Economic Document," it was repeatedly noted that the budget must serve many purposes and that no single set of figures can be sufficient for all uses. This continues to be true. Nevertheless, it is our hope that the new unified comprehensive concept and presentation will make the budget a more understandable and more useful document.

Let me turn now to the substance of the budget and describe what I view as its major fiscal implications.

Fiscal Implications of the 1969 Budget

The 1969 budget is based on a very strict ordering of priorities, with several overall fiscal policy objectives in mind.

The American economy will shortly enter its eighth year of sustained expansion. Fiscal policy must play a central role in promoting continuation of this unparalleled growth. It must, at the same time, help assure that this growth is real—that it is not eroded by excessive increases in prices which tax those least able to pay and which contribute to worsening of our foreign trade balance. Moreover, fiscal policy, combined with monetary policy, must seek to assure the availability of credit at interest rates which do not cause undue burdens on groups and industries heavily dependent on capital markets.

Our economic achievements in the past 7 years have been remarkable.

Our total national output of goods and services has risen more than 40 percent.

Ten million more people are employed.

Per capita income after taxes has risen 29 percent after adjusting for price changes.

More than 12 million people are no longer living in poverty.

And unemployment fell to an average level of 3.8 percent in 1967 for the second year in a row, compared with 6.7 percent in 1961.

Fiscal policy—mainly in the form of tax reductions and reforms—played a major role in this performance.

Between calendar years 1961 and 1965, substantial economic growth was achieved with relatively stable prices. The annual increase in consumer prices was about 1⅓ percent. Wholesale industrial prices rose by only about one-half of 1 percent per year.

In the past 2 years, however, prices and interest rates have risen at unacceptable rates. The consumer price index has risen at an annual rate of 2.9 percent, and wholesale industrial prices at an annual rate of 1.8 percent. And if you will look at the most recent quarter, the last quarter of last year, the consumer price index was rising at a rate of about 3½ percent per year, and industrial wholesale prices at about 3 percent—clearly an unacceptable acceleration in the rate of price inflation.

Interest rates advanced sharply in 1966, and, following a short period of decline, rose again in 1967. The deficit in our balance of payments—which had dropped from $3.9 billion in 1960 to $1.4 billion in 1966 worsened in 1967.

Fiscal policy now must, therefore, be directed toward—

(1) lessening of inflationary pressures;

(2) improving the balance of payments; and

(3) stemming the upward pressure on interest rates.

The 1969 budget aims to accomplish these objectives through a tight rein on outlays coupled with a temporary tax increase, with a resulting substantially reduced budget deficit. Table 1 shows the estimated budget totals for fiscal year 1967 through 1969 under the new budget concept.

(Table 1 referred to follows:)

TABLE 1.—BUDGET TOTALS

[Fiscal years. In billions of dollars]

	1967 actual	1968 estimate	1969 estimate
Total budget:			
Receipts	149.6	155.8	178.1
Outlays (expenditures and net lending)	158.4	175.6	186.1
Budget deficit	−8.8	−19.8	−8.0
Of which:			
Expenditure account:			
Receipts	149.6	155.8	178.1
Expenditures	153.2	169.9	182.8
Expenditure deficit	−3.6	−14.0	−4.7
Loan account:			
Disbursements	17.8	20.9	20.4
Repayments	−12.6	−15.1	−17.1
Net lending	5.2	5.8	3.3

Mr. ZWICK. As the table shows, total outlays in fiscal year 1969 are estimated at $186.1 billion, of which $182.8 billion is spending and $3.3 billion is net lending. Revenues, including $12.9 billion to be raised through the proposed tax measures, are estimated at $178.1 billion, leaving an overall deficit of $8 billion. This compares with an estimated deficit in the current fiscal year of $19.8 billion, so that the deficit would be reduced by $11.8 billion from 1968 to 1969.

In the expenditure account alone, which offers a better measure of the direct impact of the Federal budget on income and output, the deficit in fiscal year 1969 is estimated at $4.7 billion compared with $14 billion in 1968.

Now, that $4.7 billion, I am sure you know, relates fairly closely to the NIA deficit which in fiscal year 1969 will be $2½ billion. So that there is a difference in this case of $2.2 billion between the NIA deficit and the expenditure deficit.

The income tax proposals contained in the budget are in the same form as recommended last year—a temporary 10-percent surcharge on individual income taxes to be effective as of April 1, 1968, and a similar surcharge on corporate income taxes effective January 1, 1968.

In addition, acceleration of certain corporation tax payments is proposed, as in last year's tax package, and the present excise tax rates on automobiles and telephones would be extended beyond April 1, 1968.

A number of new and increased user charges are being recommended, particularly in the field of transportation, which will shift the burden of financing Government services from the general taxpayer to the specific beneficiaries and make the provision of these services dependent upon the willingness of the users to pay for them.

The budget outlays of $186.1 billion represent an increase of $10.4 billion over the current fiscal year. Virtually all of this increase is for national defense programs and for expenses which are mandatory under present law in the coming year. We have held controllable outlays just about level by proposing reductions and program modifications affecting almost every agency.

Between 1968 and 1969, the *normal* growth in revenues, which accompanies expanded economic activity and rising incomes, is estimated at $11.5 billion. This normal growth will more than cover the $10.4 billion increase in outlays. The revenue yield of the proposed surcharge and corporation tax acceleration will, therefore, be applied entirely toward reducing the budget deficit, not toward covering the added outlays, including those for Vietnam.

The rise in total outlays as defined under the new concept, or in expenditures under the old administrative budget concept, is significantly lower than in 1968 or in 1967. Outlays rose by $24 billion in 1967 and $17 billion in 1968, compared with the $10.4 billion increase expected for 1969. Excluding national defense, the comparable increases are $10½ billion in 1967, $11 billion in 1968, and $7 billion in 1969. And the increase in 1969 is measured against a 1968 base which has been reduced through combined congressional and administration actions by $2 billion for defense programs outside of Vietnam and by more than $2 billion for controllable civilian programs.

To highlight the temporary nature of the need for the tax surcharge, let me point out that our special outlays for Vietnam come to about 3 percent of the gross national product. The social insurance trust funds—for social security, medicare, unemployment insurance and other retirement programs—have been increasing more rapidly than the GNP. As shown in table 2, other outlays have been declining as a share of the GNP in recent years.

TABLE 2.—BUDGET OUTLAYS AS A PERCENTAGE OF GROSS NATIONAL PRODUCT

[In percent]

	Fiscal years			
	Average 1958–60 actual	1965 actual	1968 estimate	1969 estimate
Total outlays:				
Vietnam		(1)	3.1	3.0
Social insurance trust funds	3.0	3.4	4.2	4.4
Other outlays	16.0	14.6	14.2	13.9

1 Less than 0.05 percent.

As I said, the "Other outlays" have been declining steadily as a share of gross national product in recent years. For fiscal year 1969 we estimate "Other outlays" as 13.9 percent of the GNP.

The temporary expenditure add-on for Vietnam is estimated at about $26 billion in 1969—25 percent more than the sum of the $12.9 billion yield from the proposed tax measures and the remaining $8 billion budget deficit. This is another indication that the added taxes will not be needed once peace is attained in Vietnam.

To sum up, the 1969 budget—

Requests a temporary and modest tax increase to help pay the cost of Vietnam responsibility.

Reflects efforts by both the Congress and the administration to cut back on outlays in 1968.

Calls for a tight holddown on outlays in 1969, which will also require the cooperation of the Congress.

Assures that the tax increase will be temporary in duration, and

Promote sustained real growth at home and increased confidence in the dollar abroad.

As I said earlier, the outlays included in the budget have been put to strict tests of priority. This is indicated in the program content of the budget, which I would now like to discuss briefly.

I am sure that there are some that will disagree with our sense of priority. But none can disagree with the fact that a strict set of priorities have been applied. This is indicated in the program content of the budget, Mr. Chairman.

PROGRAM IMPLICATIONS OF THE 1969 BUDGET

The estimated $10.4 billion increase in outlays between 1968 and 1969 is, as I noted earlier, required almost entirely for national defense needs and for charges which are relatively fixed under present law. The figures are shown in table 3.

TABLE 3.—CONTROLLABILITY OF BUDGET OUTLAYS

[Fiscal years. In billions]

Type of controllability	1967 actual	1968 estimate	1969 estimate	Change, 1968 to 1969
National defense	$70.1	$76.5	$79.8	+$3.3
Relatively uncontrollable civilian programs:				
Open-ended programs and fixed costs:				
Social security, medicare, and other social insurance trust funds	30.3	34.3	38.5	+4.2
Interest	12.5	13.5	14.4	+.9
Civilian and military pay increase			1.6	+1.6
Veterans' pensions, compensation, and insurance	4.9	5.1	5.2	+.1
Public assistance grants	4.2	5.2	5.7	+.5
Farm price supports (Commodity Credit Corporation)	1.7	2.8	2.9	+.1
Postal operations	.8	.7	.3	−.4
Legislative and judiciary	.3	.4	.4	(1)
Other	2.4	2.7	2.8	+.1
Subtotal, relatively uncontrollable civilian programs	57.1	64.7	71.8	+7.1
Relatively controllable civilian programs, including outlays from prior year contracts and obligations	35.2	39.0	39.5	+.5
Undistributed intragovernmental payments (−)	−4.0	−4.6	−5.0	−.5
Total budget outlays	158.4	175.6	186.1	+10.4

[1] Less than $50,000,000.

Of the $10.4 billion increase—

Three and three-tenths billion dollars is for national defense, including, in addition to the Department of Defense and the military assistance program, the added expenditures of the Atomic Energy Commission for nuclear weapons, and certain other defense-related activities. The amounts provided for in the budget allow for the possibility of a continuation of hostilities in Vietnam beyond the end of the coming fiscal year. They also cover the pay increase which became effective last October, and will permit selective improvements in our strategic and general purpose forces.

Four and two-tenths billion dollars of the increase is for the largely self-financed social insurance programs of the Federal Government, chiefly social security and medicare.

One and six-tenths billion dollars is estimated for the second step of the pay increase for Federal civilian and military personnel, scheduled to take effect on July 1, 1968, under the pay legislation enacted last year.

One and three-tenths billion dollars is for other relatively fixed charges, such as interest on the Federal debt, public assistance grants, and veterans' compensation and pensions.

As you can see in table 3, this leaves an increase of $0.5 billion for relatively controllable civilian programs from 1968 to 1969. Within this relatively stable total, however, there are a number of significant increases and decreases. These are based essentially on three kinds of actions, as noted by the President in the budget message.

First, there are selective expansions of existing programs and proposed new programs, only as necessary to meet those urgent requirements whose fulfillment cannot be delayed.

Second. delays and deferments have been proposed wherever possible without sacrificing vital national objectives.

Third, the budget sets forth recommendations for basic changes, reforms, or reductions designed to lower the budgetary costs of a number of Federal programs which, in their present form, are not effectively meeting today's needs.

The overall increase in controllable civilian outlays is made up of increases totaling $3 billion and decreases totaling $2.5 billion. Out of the $3 billion, about $2 billion is for payments on contracts and commitments made in prior years in a variety of programs. Another required increase spread throughout the Government is for last October's pay raise, which will be in effect for the entire fiscal year in 1969 instead of for only three-quarters of the fiscal year, as in fiscal 1968.

In addition to these increases which had to be provided for, selective increases are included in the budget for certain activities of high urgency and priority.

Some of these activities expand merely by virtue of increased workloads brought on by a growing population with rising incomes. For example, 2.8 million more tax returns will have to be processed by the Internal Revenue Service in 1969 than in 1968. The Federal Aviation Administration will be handling a level of aircraft traffic over 10 percent greater than in the current year. The national parks will have an estimated 17½ million more visitors next year.

A few other areas are being expanded selectively in response to the most urgent needs in the Nation—the elimination of poverty, improvement in the quality of our environment, and reversal of the rising rate of crime. Among the more important increases provided are:

—$231 million for expanded manpower training efforts, emphasizing cooperation with industry to provide on-the-job training for the hard-core unemployed.

—$81 million for stepped-up efforts to control crime.

—$436 million for enlarged programs to attack urban blight through the new model cities program and greater urban renewal activity.

—$179 million for increases for family planning, and expanded programs to reduce infant mortality through better health care for mothers and infants.

—$89 million for air and water pollution control.

Table 4 illustrates the pattern of the total budget, including both uncontrollable and controllable outlays, in terms of selective program changes such as I have just mentioned.

TABLE 4.—BUDGET OUTLAYS—SELECTIVE PROGRAM CHANGES

[Fiscal years. In billions]

Description	1967 actual	1968 estimate	1969 estimate	Change, 1968 to 1969
National defense	$70.1	$76.5	$79.8	+$3.3
Social security, medicare, and other social insurance trust funds	30.3	34.4	38.6	+4.2
Other major social programs:				
Education	4.0	4.5	4.7	+.2
Health (excluding medicare)	3.4	4.3	4.8	+.5
Labor and manpower	1.1	1.3	1.5	+.2
Economic opportunity programs	1.5	1.9	2.0	+.1
Welfare	3.9	4.6	4.9	+.3
Urban community development, and low- and moderate-income housing	1.1	1.9	2.3	+.4
Regional development	.2	.4	.5	+.1
Interest	12.5	13.5	14.4	+.9
Pay increases for military and civilian employees			1.6	+1.6
All other	34.2	36.9	36.0	−.8
Undistributed intragovernmental payments (−)	−4.0	−4.6	−5.0	−.5
Total budget outlays	158.4	175.6	186.1	+10.4

The increases in controllable outlays were offset by reductions elsewhere. A substantial decrease is estimated in the outlays of the Federal National Mortgage Association trust fund for its secondary market operations through proposals designed to increase the supply of private mortgage money. In addition, two kinds of measures are recommended in the budget to reduce Federal outlays, as shown in table 5 which appears later in my statement. These are spelled out in detail in the budget message, but I will summarize them for you here.

First, we are proposing reductions in program levels which do not substantially alter the character of the programs involved, but which primarily reflect a ranking of priorities in a period of budget stringency. These reductions represent cuts in the levels of obligations, commitments, or contracts totaling $1.6 billion in 1969 below the 1968 appropriated levels. A major area of reduction is in construction programs—both direct Federal construction and construction grant programs—which we believe can appropriately be deferred in an inflationary period when construction costs are rising sharply—5 percent in 1966 and 6 percent in 1967. The budget also proposes to reduce the space program, curtail selected agriculture and small business loan programs, and shut down two of the nine operating plutonium production reactors of the Atomic Energy Commission.

Second, reforms and modifications are recommended in a number of programs to increase their effectiveness and reduce their cost to the taxpayer over time. Some of these programs have become outmoded in their present form and need to be brought into line with current conditions. In other instances, the proposals call for the rising costs of certain essential programs to be borne increasingly by the direct beneficiaries rather than the taxpayer—the transportation user charge proposals are an example.

Adoption of the reform proposals would reduce the budgetary burden in 1969 for the programs involved by $1.2 billion below the current-year levels. In 1970, the corresponding reduction is estimated at $1.4 billion.

Most of the proposed reforms will require congressional approval. Unquestionably, the changes will be painful and difficult to achieve. But if we mean to keep our programs in touch with current needs and demands, and have the budget reflect present piorities more appropriately, change is essential. I strongly urge you to support these reform proposals, which are an integral part of the budget program for 1969.

TABLE 5.—BUDGET PROGRAM REDUCTIONS AND REFORMS

[Fiscal years. In millions]

Program	Cuts below 1968 program level, as funded	
	1969	1970
Budget reductions:		
NASA (manned space flight and other)	−$447	
Education programs (mainly books and equipment and college facility grants)	−361	
Agriculture (loan programs and other)	−197	
Ship construction subsidies and research	−163	
General Services Administration (construction)	−143	
Small Business Administration (loan programs)	−90	
Interior (construction)	−61	
Health facilities (research and medical library)	−39	
Atomic energy programs (special nuclear materials and other)	−36	
Other reductions	−95	
Total, budget reductions	−1,632	
Program reforms:		
Private housing—place greater reliance on the private market	−669	−$669
Transportation—charge users for benefits received	−286	−319
Education—tie impacted aid more closely to Federal burden		−100
Veterans—eliminate overlapping and outmoded benefits	−107	−107
Agricultural conservation program—limit to long-term benefits	−120	−120
SBA disaster loans—employ more equitable and rigorous criteria	−50	−50
Water resources projects—raise the interest rate used for evaluating projects	(1)	(1)
Other reforms	−3	−3
Total, program reforms	−1,235	−1,368
Grand total, budget program reductions and reforms, 1969	−2,867	

[1] No immediate savings are realized, but long-term effect could be substantial.

Conclusion

To conclude my statement, I would like to underscore several points.

The 1969 budget represents an effort to meet important fiscal and program objectives responsibly. The proposed temporary tax increase—which averages about 1 additional penny on each dollar of our income—is the most equitable way to finance the added cost of Vietnam. With its enactment, we can sharply reduce the Government's deficit, start back on the road to price stability, and restrain increases in interest rates. Without its enactment, we will be running a deficit in 1969 of around $20 billion for the second straight year. Having participated in the careful and painstaking review of the individual agency proposals, I believe it is unrealistic to expect reductions in outlays sufficiently below those already in the budget to reduce the deficit to manageable proportions without the tax increase.

The budget calls for tight controls on all programs—with selective expansions in some areas almost entirely offset by reductions in others. This combination of expenditure control and tax increase will enable us to maintain the unbroken economic programs that have characterized the last 7 years.

Chairman Proxmire. In view of your very provocative statement—you say: "Nobody can disagree that we have a strict set of priorities by which the budget can be determined"——

Mr. ZWICK. Yes.

Chairman PROXMIRE. I would like to know what they are. You say: "The 1969 budget is based on a strict ordering of priorities, with several overall fiscal policy objectives in mind."

And then you go on to say:

"Delays and deferments have been proposed wherever possible without sacrificing vital national objectives."

And little further on, you say:

"* * * reflect a ranking of priorities in a period of budget stringency."

And so on. Well, this is something on which I think the Congress can use some enlightenment. Because, as you know, last year many people in Congress were anxious to reduce the budget. And there was a reduction of sorts in the budget. There were many proposals in the Senate—and I am sure in the House, too—proposals which generally had no relation to priorities, just a flat across-the-board reduction of 2 percent, 5 percent, 10 percent in controllable spending, and 2 percent overall, with no relationship to priorities, at least that were apparent. And one reason for this is because the Congress just did not have a basis for logically and swiftly determining priorities.

Now, if you have gone through the agony of setting up priorities, I presume that within the $186 billion that remains, you still have some priority notion of what would be the least necessary $10 billion or $5 billion that could be eliminated from spending in the 1969 budget. And if you could, you might indicate whether or not you have such a priority system.

Mr. ZWICK. Let me take a crack at that in several different ways.

First, I think there could be no doubt, just looking at the aggregate statistics, that we have held down expenditures in fiscal 1969. This is shown by the increase of $10.4 billion contrasted with the increase of $17.2 billion in 1968, and the $24 billion increase in 1967. Clearly, if you just look at the aggregate statistics, there has been a holddown.

The next question is: Has there been a sense of priority in this holddown, or it is just a sort of across-the-board holddown of expenditures?

Let me react to that in several different ways.

First, I invite your attention to the President's budget message, page 7, the first page of his message, where he outlines the three major priorities. And I will just read them—it is only a paragraph—and then I will try to illustrate with examples.

First:

> I have carefully examined the broad range of defense and civilian needs, and I am proposing the selective expansion of existing programs or the inauguration of new programs only as necessary to meet those urgent requirements whose fulfillment we cannot delay.

This is the first criterion—a feeling that we should not, we cannot, delay on certain programs.

Second:

> I am proposing delays and deferments in existing programs, wherever this can be done without sacrificing vital national objectives.

This, I think, as an example of deferral or stretchout, is most clearly shown in the construction area. If you look at the proposed budget reductions on pages 20 to 21 of the budget you will notice it is heavily weighted toward construction holddown. If you will look at the education message that the President sent up to Congress, yesterday, the emphasis was on keeping other programs going or expanding while holding back on the bricks and mortar part of the education area. So, there has been a conscious effort to stretch out and defer construction activities in contrast to other programs.

Third, he says:

> I am proposing basic changes, reforms, or reductions designed to lower the budgetary cost of a number of Federal programs which, in their present form, no longer effectively meet the needs of today.

Now, again, that means a reduction in the cost of some programs, which is the third element that we ought to consider here, including increased user charges. One of our concerns has been the burden on the general taxpayers of certain Federal programs. We think it is quite appropriate, where some programs convey special benefits to particular individuals, that they pay the cost of these benefits, and, therefore, reduce the burden on the general taxpayer, even though this does not reduce Federal spending.

On the air traffic control system, for example, you are reducing the burden on the general taxpayers by making it available to those who are willing to pay the cost for these services.

So, I think these are three major elements of the priority system.

Chairman PROXMIRE. I think you are very sincere, and the President is, too, in the generalizations which are specified here. What I am getting at is not the generalized notion that you are determined to hold down spending. In your own view and the President's views you have done so, and it is a lesser increase in spending in the last 2 years. What I am getting at is: What are the specific areas where you have your lowest priorities that are now funded? In other words, can you specify areas which barely made it into the budget? Or can you not? I would understand that if your answer is you cannot do so. You see, it is awfully hard for Congress to do any more than make an across-the-board cut without great injustice and great inefficiency if you do not give us some priority basis. Now, one of the things that might help us is if we can get a clearer and more comprehensive picture of what PPBS has told us. We have had hearings on this. And we do know that the Defense Department has established a system of priorities within their defined objectives, and have determined their spending on this basis. We know that a few other agencies have gone a little distance along the line. We know that some agencies have done nothing at all or have done very little in terms of applying this, at least to the extent that the Defense Department has. But if you could give us at least the results that you have from your PPBS programs in the agencies, if you could tell us what are the programs that have the lowest return, that have the poorest benefit-cost ratios, we would have at least some basis for developing a system of priorities so that we would know specifically where to cut.

Mr. ZWICK. Let me react to several points you have made, Mr. Chairman.

First, the question of sort of cutting further. The President's budget reflects a fiscal plan which includes both revenue and expenditures. He has clearly determined that rather than cut back programs even further, it is appropriate to ask for a temporary tax surcharge.

Chairman PROXMIRE. We all appreciate that.

Mr. ZWICK. So that clearly our overall plan is one with a scope and composition which is consistent with the requirements and capabilities of the country. That is a basic point.

Now, as to the question of programs with the lowest return, I am in something of a dilemma here. I agree that if you had to cut back we would not recommend cutting back across the board in an indiscriminate fashion.

Chairman PROXMIRE. Good.

Mr. ZWICK. The second point, though, is that we do not have any contingency plans for cutting back because we think we have presented a responsible, correct budget level and composition, and so we are up here fighting for that budget level and composition. And we are not at this point in time, certainly, interested in talking about how to cut back from this budget level.

Chairman PROXMIRE. Is the administration going to give us any information, any knowledge, any intelligence so that we can avoid, if we are going to cut back—and there is a lot of determination in the Congress to do so, and it may be hopeless, and we may not do it—but is the Budget Bureau or the President going to give us information on the basis of your very comprehensive study—the only study that is really made, in my view, on a comprehensive basis of Government spending? You have a very large staff compared to what our committees have here. If you do not give us this information, it seems to me we are going to be in a position where any cut is likely to be less efficient and less intelligent. How do we resolve this? I understand your viewpoint. It is hard for the Budget Director to come up and say to the Congress that some programs are more vital than others. But you have told us very clearly that you have controllable and uncontrollable, or partially controllable, expenditures. Can you go a little bit further than that and indicate to us where the expenditures have the best return, and where they have the least, where they have the best benefit-cost ratio and where they have the least?

Mr. ZWICK. Since you have phrased your question in terms of a benefit-cost ratio calculation per se, I think that it is very difficult to give you specific examples. Clearly, in some broad theoretical sense, taking into consideration the social welfare function of this country, you should be able to come up with a benefit-to-cost ratio. And the one with the highest number is the item that you should pick first, and the one with the lowest number is the program you should pick last. We do not have that broad social welfare function. What we have are numbers that quantify some parts of the total and not other parts of the total. And we also think it is quite appropriate that these benefit-cost numbers are reviewed in terms of broader considerations.

Chairman PROXMIRE. I think that is very necessary.

Mr. ZWICK. For example, this year, in the Corps of Engineers, we withheld, even though they had high benefit-cost ratios, programs for small boat harbor improvements for recreational purposes. Even though the benefit-to-cost ratio was very high, under a tight budget we thought we could defer them. So we do not have today—I think it is important that we all recognize that—a nice, neat set of numbers which ranks programs from one to a thousand, from which you can choose. We can rank programs with numbers, but then you have to bring judgments to bear for other considerations which are not in the numbers. In the normal appropriations processes, the Congress, through the subcommittees, does look at those numbers in detail, and they do look at other information, and they try to approximate through the appropriations process the overall welfare maximization that we are all aiming at. But, I think it is a mistake to think that there is anywhere, either up here or down the street, a set of numbers which rank programs from one on.

(The following material was later submitted for insertion in the record:)

The following material is submitted as an illustration of why the applicability of most cost-benefit ratios that can now be calculated is limited, making comparisons among diverse program areas dangerous and why the ratios must be applied with a great deal of specific knowledge about both the calculation and the program.

The Department of Health, Education and Welfare has conducted and published studies comparing costs and benefits for disease and injury prevention programs, and evaluating the limitations and applicability of the analyses.[1] Benefit-cost ratios among the programs tested ranged from 1000 to 1 for encouraging seat belt use down to 0.5 to 1 for screening for one category of cancer. There were 14 different benefit-cost ratios in the studies. Ratios such as these can be useful in contributing to decisions, but they are far from providing a conclusive basis for choice, because—

1. Different groups benefit from each program. The basis for choosing which groups are to benefit, involves value judgments that cannot generally be reflected in quantitative measures;
2. The computed benefit (the present value of private income lost plus medical costs averted) is only a partial proxy for the actual benefit which is what society is willing to pay to prevent death, illness or injury. There are no market prices (the usual basis for costs and benefits) for this, nor is it known at present how to estimate it adequately; and
3. The degree of uncertainty and the reliability of data are different for each program. Thus we may choose to emphasize a program with a more certain but lower benefit-cost ratio in place of programs with a higher expected benefit-cost ratio that is very uncertain.

These and many others are well known problems of benefit-cost analysis and do not invalidate proper use of the technique. A partial estimate of benefits, for example, may confirm the urgency of expanding a highly productive program or it may show which of two similar programs is preferred even if the absolute levels cannot be estimated.

Thus these benefit-cost ratios give us partial insights into the programs rather than a strict ordering of programs from best to worst. Similar comments would apply to cost-benefit ratios in other program areas, such as manpower and water resources. Although the technique is subject to misuse if applied uncritically and too broadly, the validity of the analyses is increasing in terms of both their logical structure and the soundness of the data on which they are based. It is expected, therefore, that they will play a rapidly increasing role in comparisons among similar types of programs.

Chairman PROXMIRE. My time is up. When I come back I want to see how we can go along with the line—and not getting a neat set of numbers so that you can just automatically clip off the bottom $10 million—but so that we have some basis of comparing and ranking the objectives, and so that within our value judgments we can determine where it is most efficient to make reductions. But I will come back.

Congressman Bolling?

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[1] See, for example, U.S. Department of Health, Education, and Welfare, Office of the Assistant Secretary for Program Coordination, "Selected Disease Control Programs," September 1966.

Representative BOLLING. I would like to pursue the line the chairman is taking. I am not sure I am entirely sympathetic to his particular approach to it. I want to be sure that I understand what the Budget document is. It seems to me that the Budget document is an implementation of the series of policy decisions, political decisions. People like to say that there is a difference between policy and politics, but as far as I can see there is not. And insofar as the expenditure of money is involved in the implementation of policy, there are choices. And those choices do not lend themselves to objective analysis. They are inevitably subjective opinions.

I mentioned, yesterday, that I might find it convenient in the interest of cutting the budget to drastically curtail construction expenditures, even beyond the construction expenditure curtailments already, in the interest of preserving a larger proportion of the funds for education, and so on. Isn't each one of these decisions basically the President's decision, with a lot of help from a lot of people, on a policy program?

Mr. ZWICK. Yes, sir. As I understand what you have said, I agree 100 percent.

Representative BOLLING. So that really what we are talking about does not lend itself to an objective set of figures, sets of numbers. Somebody may say that the most important thing that is available to me at the moment is the fact that there is funded, or proposed to be funded, the site acquisition and planning for a post office in my district. Well, I might happen to think that the summer program for the OEO would be more important to the district. But that would be a subjective policy decision.

Mr. ZWICK. May I talk about the other side of this objective-subjective thing for a moment?

Representative BOLLING. I wish you would.

Mr. ZWICK. I think in terms of broad program emphasis I agree with you. We have no way, for example, at this point to quantify how much money we should spend on space research on the one hand, for example, and, on the other hand, foreign aid or the many problems of our cities. So the broad tradeoff between major program emphasis is still a subjective, political policy decision. Within those areas, though, I think you can make great progress in terms of quantifying alternatives, how do you best help create jobs for the hard-core unemployed, for example, and how does on-the-job training compare with institutional training, with vocational education, et cetera.

And I think it is this latter area that Chairman Proxmire was pushing—it is in this area that we can indeed make great progress in quantifying how effective programs A, B, and C are, and compare alternative ways of meeting objectives such as providing jobs for hard-core unemployed. But to balance off providing additional jobs for the hard-core unemployed, versus inflation, space, and so forth—that is different and cannot now be done by means of an objective policy decision based on quantifications.

Representative BOLLING. I am glad you make that comparison, because that is the way I think it should be. I agree with it.

Chairman PROXMIRE. So do I.

Representative BOLLING. I would like to pursue one thing. Are you in a position to tell me why, for example, the amount of money allocated in the Budget document to the supersonic transport is proposed for 60 percent of the increase? Is there a policy reason for that?

Mr. ZWICK. Yes. In fact, it is an overall construction policy which yielded that result. Again, we took a very hard line on construction policy this year. As part of this policy, essentially, we said we will not stop any project. We first considered the possibility of stopping projects. But when you start thinking of the costs of stopping, the payment of high cancellation costs, and the local disruptions and hardships that would result—if you think of the case of flood-control projects, of stopping projects in midstream, where by the time you come back to them erosion will have done away with what you have already done—we decided that stopping projects was a disorderly, inefficient way of operating Government programs. So we adopted a basic construction approach which said, "we will keep all programs going at minimum levels."

Now, if you look across the board of construction—and I will come back to the supersonic transport—if you look at the construction programs, for example, you will find a bigger cutback in GSA and education construction efforts than you do in the Corps of Engineers and the Bureau of Reclamation. Well, this was a result of that policy decision. It just happens that the Corps projects and the reclamation projects have long leadtimes, and many of them are in midstream. Therefore, even though you hold back on new starts and hold everything to minimum levels but do not stop anything, you end up by cutting back more severely on buildings, because they are built in about 2 years, whereas dams take longer periods of time.

Similarly, coming to the SST, we just moved into phase 3, prototype development, the peak program element of the SST. Following that same ground rule as to whether we should cancel or keep the program going, the decision to keep the program going meant automatically that there would be a big expenditure increase at the time. We just happened to catch the SST at a point where a commitment was made in April of 1967 to go to the prototype phase of the program. And when the decision was made in April of 1967 to go into the prototype, the decision meant that we would have to spend large amounts of money in 1968, 1969, and 1970. Now, you either have to pull back from that or accept a very large proportion——

Representative BOLLING. In other words, it would very largely reverse a policy decision made here?

Mr. ZWICK. That is right, a decision made in April of 1967. I do not have the figures here with me, but I remember that the votes on the floor of the Senate last year were overwhelming in favor of supporting that policy decision.

Representative BOLLING. One other area that I am curious about: the question of user charges. If you do not have it available, could you make it available without too much effort? Because I do not believe in asking these questions that involve 10 man-hours of effort to fill the record up—without too much effort, could I get for the record, the record of the last x years, you choose the time, of the Congress reaction to requests for user charges and cuts in programs?

Mr. ZWICK. Yes, sir; we can make that available. With respect to our record on user charges, we have an official policy that is covered in Budget Bureau Circular A–25. We have administratively increased a large number of user charges, and we do have that information available. I do not have the numbers right here, but we can submit them for the record. We have a good record in terms of user charges——

Representative BOLLING. That is exactly what I would like to find out. Because my impression is that administration, over time, has made a number of suggestions for cuts in programs. On occasion they have involved replacing programs that were less efficient with programs that the administration judged to be more efficient. And my impression has been that on occasion, at least, the Congress has kept the old program without accepting a cut and then added the new program. And what I would like to get is some sort of perspective on the relative records.

Mr. ZWICK. The user charge one will be easy, Mr. Bolling. I am afraid the other one will not be as simple—we will do what we can.

Representative BOLLING. I do not want you to put in a lot of effort on this, because I disapprove of the idea.

Mr. ZWICK. Impacted school aid is another example.

Representative BOLLING. That is the kind of thing I am particularly interested in.

Mr. ZWICK. I certainly concur with the thrust of your statment. The cutbacks we are proposing on pages 20, 21, and 22 of the Budget document are very difficult to achieve. They were put in there because we believe these were appropriate and consistent with our priorities. We are urging Congress to act on them. It is always difficult to cut back old programs. But, if we are going to have expenditure restraint, (*a*) on the one hand, and (*b*) new programs, new priority emphasis, the issue that the chairman opened the meeting with, I think we have to face up to these.

Representative BOLLING. When you get into the area of impacted school districts, people immediately forget the history. That particular piece of legislation was a retreat in the 81st Congress; because the Congress was unable to pass a general aid to education bill, it accepted an imperfect but politically more viable bill. And now we have a general aid to education bill, and we still have the other bill. And it seems to me it demonstrates the sort of classic but continuing inconsistency on the part of even many of us who are constantly trying for economy in Government.

Mr. ZWICK. Well, as you know, sir, we are trying again this year, and we are trying a new approach at it. We are giving a 2-year leadtime before the proposed cutback takes effect. And we are putting into it also a grandfather clause which says that after the impacted area aid is reduced, if any school district is worse off, we will make it up. So, we are trying a new approach at this problem. But, it is always very difficult to get rid of old programs.

Representative BOLLING. Thank you.

(The Budget Bureau later supplied the following:)

USER CHARGES

From 1963 to 1967, recommended legislation not enacted by Congress

	Submitted
1. Establish a fuel tax on fuel used on the inland waterways	1963–67
2. Establish a tax on air freight	1963–67
3. Increase the fuel tax on general aviation and extend it to jet fuel	1963–67
4. Increase and extend certain taxes paid by users of the Interstate Highway System	1965–67
5. Establish fees for meat and poultry inspection	1964–66
6. Establish fees for commodity grading and warehouse inspection and licensing	1964–67
7. Establish fees for certain services under the navigation laws	1964–67
8. Establish fixed fees for overtime border inspection	1964–67
9. Establish fees for technical services in the design and installation of soil and water conservation practices	1965
10. Recover the costs of administering safety and workmen's compensation programs for longshoremen and harbor workers	1966–67
11. Establish fees for various merchant and towing vessel inspections	1966–67
12. Establish fees for various services performed by Agricultural Research Service	1965–67
13. Establish fees for licensing under the Federal Firearms Act	1966–67
14. Increase charges for various reimbursable services	1965–67
15. Increase fees for processing various applications under the immigration aid	1966–67
16. Establish new and increased fees for overtime plant supervision and sale of certain Treasury Department forms	1966–67
17. Establish fees for inspection of food and drug imports	1967

FROM 1962 TO 1967, LEGISLATIVE ENACTMENTS

FISCAL YEAR 1962

1. Licensing of individuals who engage in the business of forwarding freight.
2. Increasing the fees for services rendered to private litigants by U.S. Marshals.
3. Increasing the maximum fee authorized for a license under the Perishable Agricultural Commodities Act of 1930.

FISCAL YEAR 1964

4. Establishment of fees for the use of recreational areas and facilities.
5. Removal of the statutory limitation on the price to be charged for charts and other publications issued by the Naval Oceanographic Office and the Coast and Geodetic Survey.

FISCAL YEAR 1965

6. Making permanent the 5% ticket tax on air passenger transportation, which was to have expired.
7. Increasing substantially the fees charged by the Patent Office.
8. Increasing the fees charged by the Securities and Exchange Commission for registration of securities.

FISCAL YEAR 1966

9. Establishment of fees for licenses issued by the Department of Agriculture in connection with regulation of the transportation, sale, and handling of certain domestic animals used for research.

Administrative Actions Since Fiscal Year 1962

Fiscal year 1962:	
New fees established	39
Fees increased	78
Fees either reduced or a combination of an increase and a decrease	24
Fiscal year 1963:	
New fees established	44
Fees increased	114
Fees either reduced or a combination of an increase and a decrease	27
Fiscal year 1964:	
New fees established	60
Fees increased	130
Fees decreased	26
Fiscal year 1965:	
New fees established	56
Fees increased	171
Fees decreased	28
Fiscal year 1966:	
New fees established	102
Fees increased	105
Fees decreased	48

The overall growth of the user charges program is illustrated by the following figures, showing total annual deposits of user charges (in millions of dollars) to miscellaneous receipt accounts:[1]

1958	$564.4
1959	614.1
1960	661.5
1961	634.5
1962	652.9
1963	1,076.5
1964	728.9
1965	805.0
1966	1,101.2
1967	[2] 1,181.4

Examples of administration proposed program cuts and user charges legislation not acted upon favorably by Congress:

Proposal	*Millions*
Fiscal year 1965:	
User charges	$104
Reduce agricultural conservation program	100
Reduce REA rural telephone loan program	7
Reduce Farmers Home Administration loan program	35
Rescind prior appropriation for VA housing loans	150
Fiscal year 1966:	
User charges	500
Close some agricultural research stations	2
Reduce agricultural conservation program	100
Reduce special milk program	3
Reduce Farmers Home Administration and REA loan programs	50
Reduce number of new nuclear powered submarines per year from 6 to 4	134
Close 5 VA hospitals and 2 domiciliaries	14
Fiscal year 1967:	
User charges	313
Reduce REA loan program	157
Reduce special milk program	83
Reduce school lunch program	19
Reduce agricultural research program in 70 locations and close labortories in 24 locations	15
Reduce agricultural conservation program	120
Rescind prior appropriation for grants-in-aid for airports	21
Reduce endownment of colleges of agriculture and mechanic arts	12
Reduce grants for acquisition of equipment-defense education activities	25

[1] Data from Fiscal Year 1966 Annual Progress Report on User Charges, p. 4.
[2] Estimate.

Proposal	*Millions*
Fiscal year 1968:	
User charges	$273
Reduce agricultural conservation program	120
Refine veterans pensions and benefits	94

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

Welcome, Director Zwick.

I want to pursue the same inquiry into judgment priorities and cost-benefit that my colleagues have.

Let us take education. On pages 155 and 156 of the Economic Report there is a very moving and even terrifying account of the need for more aid in central city schools to help disadvantaged children somehow get a chance at better education. I note that last year, under the Elementary and Secondary Education Act, the budget request was $1,690 million, and the amount appropriated was $1,670 million, almost the same, whereas this year the request is only $1,560 million, more than a hundred million less than last year. In this connection, we read in the press about the disappointment of Secretary Gardner of HEW with what is being done with the educational program. I have not been able to confirm that personally. But, a great many news stories have been written about it.

Take the example that Congressman Bolling gave of the supersonic transport, which is the subject of a 60-percent increase in expenditures this year. Will you give me the philosophical judgment on the part of the administration in cutting back on elementary and secondary education—and I note in this connection that Head Start and Follow Through programs are going to leave outside their scope, because of lack of funds, countless children who could have been benefited by them—in cutting back on educational funding and raising the ante so pronouncedly on the supersonic transport, for example.

Mr. ZWICK. Let me simply refer back on the SST, to my earlier answer to a question as to why, if you are going to continue the SST program, you have to have large expenditures in 1969.

As far as aid to the poor is concerned, and education specifically, first, I would draw your attention to the table on page 36 of the Budget, which does give a breakout of total Federal aid to the poor, by fiscal years. You will note in that table that it is up $3.1 billion in fiscal 1969 over fiscal 1968.

Representative REUSS. Yes. I was talking about the Elementary and Secondary Education Act.

Mr. ZWICK. First, I want to sort of draw the big map in which the aid to the poor is up by $3.1 billion. I have a breakout of that $3.1 billion which I can submit for the record. The education component in that $3.1-billion increase has gone up from $2.3 to $2.5 billion.

Representative REUSS. But, doesn't that include things like the Army War College?

Mr. ZWICK. It includes title I, OEO, Head Start, Follow Through, Indian education under Interior, and undergraduate student aid for the poor—these items make up almost 90 percent of the total.

Representative REUSS. All these things are interesting. But the fact is that the budget request for the Elementary and Secondary Education Act has been reduced from $1.7 to $1.5 billion.

Mr. ZWICK. All I am saying is that the overall total for aid to the poor and education for the poor and manpower training are up significantly.

Representative REUSS. I will stipulate all that. But would you address yourself to my question. What is the philosophical underpinning for the decision that we are going to cut back on the Elementary and Secondary Education Act appropriation request, and greatly increase the request for the supersonic transport? If you say that the supersonic transport was in the pipeline, and expectations were that it would be increased this year, I am sure that if we had spoken to Secretary Gardner, he would say that he expected elementary and secondary education to be increased this year. So, I do not think that people's expectations are determinative.

Mr. ZWICK. Let me repeat, on the SST it is more than expectation. You really have to bring production lines to a halt, and disrupt the program. And we set a basic policy with philosophical underpinnings, if that is the proper phrase, that we would not stop the projects in being but would keep them at a minimum level.

Representative REUSS. Did the relative political importance of Boeing Aircraft and its subcontractors, on the one hand, versus the political importance of the parents of the disadvantaged children who were the beneficiaries of the Elementary and Secondary Educational Act, on the other hand, have anything to do, in your judgment, with the decision?

Mr. ZWICK. No, sir. And I doubt if any such things did have an influence, that we would have increased by $3.1 billion the amount of aid to the poor. I think our overall record on that is quite clear in terms of the aggregate statistics.

I am not quite sure, on elementary and secondary education, whether or not we are holding it basically at the level for 1968.

Representative REUSS. Are my figures incorrect?

Mr. ZWICK. I am not sure; I could not correct the figures.

Representative REUSS. My figures were the 1968 budget request, $1,690 million, budget appropriation, $1,670 million, budget request for fiscal 1969, $1,560 million.

Mr. ZWICK. All right. I know now what the problem is. What we did was hold the program level constant. If you will look at actual expenditures out of those appropriation requests and obligations, if you look at expenditures for the 3 years for title I, you get the following picture:

In 1967, $1,057 million; 1968, $1,070 million; and 1969, $1,073 million—in other words, a basically level expenditure program. We held expenditures constant, and we held the program at a constant level. That was the program decision. The expenditures are constant, whereas, indeed, your numbers are also correct. We asked for more appropriations last year—we were more ambitious in the 1968 budget in terms of an expansion than we were in the 1969 budget.

Mr. COHN. I might add a point to that Mr. Reuss. If you look at the total appropriation in detail on page 395 of the budget appendix, you will find that looking behind the figures for the total elementary and secondary educational program, the total figures which you gave——

Chairman PROXMIRE. Could I interupt just for a minute?

This is the Assistant Budget Director, Mr. Samuel Cohn.

Mr. COHN. Thank you, sir.

The amount for educationally deprived children is held level, or actually goes up $9 million, from $1,191 million in 1968 to $1,200 million in 1969. Other parts of the elementary and secondary educational program go down somewhat, the biggest decrease being in libraries, another big one being in equipment and minor remodeling. So, again we can see the type of allocation within the total that we tried to make.

Representative REUSS. I will still rest on my point, which is this—I am still bewildered at the 60-percent increase in the SST at a time when, under your explanation, we merely held level the funds allocated to deprived children.

Let me turn now to the so-called gold budget, our international balance of payments.

Is it not a fact, Mr. Zwick, that the so-called conventional, mainly private sector element in our balance of payments, actually is in balance and even yields a small surplus? Specifically, and rounding out the figures a bit, we export $31 billion worth; we import $2.7 billion; we make about $1.1 billion on travel and spend about $2.6 billion; our investment income is $4.3 billion, and our investment outgo is about $3.8 billion—all of which yields a little surplus.

And then you take the military account. That comes to $1,500 million for Vietnam, $1,500 million for Europe, and $1 billion plus for the rest of Asia, Latin America, et cetera, totaling $4 billion plus, which just about equals our balance-of-payments deficit. My question is: Is it not a fact that our balance-of-payments deficit is caused almost entirely by our military posture overseas, and is it not the private sector, the conventional items, which more than pay their own way, and they are asked to bear the brunt of such things as controls over investment overseas, controls over tourism overseas, and pretty soon, I am told, controls over imports to this country? Is not that a fair statement?

Mr. ZWICK. I have to approach this somewhat tentatively, because I do not have those numbers on the top of my mind. But accepting them, I am a little surprised. I thought in recent years one of our main problems has been that our trade surplus has been declining. And the trade surplus was the balance of the wheel in this process. Leaving the Government aside for a moment, within the private economy it was a weakness of the trade surplus which, I might note, partly results from Public Law 480 and other sales which are Government expenditures.

Representative REUSS. It is down from a glorious $5 billion a few years ago to a still pretty creditable $4 billion last year, give or take a few millions.

Mr. ZWICK. I am a little surprised by your statement that the private sector is roughly in balance. I thought it was a little in deficit. But leaving that aside, you are certainly correct that if you turn to the Government sector and leave Defense aside, you will find the rest of the Government has been approaching surplus. In fact, in fiscal year 1969 we were projecting on a good budget basis a surplus position for the Government—that is, leaving Defense aside—the rest of the Government would have been nearly in a surplus position. And, given the recent actions that the President has directed in terms of cutting back overseas staffs, reducing travel, and other actions we are in the process of taking, I think we would clearly be in surplus in the rest of the Government. So that the big deficit is from the overseas expenditure associated with Vietnam and our other national security commitments around the world. And that is the issue. If we are going to fulfill our responsibilities, our international responsibilities, we are going to have these sorts of deficits. And we are going to have to find ways as a country to meet these deficits.

Representative REUSS. I think yours is a very fair statement. And this needs to be said, because so many spurious causes are being found for our very discombobulated balance-of-payments deficits that I think it is important to recognize where the deficit really comes from, which is our military effort overseas.

Let me ask one more question on another subject. On page 5 of your statement you point out—and it certainly is good news to me—that the sales of participation certificates are no longer treated as an offset to expenditures, but are handled as a means of financing the deficit, similar to Treasury securities.

I applaud the rational piece of accounting in our budgetary procedures. And, now that we have removed the original reason for participation certificates, which was to kid everybody into thinking that our deficit was less than it really was—a form of buffoonery, I might add, which was indulged in by Republicans and Democrats alike—why do we need to mulct the taxpayers so much by fooling around with these participation certificates any more and paying a premium rate of interest? Why do we not simply have the Treasury borrow where it can do so most cheaply, in accordance with the Reuss bill which has been before the Congress?

Mr. ZWICK. Mr. Reuss, there are two answers to that. A short one is, I could not disagree with you more. I could also give a long one which would take us down the whole set of arguments about the Federal credit program report from the committee chaired by Secretary Dillon—we can get into that whole set of arguments. I will make an intermediate reply and then see whether we want to go into the extended reply.

Representative REUSS. I would welcome your putting in an extended reply, too.

Mr. ZWICK. I would be happy to submit one for the record. But an intermediate reply is that we do think it is consistent with the notion that the Federal Government is acting as a financial intermediary in the loan credit area as such. In fact even though we are now treating this as a means of financing, if you read the President's Commission on Budget concepts, you will find that Director Schultze, Secretary Fowler, and Professor Turner from the University of Indiana, dissented from that specific recommendation. We do think that the PC's really should be offset against the net lending figure. I do not think there was any intention in Congress, in enacting legislation to provide credit to build up a huge portfolio of notes, which is what we have been doing. And the notion of selling these assets is something which made sense then, and we still think it makes sense. The Budget concept now is a little inconsistent, in that if we sell these notes, individually, today we do get a deduction from expenditures. It is only the receipts from the sale of PC's that we cannot deduct. So that if we go out and sell an individual note, it is a negative expenditure, and we can still do that.

The second point I would like to draw to your attention, and only briefly—it will be highlighted when the housing message comes up—is that the PC approach, I think, was a very interesting forerunner, innovator, in terms of methods of increasing flows of money into the housing market. There is, I think, general recognition that we have to have some institutional modifications to provide long-term financing to the housing industry. And, you will find in the housing message, when it comes up, an elaboration which takes off from the PC approach of pooling mortgages and raising money against those pools of mortgages in the private sector. I think it is a very useful, valuable innovation.

So, that is my intermediate answer. I could not disagree more. We can provide the longer arguments.

Representative REUSS. Your disagreement is noted. Thank you.

(The following was later supplied for the record by the Budget Bureau:)

One of the major, if not the predominant, reasons for introducing and expanding the sale of participation certificates was the need to find a more effective way of increasing private participation in financing the lending programs of the Federal Government.

President Kennedy's Committee on Federal Credit Programs, chaired by Secretary Dillon, in its February 1963 report placed maximum emphasis on removing gaps in the private credit system by (1) broadened authority for private lending institutions, (2) guarantees or insurance of private loans, (3) government-sponsorship and aid to creation of new types of private credit institutions, and (4) provisions of a secondary market to encourage private participation. It recommended direct Federal loans only when these alternatives could not meet legitimate needs for credit assistance. The Committee specifically urged sales of existing loans and other assets as "an appropriate source of funds for new loans," particularly when such sales would encourage the eventual substitution of private for Government credit in the primary lending operations. Issuance of "collateral trust certificates backed by a pool of government loans" was mentioned as a possibility.

About the same time—February 27, 1963, to be exact—when the Secretary of the Treasury was before the House Ways and Means Committee, the minority members urged him to sell more government loans before coming to the Congress for an additional increase in the Federal debt limit.

It was evident in 1963—and has been verified since then—that sales of individual loans in volume are difficult to accomplish without excessive costs or discounts. By pooling many thousands of loans and selling certificates in such pools, however, it has been possible to make a much larger volume of sales on a wholesale basis at a fraction of the cost involved.

The original participation sales authority provide in the 1964 legislation and especially the broader authority in the 1966 Act made it possible for a substantial minority of all direct loans held by Federal credit agencies to be pooled and for Federally-guaranteed certificates in such pools to be readily sold to investors. Many lenders bought them who would not otherwise have been willing to purchase or make such loans to the individual borrowers. The Federal Government thus, as a financial intermediary, has broadened the sources of funds available, for example, for the housing mortgage market by selling guaranteed certificates of participation. This role is analogous to the actions taken in earlier decades of insuring individual housing loans. There is reason to expect that this latest innovation can be carried further through wholly private ventures, if proposals which will be advanced in the Housing Message are enacted.

Another useful by-product of the participation sales device has been the disclosure of the full costs of certain credit programs. In many cases, Federal credit agencies under existing laws make direct loans at rates of interest which do not cover the full cost of the direct Treasury borrowing necessary to finance them. Under the Participation Sales Act of 1966, authority was provided for payment of "participation sales insufficiencies" adequate to cover the differences between the interest payable on the participation certificates and the interest received on the loans in the underlying pool. By financing through the use of certificates of participation, the lending agencies, in effect, are charged the full cost of borrowing in the private market. The subsidy intended by law is no longer hidden in the interest on the public debt.

The cost of such market borrowing by the use of participation certificates is somewhat higher than for direct Treasury borrowing. However, it more nearly reflects the cost which private lenders have to pay for their money. The relatively small differential involved is justified by the benefits gained in encouraging greater private participation and in broadening the sources of funds for the programs involved.

These are some of the considerations which caused Secretary Fowler and Mr. Schultze to indicate in a footnote to the Report of the Commission on Budget Concepts that they "regard the proceeds of sales of participation certificates and sales of credit agency obligations—to the extent that these proceeds and other principal repayments do not exceed aggregate loan disbursements—as proper offsets to loan expenditures. They should be subtracted from gross loan disbursements in arriving at 'net lending.' To the extent that its credit programs finance themselves through participations, agency issues, sales of individual assets, or loan repayments, the Federal Government does not call upon the revenues or general borrowing of the Treasury. It is the call upon the Treasury revenues or borrowing which the net lending figure should equal. For the self-financed portion of the loans, the Government is primarily acting as a financial intermediary with much the same impact as the insurance of private loans. Federal guarantees of participation certificates come into play only in the contingency that the underlying assets of the credit programs default."

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Budget Director, what would be the consequences if the Congress should exercise its prerogative and transfer $4 billion in priority from the way you people set it up, to wit, from space, agricultural subsidies, SST, et cetera, to antipoverty, Federal aid to education, et cetera? What will happen if we do that?

Mr. ZWICK. I am not sure I understand your question, Senator Javits. Through your appropriations actions you would do this?

Senator JAVITS. Sure. And in our authorizing legislation, suppose we decide——

Mr. ZWICK. Then you are doing that as the law of the land, and we would proceed to operate in that fashion.

Senator JAVITS. In other words, there is no change in the total budgetary approach, the deficit prospects, or any other factors. We would have decided that we will take the bit in our teeth and we will have set different priorities for $4 billion than you people did. There is nothing holy about yours, is there?

Mr. ZWICK. That is correct. Ours is the result of a long process of evaluating and considering—the budget represents the President's recommendations. It is the Congress' responsibility to take those recommendations, consider them, accept, reject, or modify them.

Senator JAVITS. And nothing will happen in the total budgetary picture and outlook if we do; is not that correct?

Mr. ZWICK. I do not know what you mean by the total budgetary outlook, sir. If you did what I think you were implying, you would have major dislocations and disruptions throughout this economy. You would be cutting or stopping production facilities, you would be stopping programs in midstream. You would in that sense create a large number of local economic distress situations.

Senator JAVITS. Let us test that out. In other words, what you are telling me is that if we moved into the space program, and we cut it

x dollars, and we moved into the agricultural subsidy program, and we cut it x dollars, you say we would be incurring disruptions, correct?

Mr. ZWICK. That is correct.

Senator JAVITS. If you had decided that those were the proper priorities, would the President have had any hesitancy in changing them also?

Mr. ZWICK. No. But we approached it differently. We started out by saying, what we want to do is to minimize that sort of local disruption with its unfair impact on individuals, and, therefore, we will hold back certain programs to minimum levels, but we will not stop them in midstream. And we would prefer to ask for a temporary surcharge to pay for the added expenditures which we feel we need rather than expecting particular local communities to take the burden of these sorts of drastic actions.

Senator JAVITS. And did you evaluate riots in the streets of our big cities as against stopping the production in a particular line in space? Did you evaluate that in ordering your priorities?

Mr. ZWICK. Yes, sir. And that is why our total aid to the poor goes up by $3.1 billion. And why we have got a major expansion——

Senator JAVITS. $3.1 billion, did you say?

Mr. ZWICK. Yes, sir. If you will turn to page 36, I believe it is, of the Budget document, you can see the increase in aid to the poor. And I am going to provide for the record the backup on that. Aid to the poor goes up from $24.6 billion in 1968 to $27.7 billion in 1969. And that contrasts with a $12.5 billion level in 1963, and a $9.5 billion level in 1960. So, I think, in that aggregate sense, there is clearly a major expansion in this area in this budget.

Furthermore, you will note that the specific program increases that we did include in the budget provide for a major expansion to $2 billion for manpower training, a full funding of the $1 billion authorization on model cities, and an increase of roughly half a billion dollars on health programs. There is also a new housing program for low- and moderate-income families.

Now, you may disagree that we did not go far enough, Senator. But I clearly would submit that the proper priority emphasis is in this budget.

Senator JAVITS. How much of this $3 billion is social security benefits?

Mr. ZWICK. They are up $1 billion.

Senator JAVITS. And welfare payments are up——

Mr. ZWICK. Public assistance would be up only $100 million, and VA compensation is up $100 million. Health insurance for the aged is up $300 million.

Senator JAVITS. Health insurance for the aged is up what?

Mr. ZWICK. $300 million.

Senator JAVITS. What does that mean?

Mr. ZWICK. This is medicare. There is another $300 million increase for medicaid.

Senator JAVITS. Medicaid?

Mr. ZWICK. Yes.

We have the breakout, Senator. And we would be happy to provide it for the record.

(The following material was subsequently furnished to the committee for inclusion in the record:)

ESTIMATED FEDERAL FUNDS FOR PROGRAMS ASSISTING THE POOR, FISCAL YEARS 1960-69

[In billions of dollars]

Category and program	1960 actual	1963 actual	1967 actual	1968 estimate	1969 estimate
Education:					
HEW:					
ESEA Act of 1965, title I			1.1	1.2	1.2
Other	(1)	(1)	.4	.6	.7
OEO: Head Start, follow-through, etc.			.4	.4	.5
Interior: Indian education	0.1	0.1	.1	.1	.1
Subtotal	.1	.1	2.0	2.3	2.5
Work and training:					
HEW: Work incentive activities				(1)	.1
OEO			.8	.8	1.1
Labor:[2] MDTA, etc.	(1)	(1)	.2	.3	.4
Subtotal	(1)	(1)	1.0	1.1	1.6
Health:					
HEW:					
Health insurance for the aged[3]			1.3	1.7	2.0
Public assistance medical care	.2	.4	.9	1.4	1.7
Other	.1	.1	.3	.3	.3
VA: Hospital and domiciliary care	.3	.4	.5	.6	.6
OEO			.1	.1	.2
Subtotal	.6	.9	3.2	4.1	4.7
Cash benefit payments:					
HEW:					
OASDI[3]	4.0	5.3	6.7	7.9	8.9
Public assistance	1.8	4.2	3.0	3.5	3.6
Railroad retirement[3]	.4	.3	.3	.4	.4
VA: Compensation and pensions	1.6	2.0	2.3	2.4	2.5
Labor: UI[3]	.5	.6	.4	.5	.5
Subtotal	8.3	10.4	12.8	14.6	15.9
Other social, welfare, and economic services:					
Agriculture:					
Food programs	.2	.3	.3	.4	.5
Other	(1)	.1	.1	.2	.2
Commerce: EDA		.1	.2	.2	.2
OEO			.3	.4	.5
HEW	.1	.1	.4	.4	.5
HUD:					
Public housing and rent supplements	.1	.1	.2	.2	.3
Other			(1)	.1	.3
Interior: Services to Indians, etc.[2]	.1	.2	.4	.3	.3
Labor	(1)	(1)	(1)	(1)	(1)
SBA: Economic opportunity loans			(1)	(1)	(1)
Appalachian program (FAP)			.1	.1	.1
Subtotal	.5	1.0	2.0	2.4	2.9
Total	9.5	12.5	21.1	24.6	27.7

Note: Totals may not add due to rounding. The amounts shown in this table are (a) NOA for regular budget accounts except where program level is the more meaningful concept, (b) expenditures for trust funds.

[1] Less than $50,000,000.
[2] Includes some trust funds.
[3] All trust funds.

NOTE

The tabulation prepared by the Bureau of the Budget does not encompass all programs which affect the poor, but only those that have special impact on them qua poor. The following are the criteria used in selecting the programs for inclusion in the tabulation.

1. Programs which are aimed at the *poor* in general or at a specific group of the population who are poor (example, Indians) or at a particular region which is considered poor (example, Appalachia).

2. Programs which are aimed principally at *low income* groups of which the poor constitute a significant proportion.

3. Programs which are open to *all* regardless of income but which are taken advantage of most by low income groups.

4. Programs which are open to *all* regardless of income but which contain specific benefits to the poor or to the very low income groups.

Programs in the first category are included in the tabulation at 100%. For the remaining categories only that portion of a program which is estimated to relate to poor beneficiaries is included. It should be emphasized that this tabulation relates to *outlays* of the Federal Government assisting the poor and should not be taken to measure the *benefits* that the poor derive from these programs.

Senator JAVITS. Now, the one that I happen to know about is what you have done with work and training. You have cut that in order to get more people in the work training. And you have cut a considerable amount, haven't you, out of Head Start and Job Corps and similar things; right?

Mr. ZWICK. No, sir. This is the same dialog I had earlier with Congressman Reuss. The 1969 budget keeps those particular programs at existing levels, less than most people were talking about a year ago. But, in terms of those specific programs, we are holding them constant. Of course, we have increased overall manpower programs significantly. There is an increase of $442 million in appropriations of 1969 for work experience and training programs, the whole manpower program category.

The additional slots this increase will allow I do not have on the top of my head, but there will be a significant increase in the number of total slots available for hard-core unemployed to receive training.

So, there has been clearly a restructuring. And again, every time you try to restructure by holding old programs constant and adding new programs, people say, "Why don't old programs get raised?"

Senator JAVITS. Everything comes out of something, so you cannot do too many tricks. Somebody is losing if somebody else is gaining.

Mr. ZWICK. That whole program area of manpower training, to be clear, is up $442 million, the total set of programs on work training and related activities. We can give you a breakdown if you will like it.

Senator JAVITS. Give us that.

(The following was later supplied for the record:)

SELECTED DATA ON FEDERAL MANPOWER PROGRAMS

[Dollars in millions, individuals served in thousands] [1]

	Fiscal year 1968		Fiscal year 1969	
	Number	Percent of total	Number	Percent of total
NOA by activity and major program:				
OJT (MDTA, OEO comprehensive employment activities, VA OJT)	$182	11	$404	19
(Jobs)	(106)	(6)	(244)	(12)
Institutional (MDTA, work incentive)	246	15	310	15
Job Corps	285	17	295	14
General work experience (NYC, work experience)	375	23	422	20
General manpower services and support [2]	428	26	512	25
Other [3]	129	8	144	7
(CEP) [4]	(210)	(13)	(495)	(24)
Total	1,645	100	2,087	100
Individuals served by activity:				
OJT	186	19	281	22
(Jobs)	(30)	(3)	(70)	(5)
Institutional	129	13	170	13
Job Corps	98	10	98	8
General work experience	435	45	590	46
General manpower services and support	44	5	65	5
Other [3]	80	8	90	7
(CEP)	(89)	(9)	(200)	(15)
Total	970	100	1,292	100
Appropriation by agency: [5]				
Labor	$723	44	$787	38
HEW	40	2	135	6
OEO	842	51	1,096	53
VA	18	1	44	2
Interior	21	1	25	1
Total	1,645	100	2,087	100

[1] Totals may not add due to rounding.
[2] Employment Service, CAP manpower activities, special impact.
[3] New careers, Indian manpower services, MDTA part-time and employability training.
[4] CEP uses funds from a variety of programs to deliver manpower services more effectively. There is no overall appropriation account for CEP as such. The amounts shown here are preliminary estimates of funds to be earmarked for this activity. There is an overlap between CEP and jobs as far as funds and people served.
[5] Department of Labor will administer about 78 percent.

Senator JAVITS. But let us get back to the main point. You say in your statement that the 1969 budget is based on a very strict ordering of priorities. That is your ordering, that is what the President and his people think is the right order?

Mr. ZWICK. That is correct.

Senator JAVITS. And you evaluate violence in the city at a certain level as compared with the space program. But, if we differ with you and we change it, then there is no major dislocation except for the nitty-gritty, in details of what you have to pay for canceling the contract.

Mr. ZWICK. The nitty-gritty depends on whose nitty-gritty it is.

Senator JAVITS. Who is being nitty? That is exactly what we are talking about, whether it is the space manufacturers or the teeming millions in the cities. I am not charging that you did not do the right thing. I am only asking you whether, if we change priorities, if we differ from you, if that is going to turn this whole budget over, and you have already answered my question, it would not, except that we have to be careful about the finite details.

Mr. ZWICK. That is correct. And as I understand you, you are saying that you would even do more than we have done for the poor of the cities.

Senator JAVITS. I am not sure what you have actually done. I do not want to get lost in that maze right now, I am only stating the basic principles. We can transfer the priorities.

One other question. The control of expenditure business interests me greatly. You say that programs which are relatively controllable involve about $39½ billion in fiscal 1969?

Mr. ZWICK. That is correct.

Senator JAVITS. Now, are there any defense items that should be put in the same category? In other words, if you are going to construct a swimming pool at posts in San Francisco, what is holy about that, and why isn't that a controllable expenditure?

Mr. ZWICK. Let me make two comments. First, the way we constructed this table was to exclude defense. You are obviously correct that some defense programs are controllable. And last year when we went through the cutback exercilse, we did it roughly equally; that is a non-Vietnam defense cutback of $2 billion, and a cutback of $2 billion in civilian programs. So that the basic thrust of your comments is certainly correct, Senator.

I would correct it in one way, however. I do not think we are building any swimming pools at this point. Last fall Secretary McNamara initiated an overall construction freeze, and he has not removed the freeze to date. He has made exceptions. I do not know what the list in detail looks like, but I would be very surprised if there were any swimming pools on it.

Senator JAVITS. My time is up. But just to complete it, can you give us any estimate of what would be the controllable expenditures in the defense piece?

Mr. ZWICK. Yes, sir.

Chairman PROXMIRE. You cannot do it now?

Mr. ZWICK. No.

Senator JAVITS. Thank you very much.

(The material below was later submitted by the Budget Bureau:)

In applying the "controllability" concept, outlays for national defense are considered apart from outlays for both the relatively uncontrollable and controllable civilian programs. This is not to imply, however, that Defense expenditures cannot be controlled.

In any budget as large as $75 billion there are outlays of lesser priority. Some of these may be deferred without seriously impairing short term effectiveness. In reviewing the 1968 budget and in formulating the 1969 budget, strenuous efforts were made to delete all defense programs which could be deferred safely until a later time.

For example, requests of the services for construction funds were reduced approximately 80%. Only those projects required for Southeast Asia, for new weapons systems, or for the health and safety of personnel are included in the 1969 budget. Overall, 1969 service budget requests were reduced by more than $20 billion in the process of preparing the budget.

Chairman PROXMIRE. Senator Talmadge?

Senator TALMADGE. Mr. Zwick, I was a little late, and I regret I did not get to hear your testimony in full. I have scanned it very hurriedly. Where is all this exuberance that we hear about in our economy?

Mr. ZWICK. Well, Senator Talmadge, I would be happy to go over those statistics. I think if you would look particularly at the fourth quarter of last year you will find that the GNP was up 8.6 percent; the Consumer Price Index was up around 3½ percent; and wholesale prices, industrial commodity prices, in the fourth over the third quarter were up 3 percent. These figures are all annual rates of growth.

It is not only exuberant, I would say, but the rate of change has been moving up through 1967. And, as we look into the first quarter of 1968, everybody is agreeing that we are going to have a large economy. How much exuberance is obviously a judgment, a tradeoff we all have to make. But, I would say that we are moving into a situation in which unemployment is going down again. The statistics on this will be out this week and we are moving into an even lower unemployment rate than last month. When you are having this sort of acceleration in prices, with an unemployment rate among married men which is under 1.7 percent, I would say that you are now in a posture where you need to say whether you want more fiscal restraint than would be inherent in this budget without a tax increase—with the deficit running about $19 or $20 million.

Senator TALMADGE. I have some that do not look so rosy. According to statistics handed me, real growth for 1967 was only 2½ percent; is that correct?

Mr. ZWICK. That is right. That is why I stressed the fourth quarter and where we are going. I think it is more important to look at what has happened over the last several quarters and where we think we are going, than to go back and average in the first half of calendar year 1967, which we all admit was not a good period. When you put that first half in you get averages for the year which are not impressive.

Senator TALMADGE. Retail sales for December were only eight-tenths of 1 percent below the low number estimate, and only 3½ percent above the level of December of 1966. Is that correct?

Mr. ZWICK. Without having the specific statistics, they sound essentially correct.

Senator TALMADGE. The December index of industrial production was only 1 percent above the level a year ago.

Mr. ZWICK. That sounds a little low, sir.

Senator TALMADGE. And lots of others were handed me along the same line. So, it seems to me——

Mr. ZWICK. But I will give you a couple of other statistics. In December new orders for durable goods rose 12 percent.

Manufacturers' shipments rose about 5 percent.

Shipments were growing much faster than inventories.

The inventory sales ratio fell to 1.69, the lowest since August of 1966.

There are certainly particular indexes you can find in particular time periods which will show soft spots. But I just do not think that you can look at the aggregate economic performance in the fourth quarter of calendar 1967, or in the first quarter of calendar 1968, and conclude that there is anything but a rapid acceleration occurring in the economy as a whole.

Senator TALMADGE. According to these statistics, further, the manufacturers' inventory shipments ratio for December 1967 is 1.7, the same as the December 1966.

Mr. ZWICK. Yes; but there has been adjustment of those, sir. The difference between what you have, 1.7, and what I have, 1.69 is due to recent revision of the figures.

Senator TALMADGE. My statistics do not show too many signs of exuberance. Most of the forecasts I have heard indicate that they see some acceleration in the first half of 1968, with perhaps a substantial slowdown in the second half.

Mr. ZWICK. Sir, on the slowdown in the second half, while none of us should be very sanguine about being able to forecast that far in the future, nevertheless we have to forecast and make public policy which will affect the second half of the year. And as I sit here looking at our forecast, we have a strong second half. Reasonable people can project a weak second half. But, if you look at the risks involved, and our problems in Southeast Asia and other places, to assume that you are going to have a weak second half seems to me to be playing a longshot.

Senator TALMADGE. Congressman Reuss in his questions referred a moment ago to something that I have had on my mind. I think the balance-of-payments problems is caused primarily by governmental action and not the action of private individuals. Now, how can we ask tourists, schoolteachers and students and others that look forward all their lives to making one trip overseas, to pay a tax on that trip, before the Government itself does everything it can to reduce its own contributions to this balance of payments? What I am referring to specifically are the troops in Europe. We have got five or six divisions there. What do they cost?

Mr. ZWICK. I cannot give you that number right off the top of my head, Senator. I will be glad to supply it. (See p. 98.)

Senator TALMADGE. I noticed Congressman Reuss used the figure of a billion and a half. Secretary Dillon, when he was before the Finance Committee, shortly before he left as Secretary of the Treasury gave, I believe, a figure of $2½ billion. Now, those troops are not needed there; they are not wanted there. They have greater manpower in Europe than we have, and a greater gold reserve than we have. Why shouldn't we bring some of the those troops home, particularly when we are fighting a war in Southeast Asia, before we ask students and schoolteachers to pay taxes on a trip to London?

Mr. ZWICK. Senator, let me back into that, and first, point out that I think you are right. The most important thing we can do here would be to have the tax increase, which would help bring down the rates of increase in industrial prices, and make our commodities more competitive, and increase our trade balance. Then we would not have to go to measures which are a basic departure from the usual American effort to balance our international payments. And, therefore, I think the most important thing we as a government can do is to move expeditiously on the tax increase to get our domestic eonomy in some better shape so that it can compete in world markets.

The second point: I think it is important to recognize—you do not say this, but I want the record to be clear on this—that outside of our national security, outside of defense, the rest of the Government is in balance. In fact, we have not done our calculations including the recent actions taken by the President. But they will clearly put us in a surplus position for the rest of the Government. So that it is our national defense commitments around the world that are at issue. And, I think that is a foreign policy determination which we have to face up to as a country.

And I still come back to my basic point that the most important thing I think we can do, given our foreign policy and foreign commitments, therefore, would be to have the tax increase so that we can make our economy more competitive, and then we would not have to go to some of these other things.

Senator TALMADGE. Why can't we bring some of those troops home from Western Europe?

Mr. ZWICK. As I say, that is a basic foreign policy decision.

Senator TALMADGE. The defenses, though, one of them relates to the others. I know you do not determine why we keep troops there. But it seems to me that when we have been kicked out of France—and some countries over there are not even drafting their young men—when their gold reserves are greater than our own, their manpower is greater than our own, it seems to me that they could do more for their own defense without looking to us to carry the burden, when we cannot balance our budget, when we are having a gold drain, and balance-of-payments difficulties. It seems to me that the priority would be to bring home some of those troops before we start looking around at tourists, at ordinary taxpayers. It seems that the Government ought to do its part before we look at taxpayers to carry the burden.

Mr. ZWICK. Sir, I reiterate that this is a basic policy determination. I want the record to be clear on one point—that if you bring those troops home in 1969, both your expenditures and your balance-of-payment costs would go up in 1969. It would not do anything to help you temporarily on this problem. You would certainly in the long run help your balance-of-payments posture if you brought them back. But in the first year, or maybe the first 2 years, I do not have the details, but certainly in the first year and possibly the first 2 years it would not help.

Senator TALMADGE. Why would it not help our balance of payments? Assuming that Congressman Reuss is right, and it takes a billion and a half to keep them there, and then assume that Douglas Dillon is right—he said two and a half billion—if you brought half of them home you would reduce the expense by half, would you not?

Mr. ZWICK. I am saying that during the first year the whole cost of redeployment, transport, and everything else would probably hurt your balance of payments. It would certainly hurt your expenditures. And clearly, then, after you brought them back, whether expenditures would be higher or lower would depend again on a military policy decision. If when you brought them back you built up mobile forces, airlift, sealift, you could end up with a higher total cost for the same basic military capability. Now, if you want to cut back on your military capability, that is a policy issue that you are addressing.

Senator TALMADGE. My time has expired.

But what you are talking about would not contribute to the balance of payments; it would be dollars spent here and not dollars spent in Europe? And that would make an appreciable difference. I repeat, it seems to me that before the Government expects taxpayers to curtail their own private trips that the Government itself ought to do everything within its domain to reduce its contribution to the balance of payments. And I maintain that this troop expense in Europe is outmoded, outdated, and unwanted, and we ought to do something about it.

Thank you very much.

Chairman PROXMIRE. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

I would like to continue along the lines of Senator Talmadge.

I think we ought to get straight what the billion and a half dollars for troop expenses in Europe is. Is that under the so-called gold budget?

Mr. ZWICK. I think he is talking about the total cost. The gold budget cost, I am sure, would be less than the total cost. I do not have those numbers, but we can get them for the record.

Representative MOORHEAD. I think it would be important to have for the record, what the total dollar cost is, and then what the cost is on the gold budget or balance of payments.

It seems to me that a redeployment of troops would have a very immediate effect on our balance of payments or gold budget, even though, as you correctly stated, it might have an adverse effect on our domestic budget. If you are thinking about a balance-of-payments problem, which I think is what Senator Javits said, I believe there would be an immediate effect.

Mr. ZWICK. You would have the immediate cost of closing installations and redeploying people. And my guess would be that in fiscal 1969 you would have higher balance-of-payments costs.

That depends on how fast you pull out, obviously.

(The following material was subsequently supplied for the record in response to questions of Senator Talmadge and Representative Moorhead:)

Using available data, it is estimated that the direct budget costs of our forces in Europe are approximately $2.6 billion per year. These estimates include the direct costs of military personnel, operation and maintenance, and military construction in Europe. Indirect logistic and administrative support costs from sources outside Europe, as well as amounts for major procurement, cannot reasonably be identified by geographic area and are not included.

The balance of payments expenditure effect on a transaction basis (i.e., the gold budget costs) of maintaining U.S. forces in Europe is approximately $1.5 billion per year.

Representative MOORHEAD. Mr. Zwick, I would like to review page 9 of your statement, where you list the various estimates on budget deficits. What I want to know is whether these figures include the estimate that Congress will act on the tax proposals as now proposed for individuals on April 1, and January 1 for corporations.

Mr. ZWICK. Yes. And a continuation of the existing excise taxes. Yes, $12.9 billion of the revenues in those deficits come from the tax measures. So that if you did not get the tax increase——

Representative MOORHEAD. Show me how the three columns would change.

Mr. ZWICK. Well, for 1968 it would be up $3 billion, so that the deficit would be roughly $22.8 billion. And then you would add the $12.9 billion of revenues from the tax measures in 1969, and you would get a $20.9 billion deficit in that year.

Now, let me quickly point out here that these estimates assume no feedback, in the sense that if you did not have this increase, you would get additional inflationary pressures. We would expect something to happen to GNP, personal income, and profits, and this feedback on revenues. We have not tried to make this calculation for the following reason. Exactly how much inflation you will get if you do not get the fiscal restraints, and how much the inflation will be held down if the Federal Reserve Board steps in with tighter money, we have no way of knowing. There is obviously a whole range of outcomes. The one extreme that you cannot conceive of would be that the Fed would just continue to feed reserves into the system, and then all these extra things would come out in terms of inflation. This would balloon up personal income, and it would balloon up profits and Federal revenues. And, therefore, the deficit would not be up to the $20.9 billion that you get by just adding the $12.9 billion from the proposed tax increases to the $8 billion estimated 1969 deficit. It would be something less than that. How much less, I say, really depends on what the Federal Reserve Board does, and how this affects GNP and personal income. But the deficit certainly would be something like $22 billion in 1968, and around $21 billion in 1969, assuming no feedback.

Representative MOORHEAD. It seems to me that the most serious problem is the first 6 months of calendar 1968. And the tax increase, while it helps, does not help very materially in affecting that budget deficit. If the predictions are correct, to be a strong first 6 months and then a flattening out, it would seem to me that the tax increase would begin to bite just at the wrong time, the beginning of July.

Mr. ZWICK. That is a correct interpretation of that forecast. I would quickly point out that we disagree with that forecast. And we have been saying here now since last August, it is not going to flatten out 6 to 12 months from now. And, inaction is as much a policy as, in fact, is action. So that as to the outlook we have been saying, and I think the important issue is, what does the economy look like as you leave calendar year 1968 and go into calendar year 1969? Have you turned the corner toward a return to price stability with a high level of employment, with a balanced economy, with a housing industry that is still operating as compared to one that has been severely held down by very tight monetary conditions, and so forth?

So, I think the real question is how you get out of calendar year 1968 and go into calendar 1969.

Representative MOORHEAD. I understood your testimony to be not that you were predicting a strong second half, but you were not so sure that it would be weak. Are you now saying that the Bureau of the Budget predicts a strong upsurge continuing in the second half of this year?

Mr. ZWICK. Let me just say that we do this jointly as a troika with the Treasury and the Council of Economic Advisers. Now, our forecasts——

Representative MOORHEAD. Not a quadriad? It comes out less than that?

Mr. ZWICK. In quadriad also. We have had extensive discussions with the Federal Reserve Board and I do not think our forecasts are significantly different. We have forecast leaving calendar 1968 and going into 1969 with a very healthy economy with the tax increase. Without the tax increase, the forecast leaving 1968 and going into calendar 1969 would be that you will be going out of the year either with accelerating inflationary pressures, or you are going to have a very bad lack of balance in the economy, because monetary restraint has had to carry the whole burden. And monetary restraint is going to fall disproportionately on some sectors, especially housing. That is our forecast.

Representative MOORHEAD. Mr. Zwick, you testified that an overall decision was reached, as I understand it, not to stop any ongoing programs, but to keep them at minimum levels?

Mr. ZWICK. That is correct.

Representative MOORHEAD. It would seem to me that, while this might be a good general rule of thumb to follow, that there would be some programs that we could stop in this first half of this calendar year when at least we know we are in a bad deficit situation. If we could stop some of these public works projects—not all of them, I realize, as a general rule—could you look at each one, item by item?

Mr. ZWICK. I was talking about construction when I said our basic rule was to keep projects going at minimum levels. And I think that is what you are talking about.

Representative MOORHEAD. Yes.

Mr. ZWICK. Not all programs, but construction.

We have done the following. We have said that any ongoing projects should be continued at a minimum level.

Second, we decided that we will spread the 1968 starts, starts which were planned for fiscal 1968, over 2 years. And these were appropriated by Congress. Indeed, as you remember, Congress added some 40 new starts for the Corps of Engineers to the minimum list we sent up last year. We are now taking the 1968 starts that Congress authorized and spreading them over 2 years.

And, third, we are coming up again with a very minimal list of new starts. And, hopefully, Congress will support us in keeping the new starts down.

Once you are underway, when you look at individual projects, you have all sorts of problems if you want to stop them. You have power requirements, online power requirements in the Northwest, which depend on certain dams being finished, so that you will have power 2 or 3 years from now, and a major dislocation would occur if you don't fulfill that. You have the whole flood control problem where, if you stop in midstream on a project, not only would the flood control be sacrificed, but by the time you take in account the erosion and so forth, you would probably be right back to the starting point.

So that, when we went case by case through the ongoing projects, it looked like the most sensible, the most prudent, responsible public policy was to continue them at minimum levels, and then take the authorized new starts for 1968 and spread them over 2 years, and then finally only propose a very limited number of new starts for 1969.

And, if we can hold that posture, if we can spread the new starts that were authorized by Congress in 1968 over 2 years, and, if we can hold the new starts in fiscal 1969 to the low levels we are recommending, I think we will have moved significantly in the right direction.

Representative MOORHEAD. So you did approach it on a case-by-case basis?

Mr. ZWICK. That is correct, project by project. In fact, we toyed with a rule to stop projects that were 50 percent or less complete when a particular work project stop point came. But when we started to look at projects and the problems that this policy would create in terms of insufficient power, in terms of floods, and so forth, we just decided that that policy does not make sense.

Representative MOORHEAD. My time has expired. But would you answer this question? I understand that in the political decisions between various types of programs you cannot have an arbitrary figure, but in a particular area—and I am thinking about the manpower training area—do you have a cost analysis, say between the Job Corps, the Neighborhood Youth Corps, the manpower development and training, and vocational education? If you do not have it, would you supply it for the record?

Mr. ZWICK. We can give you information on that. We do not have it quite as neatly as your request for cost-benefit analysis would imply, but we did set priorities based on the best judgments that we have on the effectiveness of programs and the ability to get them moving, and so forth. We restructured fairly significantly the manpower programs and we will provide it for the record.

(The following material was later supplied for the record by the Budget Bureau:)

The major change in the overall manpower program for 1969 from previous years lies in the very substantial increase for on-the-job (OJT) training in private industry:

$2,100,000,000 MANPOWER PROGRAM

[NOA. Dollar amounts in millions]

	1967	1968	1969	Change, 1967–69	
				Amount	Percent
On the job	$115.5	$181.8	$404.4	+$288.9	+250
Jobs	(0)	(106.0)	(244.0)	(+244.0)	
All other	1,407.3	1,463.1	1,682.6	+275.3	+20
Total	1,522.8	1,644.9	2,087.0	+564.2	+37

The bulk of the increase in OJT is for the new JOBS program to involve private industry in hiring and training the hard-core disadvantaged in our major cities. There are a number of other important changes in this period with a less dramatic effect on the totals: initiation and expansion of the Concentrated Employment Program (which is largely a pulling together of existing programs but does involve additional funds), the new Special Impact Program for economic development in concentrated areas of substantial unemployment, the replacement of the Work Experience Program for welfare recipients by the new Work Incentive Program, and the initiation of CAMPS—cooperative program planning on an area basis from the local community upward.

The figures above do not include a number of related programs—e.g., Vocational Education and Vocational Rehabilitation—which are also undergoing change, and which will increase the employability of participants, but which have been classified education or health programs.

The changed emphasis of manpower programs is chiefly based on:

The need to increase significantly the opportunities for jobs for the hard-core unemployed of our major cities, who have not been adequately reached by the recent years of national growth and prosperity.

The need to involve private industry more in hiring and training the disadvantaged (available evidence suggests that this will increase the effectiveness of the programs as measured by the achievement of productive employment of participants).

A review of the various programs, taking into account the overall fiscal situation, availability of funds and the priorities mentioned above.

The agencies have done preliminary work in the manpower area in the benefit-cost field. These studies have been useful as first steps, but have been limited somewhat because of differing technical approaches and the fact that many of the programs have little reliable or comprehensive effectiveness data because they are so new. We are moving in this field and we expect to make considerable progress.

Representative MOORHEAD. Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Moorhead.

Senator Percy, if you would like to go ahead you can. Or you can wait. Whatever you wish.

Senator PERCY. I would like to first express the disappointment that I did not get here in time.

I was hopeful that we would have some response this morning to the suggestions for budget cuts made by the chairman. The chairman suggested that we cut the space program by a billion dollars, and I presume he means from the present budget level.

Mr. Chairman, could I ask for a clarification on your statement as to whether or not when you said cut the space program by a billion dollars, you were talking about a billion from the appropriation level of 1969, or a billion from the President's proposal?

Chairman PROXMIRE. A billion from the President's proposal.

Mr. ZWICK. But appropriations, not expenditures, in 1969?

Chairman PROXMIRE. That is correct.

Senator PERCY. If we would reduce public works by $5 billion or $6 billion and if—and if four of our six divisions were withdrawn from Europe at a saving of $2 billion, what reaction would the Budget Director have to those specific proposals? I favor a cutback in European troops, and I suggested a figure of 50,000. I think, in principle, many of us feel that we ought to cut back on European troop expenditures. It is time for Europe to pick up its own defense. They are a long ways beyond where they were 15 years ago and their conditions are certainly a great deal different.

And how deep can we go on this space program, considering the overall budget requirements?

Mr. ZWICK. Let me talk first about the space program, and second, about the troops in Europe, because I think they are quite different problems, and I would like to emphasize the differences.

Chairman PROXMIRE. If the Senator from Illinois would permit, the biggest part in my proposal was that we reduce public works by $5 or $6 billion.

Mr. ZWICK. I missed that—I am sorry.

Mr. PERCY. Again, I said $2 billion, and you deducted it.

But why can't we cut public works—drastically curtail and delay those programs even if they affect Wisconsin and Illinois and New York—and delay them to the point where the economy yield—that is going pretty far.

Chairman PROXMIRE. Also Missouri and Pennsylvania.

Senator PERCY. I am quite willing to say, let us delay programs, let us cut back in Illinois and cut back in other States, if these projects can be put back into the economy when it needs a stimulant, rather than have them now feeding inflation and adding to the present pressure on the economy.

Mr. ZWICK. I will discuss public works along with the space program, because I think they are of the same nature. The troops in Europe, however, present a slightly different problem.

A short answer is that I believe we disagree with you that it is prudent public policy to make the sort of drastic cuts which you suggest in detail. We do not think that we are going to be out of the public works area forever. The program that we have come up with, just to tick it off very quickly again, is to continue existing starts at a minimum level; second, to spread 1968 starts, which Congress increased very dramatically last year over what the administration asked, over 2 years—to start them in 1968 and 1969; and third, to propose a very minimum number of new starts in 1969. We think that is prudent public policy.

We looked at another more stringent policy, as I said to Mr. Moorhead a moment ago, of stopping projects that were less than 50 percent complete. But when you look at the specific problems associated with almost every project—for example, the lack of power in the Northwest on which plant and other major decisions depend—it looked like this was not a sensible thing to do. When you look at Corps projects for flood control, and so forth, being left in midstream and deteriorating, it just did not look like a sensible policy. We decided instead that we would come up with what we think is a minimal program level without placing these burdens on the local areas. And this gets back to the point I made earlier—we would rather have a temporary surcharge and keep these projects going, we think that is more equitable and more correct public policy than asking the particular local communities that happen to have a project to bear the full brunt of economic stabilization.

Almost the same argument holds true for space. Surely unless you are making a long-term policy decision that you want to get out of space, or reduce the levels dramatically—unless you say, we made a mistake when we got up to this level, we now want to have a space program—you name whatever number you would like to have your space program at, $2 billion a year or something like that—if you are going to move into that new greatly reduced commitment by the country, then I think it should be written in an orderly fashion. We are operating on the assumption that we are going to have a significant, vigorous, important space program over the years. We think a radical year-to-year juggling of that is not good policy, if you accept our basic assumption that you are going to have a long-term space program.

As to troops in Europe, that is quite different. There you are talking about withdrawing them and not putting them back. Again, I think you have got a foreign policy, military posture decision. If you reach the conclusion on the basis of those issues to withdraw them, fine, but do not expect very many savings in 1969 or 1970. Certainly you start to get them after that.

But, again, that is a long-term policy decision, and it should be made, it seems to me, on those grounds, and not on the grounds that we have a temporary need for some revenues—we have an option of raising revenues temporarily by a surcharge of 10 percent—or that we need to get some temporary savings.

Again, I would argue that a legitimate issue on which the dialog should continue and should finally reach a conclusion, is, to the extent we are talking about reductions as temporary measures as a way to evade the surcharge, when you look at their specific implications, you are really invoking hardships on local areas and particular constituents. And that just does not seem good policy to us.

Senator PERCY. Certainly when we look at troops in Europe no one envisioned 25 years ago or 20 years ago when this was established that

23 years later we would still have a quarter of a million men in Europe. We were aiming for the economic recovery in Europe. That has been accomplished. We were aiming for a lessening of the cold war and a perforation of the Iron Curtain, and some degree of independence of the Eastern European nations. And that has been accomplished. At what point do we simply say, we are going to start to cut back that expense, we cannot afford it? And if the Budget Director does not do it, who is going to do it? The Congress has said, the majority leader of the Senate has said, resolutions have said, let us cut back our European troop forces. So I think someone must be standing in the way. Now, if it is the State Department, or the Defense Department, then we ought to get it out. But, here is an obvious place, it seems to me, we can cut back. It is in our long-range interest not to continue, to let them believe that we still have to provide that element and degree of protection, particularly considering that we can certainly airlift forces much faster to Europe now. There is a point—time when someone has to get tough, I think, and simply try to cut back. And it is the kind of places like this that have not been cut back in this budget that are discouraging.

Mr. Zwick. I repeat, to the extent you are raising a long-term policy issue, I think you are raising a different question than how we should temporarily meet our temporary problems associated with Vietnam. On that issue we have looked at it and decided that this is not the time to withdraw those troops. The Congress clearly can overturn that through its appropriations actions, but it has not seen fit to do so. So that when you say the Congress has said it wants to do it, and it is being negated in some sense by the Executive, I do not follow that kind of logic. You have ways through your appropriation processes to bring this about, if this is the congressional sentiment.

The second point I would like to make is that any reforms, any changes are hard, there is just no doubt about that, so I am very sympathetic to the point you are making. We have listed on pages 21 and 22 of the budget close to $3 billion worth of reductions. They are painful. They are going to be resisted. But we think they are the first step. The President said, "I ask Congress to join me and support these." You are now adding to that list other painful choices. I especially would like you to support ours. And then if you think that you have the support of the Congress to go further, then you obviously have the means to enact other changes.

Senator Percy. You have made some substantial cuts, certainly.

Mr. Zwick. That is right.

Senator Percy. But in looking at some of these cuts, I do recall $120 million for the Agricultural Conservation Service. This was the same cut that the administration offered before. And I took you at your word. And Senator Dirksen and I both supported that cut. But we were carried down an avalanche of opposition. I never had so many Senators come up and say, "You cannot vote against conservation. How can you do it if you come from an agricultural State?"

I wonder whether or not there has been an attempt to just show cuts in those places that you know the Congress is not going to accept. I am going to support that one again. But I presume I will go down an avalanche again.

Is it reasonable to assume that that $120 million is not going to be spent if that is one of the so-called sacred cows that every single year is supported by the Congress? You throw it in as sort of a gesture of budget cutting, but is not really a realistic appraisal of what is going to happen as a result of their budget, and, therefore, you are overstating or understating your expenses by $120 million. That one instance is illustrative of many other kinds of cuts—children's lunch programs, and things of that type that, certainly, a year ago we would not have expected to be cut off by the Congress.

Mr. Zwick. Let me react to the last point, specifically.

But, before I do that, Senator, let me say that they are all sacred cows. And I think that is the issue. We can talk in the abstract about cutting, deferring, and changing. But when we get to voting these cuts through, then people tend to back off.

We are not going to back off from our conviction. These are programs that should be cut back. And we are going to keep coming back up with them.

So we think they are lower priority programs, to go back to my dialog with the chairman at the beginning. This year we have made an attempt to put them together as a package. When you go up and try to get one sacred cow you do not do well. We thought maybe if we went with a package of them—given that the mood of the Congress was to cut expenditures, make program reforms, and set priorities—that by putting them in a package then maybe some of the people who in the past would not vote for the soil conservation reduction alone could argue that he voted for that, along with the user charges on aviation, and along with the other reductions and reforms in programs. So it would make it possible for the Congress to stand up and say, "We voted for a total package of reforms," and if one part of that package happened to hurt me and my constituents, it was the correct policy to do it. We thought by putting a whole bunch of them together maybe it would be easier for individual Members to vote for it.

These are tough, I agree. But there was no idea of putting in things which we know Congress would not vote for.

Senator Percy. I am hardly an old hand down here, but I would not say that you even have a Chinaman's chance of that concept going through. And that is a Nationalist Chinaman's chance.

Mr. Zwick. If that is the case, where are the budget cuts going to come from?

Chairman Proxmire. Dr. Zwick, before I get back to the priority question that I am very anxious to pursue with you, I would like to ask you if you would give, for the record, the analysis that I understand you prepared in more detail than what is shown on page 20 of the budget, the cuts below the 1968 level. I understand you have that kind of analysis?

Mr. Zwick. You want it from what level to what level?

Chairman Proxmire. Right down the line; yes.

Mr. Zwick. We have that, and we can make it available to you.

(The table below was subsequently received for the record:)

BUDGET REDUCTIONS AND PROGRAM REFORMS, 1969 BUDGET

[In millions of dollars]

Agency, program, and measure of program level	Program level: Provided for 1968 in 1968 funding	Program level: Proposed for 1969	Program level: Reduction
BUDGET REDUCTIONS			
Agriculture (obligations):			
Farm operating loans	300	250	−50
Rural electrification loans	390	345	−45
Forest roads and trails	122	93	−29
Sewer and water loans	100	78	−22
Water and sewer grants	30	27	−3
Watershed protection program	74	57	−17
Flood prevention program	30	19	−11
Agricultural research	332	317	−15
Forest protection and utilization	252	250	−2
Great Plains conservation program	17	15	−2
Other	117	116	−1
Subtotal, Agriculture	1,764	1,567	−197
Commerce (obligations):			
Ship construction	278	122	−156
Research—Maritime Administration	14	7	−7
Subtotal, Commerce	292	129	−163
Health, Education, and Welfare (obligations):			
College facility grants	450	226	−224
Books, equipment, guidance, and testing grants	241	121	−120
Health research facilities construction	50	21	−29
School aid to federally impacted areas	459	442	−17
Medical library construction grants	11	1	−10
Subtotal, Health, Education, and Welfare	1,211	811	−400
Housing and Urban Development:			
Grants for basic water and sewer facilities (reservations)	175	150	−25
Public facility loans (reservations)	50	40	−10
Special assistance for market-rate mortgages—FNMA (commitments)	102	75	−27
Subtotal, Housing and Urban Development	327	265	−62
Interior (obligations):			
Reclamation program	372	345	−27
Indian construction programs	73	51	−22
Road programs	56	50	−6
Sport fisheries construction	17	12	−5
Commercial fisheries construction	2	1	−1
Subtotal, Interior	520	459	−61
Justice: Elimination of new prison construction (obligations)	7	6	−1
State: Educational exchange (obligations)	46	45	−1
Atomic Energy Commission (program costs):			
Production of special nuclear materials	346	334	−12
Nuclear rocket program	87	77	−10
Space electric power	61	53	−8
Civilian application of nuclear explosives (Plowshare)	21	15	−6
Subtotal, AEC	515	479	−36
General Services Administration: Construction (obligations)	200	57	−143
National Aeronautics and Space Administration: Manned and unmanned exploration and other programs (obligations)	4,818	4,370	−447
National Science Foundation: Institutional science programs (obligations)	100	69	−31
Small Business Administration (reservations):			
Business loans	324	284	−40
Economic opportunity loans	60	35	−25
Investment company loans	55	30	−25
Subtotal, SBA	439	349	−90
Total, budget reductions	10,239	8,606	−1,632

BUDGET REDUCTIONS AND PROGRAM REFORMS, 1969 BUDGET—Continued

[In millions of dollars]

Agency, program, and measure of program level	Program level: Provided for 1968 in 1968 funding	Program level: Proposed for 1969	Reduction
PROGRAM REFORMS			
Agriculture: Agricultural conservation program (obligations)	220	100	−120
HUD: Private housing (commitments)	869	200	−669
Labor: User charges under Longshoremen and Harbor Workers Compensation Act (obligations)	3		−3
Transportation (receipts):			
Airway services—increase taxes on users		−40	−40
Waterways—impose tax on users		−7	−7
Highway trucking—user charges		−239	−239
Subtotal, Transportation		−286	−286
Veterans' Administration (obligations):			
Compensation: arrested TB		−54	−54
Duplicate burial benefits		−46	−46
Pensions—count railroad retirement benefits		−7	−7
Subtotal, VA		−107	−107
Small Business Administration (reservations): Disaster loans—more rigorous criteria	100	50	−50
Total, program reforms	1,192	−43	−1,235
Grand total, budget program reductions and reforms, 1969	11,431	8,563	−2,867

Chairman PROXMIRE. And then, I would also like to make sure that I did not misunderstand two statements that you made which seemed significant to me. It is hard for me to comprehend them as you put it. It seemed to me that you said that the Government account is in surplus in balance of payments if you leave the military out?

Mr. ZWICK. That is essentially correct. Our preliminary estimates indicated that the gold budget, excluding defense, would move into surplus in 1969.

Chairman PROXMIRE. How does this come about—I have asked the staff, and they cannot come up with the answer?

Mr. ZWICK. You have got to consider the receipts as well as the expenditures. You have the receipts from Ex-Im loans for example; that is, leaving the military out.

Chairman PROXMIRE. That is right.

Mr. ZWICK. Unfortunately I do not have the gold budget information with me. I can supply something for the record.

(The following was later supplied for the record:)

Receipts from the regular international transactions of Government agencies, excluding Defense, are estimated to be about $1.8 billion in FY 1968. The main sources of these receipts are: interest, principal, and other collections by the Export-Import Bank (over $900 million); interest and principal collections and sales of goods and services abroad by the Department of Agriculture (over $450 million); and loan repayments and other transactions, about $200 million each for the Treasury Department and AID. In addition, the Panama Canal, AEC, and several other agencies make significant contributions to the Federal Government's regular receipts from international transactions.

Chairman PROXMIRE. I think that is a very significant point.

Mr. ZWICK. Outside of Ex-Im and Defense, you will find, (a) that total payments are up somewhat from what they were in 1964; and (b) receipts are up by more.

Chairman PROXMIRE. And enough so that you are in surplus in the Government account outside of military?

Mr. ZWICK. Before these recent actions it was just about in balance. And with these recent actions it should go into surplus by a small amount.

I am not promising you any large surpluses.

Chairman PROXMIRE. Then you said in answer to Senator Talmadge that it was better in your view to have a surtax increase than the travel tax, and then you would not have to have that travel tax; is that correct?

Mr. ZWICK. No; I am not saying that. I am saying that as of the moment we need a number of actions to correct our balance-of-payments posture. Hopefully we will take those actions. The most important of those actions, we have said—and this is just repeating what has been said by the administration before—are to get our domestic economy into shape. And that requires the surcharge.

Chairman PROXMIRE. So you are going to have to have both the surcharge and the travel tax. And the travel tax and surcharge would coincide during 1969; you would have them both in effect?

Mr. ZWICK. That is right.

Chairman PROXMIRE. If you pass the surcharge, we should not repeal the travel tax?

Mr. ZWICK. That is right. If we had had the surcharge earlier who knows what would have happened?

Chairman PROXMIRE. I do not want to spend much time on this next point, but I do want to raise it, and you may want to respond briefly to it.

It seems that every time you ask any administration witness how to solve any economic policy problem these days they always answer: the surtax. This is supposed to balance the budget, stop inflation, reduce interest rates, stimulate home buying, expand the economy, and solve the balance-of-payments problem.

Let me just deal briefly with this last one, solve the balance-of-payments problem. Maybe in the long run the surtax may make a contribution. But, the most immediate contribution, it would seem to me, would have to be through reducing the level of imports. We will come to exports later.

As to reducing the level of imports, if it is going to reduce the level of imports it cannot do it very much. The Chairman of the Council of Economic Advisers advised me by letter that this would only reduce the GNP by $7 billion this year, which is 1 percent. Reduce the GNP by 1 percent, how much would it reduce imports? It would reduce imports, maybe, by 2 percent. What kind of a contribution is this to solving the balance-of-payments problem?

Mr. ZWICK. The thing is, you want to stimulate exports, you want to get the exports up, and you want to drop on the import side.

Let me make two comments. The mix of GNP is not irrelevant here. If we are going to get some stability through a very hard crunch on the monetary side, and take it out of the homebuilding sector primarily, that is not an import-heavy sector of the economy. So, I think the imbalance that you are going to get, if you try to stabilize through the monetary route by cutting back on homebuilding while other sectors boom, is something that will hurt you in terms of this import elastic issue that you are raising. I think there is a question of what the overall level of GNP is, and then what the composition is in terms of imports.

You are correct, most people just look at the change in GNP.

Chairman PROXMIRE. Yes; but we get our increase in exports when our industries fail to increase prices or reduce their prices. I cannot believe that steel is going to reduce price or fail to increase its price because the GNP drops a little, or because we have a tax surcharge. If their taxes go up, their costs go up. I cannot see them reducing their price. I cannot see automobile manufacturers doing it. It is hard to see any industry where you are going to get a price cut or slowing down of price increases, because of the surtax. Maybe you will.

Mr. ZWICK. If you look at 1966, did not Chairman Ackley send up to you in his letter—I have it here—what happened to imports during 1966, when we had huge backlogs in our production processes? It was clearly reflected in increased imports, there were delays of shipments, and so forth.

So, I think imports are sensitive to the general state of the various sectors in the economy.

Chairman PROXMIRE. As far as exports are concerned, you also have this serious problem, because once again you would have to become more competitive. That is a long, long road via tax policy. So, what you have to do is to create a sufficient slack in the economy so that our prices do not go up as much. That takes some time. And you know prices are pretty stubborn. And price momentum is hard to arrest. And then you have to proceed along that line to be more competitive. It seems to me that this is asking a lot of a surtax, to accomplish all these things. And I think, especially, it is weak in the balance-of-payments area.

Mr. ZWICK. I will make two comments. I think I basically agree with your point that this is a long-term problem of competitiveness of U.S. production. And that is what we are interested in. But, certainly, there are shortrun implications, too. I do not have the statistics on the balance of payments with me, but if you look at what happened in 1966, when we really started charging ahead at the rate we did in 1966, imports shot up and exports fell off. It was just what you would expect, considering the availability of goods and materials. We could not meet the total demand domestically, orders and backlogs built up, and we went to foreign sources just because we needed them. And, so, while it is basically a longrun issue, there are also shortrun problems involved.

Chairman PROXMIRE. Of course, if it is availability, once again these things are so complicated. Because, as you see, one of the things the surtax is supposed to do is stimulate homebuilding, construction and—we use more steel and we have more imports.

Mr. ZWICK. No; the homebuilding sector has a low import rate.

Chairman PROXMIRE. Not only homebuilding, but construction by State and local government. Reduction in interest rates will be a general stimulation to construction, which could have a countervailing effect on the balance of payments by increasing imports.

Mr. ZWICK. To the extent it stimulates GNP, it stimulates imports.

Chairman PROXMIRE. Not only that, it has a specific effect in an area, steel, where we already have importing problems.

Mr. ZWICK. I am saying that, for any level of GNP, with a more balanced growth in the economy you will have less imports than one in which you get growth by really pushing down very hard on the homebuilding industry and——

Chairman PROXMIRE. It depends on where your balance comes from. If your balance comes from an industry which uses imported materials, then I think that you perhaps worsen the balance of payments.

Mr. ZWICK. If you need restraint, and we think you need restraint, and you do not do it through fiscal policy, and you, therefore, do it through monetary policy, that is going to change the composition of GNP in a way which encourages more imports than if you do it through fiscal policy. It is a complicated argument, but I think it is correct.

Chairman PROXMIRE. Let me get into the main thrust of what I am interested in this morning. And that is the failure of the administration and the executive branch of the Government to proceed with an effective planning-programing-budgeting operation of a kind that would enable both the administration and the Congress to be in a position to evaluate these programs, and specially these investment programs that constitute such a big part of our appropriation.

We had a study by the Comptroller General and he was most unhappy about the failure of the various administration agencies, in some case, to use discounting techniques at all. If you are going to evaluate a program as to its benefits and costs, you have to discount the value of the benefits, because they are going to be received in the future. A benefit received 5 years from now is more valuable than a benefit received 10 years from now, or a benefit received 15 years from now, or a benefit received 20 years from now. So, you have to get some kind of a discount factor to evaluate that benefit.

What I pointed out was that the Defense Department uses discounting techniques extensively and a 10-percent discount factor, with one exception, they discriminate for the Corps of Engineers by using only a 3-percent discount, which means that we have a great stimulation of public works that cannot be justified.

He pointed out further—and Mr. Rathbun of GAO said that this made discounting almost useless for the rest of the Government—that there are such variations in the percentage used, in some cases 3 percent, some cases 10 percent, 12 percent, that it is very, very hard for the President and the Budget Bureau, let alone the Congress, to evaluate those programs. And the most shocking of all, I have a list here of agencies, including the Department of Housing, the Federal Communications Commission, the Department of Commerce, the Veterans' Administration, and the Post Office Department, which make great investments, and they have not used the discount technique in any of their investments for this 1969 budget. In some cases they do not intend to use it at all in the future.

Under these circumstances, it seems to me that it is very difficult for the Congress to be in a position to evaluate the public works programs, the investment programs intelligently. And, I do not see how you, as Budget Director, can really be in a very strong position to assess what programs should go ahead and what programs should not.

Mr. ZWICK. You have raised a whole series of issues, Mr. Chairman. Let me sort of tick them off.

First, let me say, I have to disagree most completely with your statement that we failed to develop a useful planning-programing-budgeting system. We are working at it. It is not all we would like it to be. We think we have made significant progress, and we will continue to work on it, and we can come back to this organization of PPBS at a later date.

On the whole question of discounting—I have sympathy with part of your comments. As you recognize, in this budget, we state that we are moving to a new way of calculating interest rates on water resources using average estimated current yield on Treasury long-term borrowing rather than the coupon rate. Now, that is a major reform——

Chairman PROXMIRE. You say you intend to in the future. That is very good. I am delighted to see it. But it is only a small step.

Mr. ZWICK. There are two more points I will make on this. One of the problems has been that Congress has to a large extent insisted on putting interest rates into evaluation procedures.

Chairman PROXMIRE. That is right. And it takes a real battle on the part of the President to help those of us who would like to equalize it to get it done.

Mr. ZWICK. That is right. We are moving in terms of this reform, and if we can get this one, we will take the next step. We agree with you.

The third point I would make, though, and I move into this fairly cautiously, because I am not on top of the current dialog you have just had on discounting—I realize that has been underway and is going on, and I have not been able to read all of your testimony—but some of this great enthusiasm, I think, has somewhat lost touch with the facts in the situation.

Let me give you an example. The theory of this is associated with discounting necessary benefits. When we have an income stream or benefits through time, those benefits, discounting them to present value—in many Government programs you cannot quantify benefits in a dollar sense, but you can get—let me give you an example——

Chairman PROXMIRE. Not one single investment program by Housing or by the Post Office Department or the Treasury or the Department of Commerce, none of them are discounted. They just do not use the technique. In some cases they intend to use it in the future, but in some cases they do not intend to use it at all. This is the Comptroller General's reports.

Mr. ZWICK. They do not use it, but certainly when we evaluate investment decisions we go through, in our evaluation process, a calculation which discounts——

Chairman PROXMIRE. That is right. But the difficulty is that it is not uniform, it is not based on an agreed-upon discounting technique. So, there is no basis for a comparison, so that Congress and the administration is in a position to make objective, intelligent determinations of how we spend our money, and how we invest our appropriations.

Mr. ZWICK. I do not want to claim too much in this area, Senator, but I do want to claim more than you are giving us.

Chairman PROXMIRE. I do not say you are not making progress, but it is way too slow.

Mr. ZWICK. We do try to apply these uniform views and arguments. For example, in the case of section 7 of the Department of Transportation Act, which says that navigation projects should be evaluated by using current freight rates, we think costs should be used instead. And we said, all right, Congress can tell us how they want programs evaluated, but we will make our own judgment as to the practicality of a project, and we will use the relevant data as we see them, in making an Executive Office determination. We have moved some in this direction.

I do not want to disagree with the main thrust of your argument, that there is much more we can do in this area, and we ought to be moving jointly with the Congress as quickly as we can. But have taken what we think is an important step in the water resources area, and we hope we get support for it this year.

Chairman PROXMIRE. Let me observe, however, that it is going to be very hard for Congress and the President to exert any kind of rational determination, any kind of efficiency, if we do not get this kind of return. Any successful business must know what kind of return it is going to get when it invests money. And every successful business that I know anything about does get it. So, it is high time the Government began to do it. And I think nothing would help our human resources programs more than this. Because I think there is a terrific payoff in human resource programs. Everything I have seen indicates that when you invest in human beings, and more education, better training, and so forth, you get a terrific return. For some of these buildings and roads, and so forth—the buildings in some of these big projects—I think the case is very weak, and I think objective criteria would help us greatly in determining our priorities more accurately.

Mr. ZWICK. Again, I use my own word "begin." I think we have made a beginning and we will keep trying. In the end, the proof is in the pudding. And when you look at investment, you can see that this administration has made a major shift in investment from physical structures into investment in human beings. You cannot look at the aggregate statistics and say we have not been moving in the direction which you apparently think is the right direction. You might argue that we have not moved quickly enough in that direction. But, certainly, the dramatic increase in investment programs in human resources as compared to physical resources is clear on the record as far as this administration is concerned.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Dr. Zwick, I have this one question to ask you. You say that we can order the priorities if we desire to. But isn't it a fact that the President, with your office as his arm, does not necessarily spend money that we appropriate for given purposes, that he can just sit on it? Isn't that a problem which we face? And are you prepared to give us any assurances on the score that if we change the priorities the President will follow?

Mr. ZWICK. Senator, as you are well aware, this is clearly a limited power that the President has, and has been the subject of a dialog over a period of years.

First, as to whether there is discretion, the answer for some programs, is "No." If they have an automatic formula, a matching formula, there we have no discretion whatsoever. If the Congress enacts that type of law, we have to make the payments.

In other areas, we have some discretion, and we have exercised it from time to time. And from time to time Congress has in mind that we have exercised it, and has developed techniques for writing provisions into the appropriation language that limit our flexibility.

So there is some room here for disagreement between the Executive and the Congress, but this is limited in a practical sense. And every time we stray too far from what Congress intended we hear about it fairly quickly.

Senator JAVITS. The other question I would like to ask you relates to the discussion about troops in Europe. And, of course, that, too, relates to the order of priorities which we have been discussing. But I notice that if you look at the Economic Report of the President, page 306, there is a table on the balance of payments. You will see the adverse item under "Military Expenditures for 1967, $4,249,000,000." Now, can you tell us, in this debate which you are having with my colleagues, and in which I join, if our right to reduce those troops is a very important possibility for cutting both our budget and our international imbalance of payments? What is the breakdown? What is the significance of such a large amount as it is shown there?

Mr. ZWICK. First, let me point out that to get the net impact of the military you ought to subtract all the military sales, the $1,173 million also on that table.

Senator JAVITS. I agree with you.

Mr. ZWICK. But you still have about two and a half billion——

Senator JAVITS. 3 billion.

Mr. ZWICK. 3 billion, I am sorry.

Now, what was the second part of your question?

Senator JAVITS. I am asking as to the significance of that.

Mr. ZWICK. It is a major foreign policy obligation that this country has taken on. And I think we have to view it in terms of the foreign policy implications. If we want to withdraw from that obligation, I think we have to make that determination. And the point I made earlier, I think, to Senator Percy is that this a long-term policy determination that the Executive and the Congress should address on its merits, not as a temporary relief measure for a temporary balance-of-payments problem.

Senator JAVITS. I don't think you are answering my question. What I am looking for is the breakdown; what does that figure cover, that net figure?

Mr. ZWICK. What is involved in that?

Senator JAVITS. Yes.

Mr. ZWICK. We could give you that in terms of offshore procurement, personnel stationed overseas, and that sort of thing.

Senator JAVITS. And where, so that we will be able to make——

Mr. ZWICK. Type of object and geographic location.

(The following was provided for the record later:)

The military expenditure figure of $4,249 million which appears on page 306 of the Economic Report is an estimate reflecting the average for the first 3 quarters of calendar year 1967 on a seasonally adjusted rates basis. Actual fiscal year 1967 military expenditures entering the balance of payments transactions accounts were $4,037 million. The following table shows these transactions by area and category:

U.S. Defense expenditures entering the international balance of payments

[International transactions basis; fiscal year 1967, in millions of dollars]

AREA	
Western Europe	$1,529
Canada	215
Japan	532
Other countries	1,761
Worldwide	4,037
CATEGORY	
U.S. Forces:	
Expenditures by U.S. military, civilians, and dependents	$1,256
Foreign nationals (direct hire and contract hire)	525
Major equipment	146
Construction	396
Materials and supplies (including petroleum, oil, and lubricants)	642
Operation and maintenance (other)	695
Other payments	223
Military assistance program: (including NATO infrastructure)	126
Other expenditures (AEC and other agencies included in NATO definition of defense expenditures)	28
Total expenditures	4,037

Senator JAVITS. Now, the other thing I would like to ask you is this. We had a great debate here yesterday about this tax surcharge, whether it was a war tax or whether it was not. And I would like to call your attention to three statements of your own which seem to point in different directions. You say: "The revenue yield of the proposed surcharge and corporation tax acceleration will, therefore, be applied entirely toward reducing the budget deficit, not toward covering the added outlays, including those for Vietnam."

Then you reiterate the same point you say: "To highlight the temporary nature of the need for tax surcharge, let me point out that our special outlays for Vietnam come to about 3 percent of the gross national product."

But then you go on on and say: "This is another indication that the added taxes will not be needed once peace is attained in Vietnam."

And finally you say: "To sum up, the 1969 budget requests a temporary and modest tax increase to help pay the cost of Vietnam responsibility."

And you finally pay that off at the very end of the document with, speaking of the tax increase, by saying: "* * * is the most equitable way to finance the added cost of Vietnam."

Which is correct, when you say that this money is going to be applied toward reducing the budget deficit it would not cover the added outlays, including those for Vietnam, or all these other statements? Because this is essentially a Vietnam tax surcharge.

Mr. ZWICK. Sir. I think it depends on which way you approach this. I think it would be a mistake to argue that it is only because of Vietnam that you need the surcharge. It is quite clear, Vietnam is only 3 percent of gross national product. The President stated in his message, and I reiterated at the beginning of this session, that we think that there are other things that this country has to do. And when you take them in combination, the things you have to do domestically and internationally, you get this deficit, which is inappropriate, given the size of the rate of growth in the economy anyway and the size of the private sector, the strength in the private sector, is what I am trying to say.

Therefore, when you start allocating the tax for Vietnam, or for the domestic programs that are normal, we have in this testimony said the normal growth in revenues would be $11½ billion. Total expenditures are up $10.4 billion, so that the normal growth in revenues more than covers the $10.4 billion of higher expenditures. And, therefore, the whole tax increase goes for reducing the deficit.

Congressman Byrnes said to us the other day, "No, it is just the other way around, the $11.5 billion normal growth is going for reducing the deficit, and the taxes are for paying for the increased expenditures." Now, you can play with these numbers in different ways. I think you have got to look at the aggregate program, which includes both domestic and military, and specially Vietnam. And that adds up to total Federal outlays of $186.1 billion. Then you have to look at the revenues that you are going to get without a tax increase. And this gives you a deficit which we think, is clearly not good policy, and, therefore, we have proposed a tax increase.

Now, we can allocate the tax increase to the war, or to reducing the deficit, or to paying for the domestic programs, or any way you want to do your accounting. But the simple fact, I think, is still that the total outlays are what the President is recommending, and they require some additional financing.

Now, you may argue that if you presented it one way would be more acceptable than the other, and I would not disagree with that.

Senator Javits. I am not trying to argue, I am just taking your word for it. You say "Requests for temporary and modest tax increase to help pay the cost of Vietnam responsibility." You say that once the peace is attained in Vietnam that the added tax will not be needed.

These are quotes from you, I did not say that, you did. And Dr. Ackley testified that in the absence of Vietnam there would not be a request for *x* increase. What are these inconsistencies?

Mr. Zwick. I stand by all these statements. I do now know what I am inconsistent in.

Senator Javits. We are not quibbling with words, and we are not trying to put the administration on the spot. But it is one thing to come to the American people and say, we need a 10-percent-tax surcharge, there is a war, we have got to have this to pay the cost of the war. And it is another thing to come to the American people and get a lot of argument about the fact that we are doing this to reduce demand, because we are in an inflationary situation.

And that is what we are trying to pinpoint. We should pay a 10 percent or $12,900 million, roughly, because we are in a war in Vietnam, and you have got to pay for it. On this basis I think you are going to get your tax surcharge. But if you people are going to fool around with the idea, "well, there isn't really a war that makes us have a tax surcharge, it is not really all that serious, but we need it to reduce demand and for other economic reasons," I think you are going to have a lot of trouble. And I think the administration is again causing itself a major difficulty.

That is the whole point of my questioning, yesterday and today. What about it? If there is a war and you need the money for the war, I think you are going to get it. If you fellows would stand up for that instead of being ambivalent about it, I think you would get it. But, if you are going to be ambivalent about it and say it is to reduce demand or some other economic reason, a lot of people are going to argue with you; they think they know better about demand.

There is no patriotism particularly involved in economic theories or principles. And that is why I pressed the point, and think others have.

Mr. ZWICK. I think, Senator, that the most definitive statement on this is obviously the President's statement. On page 8 of the budget he said:

> Even after a rigorous screening of priorities, however, the cost of meeting our most pressing defense and civilian requirements cannot be responsibly financed without a temporary tax increase.

Now, you can allocate the tax increase for war, but we do have civilian needs also—what I quoted is on page 8 if you are looking for it, the third paragraph.

Senator JAVITS. On page 12 of his message he says:

> It is not rise in regular budget outgrowth which requires a tax increase, but the cost of Vietnam.

You cannot make it any flatter than that. And, yet, when you get here to testify, you always fuzz it up with this business about decreasing demand, and so on.

And I think you are causing yourself a lot of trouble from the point of view of foreign policy, too, Dr. Zwick. This argument about withdrawing troops from Germany is a tricky one. Maybe we can withdraw more, and leave 185,000; I rather think we can. But, the basic principle is a very serious one as far as the Russians are concerned, who get great assurance from the fact that we have troops in Germany, and who are scared to death of Germany, which is a serious matter. I think it is causing a lot of misery. I hope when you go back you will tell your colleagues that the Senate, or at least this Senator, thinks that they ought to be forthright about that as the President seems to intend. But, when we get you fellows up here, it does not look like it. And I think you will get a lot further.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Dr. Zwick, when we take into account that it is not at all assured that the administration is going to get the full amount of the tax increase asked for, and when we take into account that there is a strong likelihood that you would not get all of the cuts that you have scheduled in the budgeting plan; when we also take into account the Korean offensive and the fact that the South Koreans have talked about our stepping up military support for them, and possibly even withdrawing 45,000 troops from South Vietnam, or part of them; and when we take into account the enemy action in Vietnam, it would appear to me that even though the ink is hardly dry on this budget, it is very much an obsolete budget right now, and a lot more work has to be done on it. Is that your own conclusion at this point?

Mr. ZWICK. No, sir; I make two comments. First, regarding the decisions to date, the callup of 14,000 reservists—I have not seen the exact figure, but it will be about $120 million, which is not in the budget. So, in that sense, this budget is obsolete.

Senator PERCY. That figure, the Reserve callup is not in this budget?

Mr. ZWICK. That is right; it is not in this budget.

However, I think the second point is that, given those facts that you have just ticked off, as I said to Mr. Moorhead, earlier, it is our best forecast that with this budget, this fiscal policy, this tax increase, we will come out of calendar 1968 in a reasonably good fashion. It seems to me the risks are obviously in the direction that things could get worse, and we should, therefore, go forward with the tax increase rather than thinking that things are going to get much better around the world or that we are going to be able to cut spending greatly, and so forth.

I come out of that sort of analysis feeling even more strongly about the need for the tax increase.

Senator PERCY. Do you see any indications that the 14,000 men recently called up, are going to be sent back to civilian life in the very near future, so that they would not have to be budgeted in 1969? In this budget you have a drop of 28,000 Army military personnel, and 16,000 Air Force military personnel? Do you really feel that this can be accomplished, in view of the necessity of maintaining your military capabilities with the increasing tensions? That is a pretty substantial drop—28,000 Army, plus 16,000 men in the Air Force.

Mr. ZWICK. Again, with respect to the initial callup of 14,000, we will have to make a determination at some point whether or not we can defer or slow down other programs and absorb the $120 million that is involved here. While we have not made that determination, one possibility would be that we could find ways of meeting these costs within the existing budget. You are certainly right that we are entering a period of great uncertainty. And it seems to me that prudence argues for being prepared to absorb additional costs if necessary.

(The following was later inserted for the record:)

While total *year-end* strength on June 30, 1969 is estimated to be 28,000 lower for the Army and 16,000 lower for the Air Force—than on June 30, 1968—Navy and Marine Corps forces are expected to be higher by 27,000 and 4,000 respectively. *Average* FY 1969 strength levels for the Army, Navy, and Marine Corps, compared with FY 1968, are estimated to increase by 23,872, 25,741, and 16,929. Air Force average strength is expected to decline by 13,848.

Senator PERCY. The gross Federal debt, if these figures are right, will increase next year by $17.2 billion; that is, $12 billion is Treasury debt, and $4.6 billion agency debt. And yet the deficit that is most frequently referred to is shown as $8 billion. And in addition to this amount, the Federal agencies and trust funds will increase their Federal debt holding by $9.2 billion. Why isn't this amount included as part of the deficit?

Mr. ZWICK. You are looking at the material on page 23 of the Budget, sir? I want to be sure you are using the new concept of debt. On the new budget format there is a new definition of debt which is inconsistent with the definition now used by Congress and the Ways and Means Committee.

We are showing that the total financing from the public goes up by exactly the same amount as the deficit and the debt held by the public—$8 billion. If you look at the table, borrowing from the public is up $8 billion, and the deficit is $8 billion. The gross debt, however, includes a lot of debt not affecting the public. Most of this is general fund borrowing from the trust funds. As you know, this year's budget consolidates the trust funds and the Federal fund outlays. The trust funds are estimated to have a $7.4 billion surplus.

So you are getting a significant amount of funding through the sale of notes to those funds. Is that the point you are picking up? The $8 billion deficit in this particular case happens to coincide exactly with the $8 billion of borrowing from the public. That does not necessarily have to be a 1-for-1 relationship; changes in cash balances, seigniorage, or other factors can affect it. What you are having is a transfer of borrowing from trust funds to pay for other programs within the total.

This has caused a certain amount of consternation about the new concepts. But the trust funds exist as they always have legally, and those funds are available for their own specific purposes and those purposes only. When they have surplus positions they have always invested either in agency paper or Treasury notes, and have earned interest on those investments as any private trust fund would. The new format obscures this a little bit, but the trust funds are there, and they have not been violated. And we are borrowing from them in the same way as we did in the past. It just shows up differently in the summary presentations.

Senator PERCY. I would like to send the question over so that it can be studied, and so that I can understand better the new accounting. I think, though, that your attempt to put together the 1969 budget in its new format is a herculean effort. I do not know how you did it. It is a commendable task. And I think as we understand it better, it is going to be a great deal easier to work with.

I would like once again to commend David Kennedy, a distinguished citizen of Chicago, the Chairman of the President's Commission on Budget Concepts, for the fine report the Commission issued.

(In further response to Senator Percy's question on the debt, the following information has been supplied by the Budget Bureau:)

Bridge from budget deficit to gross Federal debt, estimated 1969

	In millions of dollars
Budget deficit: The estimated difference between receipts of all funds from the public, $178,108 million, and the expenditures and net lending of all funds to the public, $186,062 million	7,954
Seigniorage, changes in cash, etc.: Consists of $226 million of seigniorage, less increase of $272 million in net available cash (cash less checks outstanding and deposit fund liabilities	46
Borrowing from the public: The net debt to the public is estimated to rise from $290 billion to $298 billion	8,000
Borrowing from trust funds: The trust funds invest their surplus cash in Government securities. In 1969 they are expected to receive $7,370 more than they spend, in total. However, within that total, some funds will be drawing down working balances, some will be borrowing, and others will accumulate even more than can be invested. Their net investments in public debt and in agency debt issued by Federal funds is estimated at	8,641
Borrowing among Federal funds: Some public enterprise funds (mainly, wholly owned Government corporations) also accumulate reserves which are invested in U.S. securities. An example is the Federal Savings & Loan Insurance Corporation. Federal Housing Administration funds buy some securities issued by other FHA funds. The net borrowing of Federal funds from Federal funds is	631
Borrowing among trust funds: Some trust funds borrow from others. For example, the civil service retirement and disability fund has some investments currently in debentures of the Federal intermediate credit banks (a trust revolving fund. In 1969 these trust holdings of trust debt issuances are expected to decline slightly	—100
Equals: increase in gross Federal debt from $369,993 million to $387,167 million, an increase of	17,174

It may be noted that the gross Federal debt is a concept of limited value—mainly for accounting control—since it includes debt between funds (including debt of trust funds to other trust funds, neither guaranteed by the Government nor entering into the transactions of the Government with the public).

Senator PERCY. I have no further questions, Mr. Chairman, other than to say that we will certainly enjoy working with Dr. Zwick.

You have taken on a tough job, and tried to be as helpful as you possibly can. The intention of our questions is to point out the areas we are skeptical of. I think we will sit in the room a year from now, and I think we will find that the deficit will be closer to $20 billion to $25 billion than the $8 billion forecast by the administration. I am very fearful of the consequences in terms of loss of confidence of the people abroad in the dollar. All of us in Congress have a tremendous task ahead of us to try to get this budget down, to cut back the constant appropriation of funds that we simply do not have, and to see if we cannot live as a nation within our means. That is a tremendous task.

Mr. ZWICK. Thank you very much for the kind words. And I hope your forecast about the deficit is wrong.

Senator PERCY. I hope so, too.

Chairman PROXMIRE. Apropos of making that forecast, which I am sure all of us would like to. And in connection with living within our means, I think one very big step that would help us a lot, or help this Senator a great deal, would be to give us your calculation—if you cannot do it we would like for you to tell us what agencies can do it—of the return on the investment program of each of these agencies. I know it is big, and I know some of them have not even computed their benefits, or their costs. But to the extent that it is available, I would like to get it on a constant discount factor. I would like it done on three rates. It is nothing that would take a great deal of time if you just take the big programs. I would like it on a 5-percent basis, which is the cost of the money to the Treasury, currently, and 7½ percent, which is the effective cost; that is, if we allow for the fact that corporate income tax is forgone. I would like it on the 12 percent, which, as I understand, a rate of return is presumed to apply in private industries. Now, if we had that—and I would like it for not just the newer programs, but for the on-going programs—I think we might be in a position to make a real fight in the Congress this year by showing that many of these programs are going to cost a lot more than their benefits. I think that there are billions of dollars in public works that should not have been expended in the past. You may make a case, but since we have already gone a third of the way or a quarter of the way, or two-thirds of the way, we ought to continue. And, I think, if we got this kind of information now, it would be very helpful, and we would be in a very strong position to make a fight for consistent discounting in the future.

Every time these things come before the Appropriations Committee, of which I am a member, I can raise the point that the payoff is less than it should be, that we are losing money. And every time it comes to the floor of the Senate we can make the same kind of fight. We cannot do that unless we get this kind of information. And, I hope, in the future, we can get these agencies that say they do not intend to use discounting at any time to recognize that this is unfair to the President, the Budget Bureau, and the Congress.

Mr. Zwick. Let me just be sure that we are talking about the same thing. We can discount costs of programs. I started to make the point earlier, and I guess I never did finish it——

Chairman Proxmire. I am talking about cost of investment programs.

Mr. Zwick. The cost of investment programs usually can be identified without too much difficulty, and, therefore, can be discounted. But the calculation and discounting of benefit streams is a much more complicated problem.

Chairman Proxmire. Of course, everything depends on your assumptions. They have to be explicit and clear. But I would certainly accept your assumptions in the overwhelming majority of cases, so long as we have something to sink our teeth into and fight for.

Mr. Zwick. I repeat, I am not too much for this whole discounting argument, so I will be a little careful here. But, my impression, in reading some of this is that there has been an oversimplification of what can be done.

Take the case of improving the servicing of social security payments—investment programs in the Social Security Administration. One might be a central computer center, and another would be a large number of small neighborhood service stations. There are many different ways to improve service. And say that my best guess is that they will improve service equally. But we know pretty accurately what it is going to cost to put in a computer center. In the case of the small stations we do not know what the costs of going out into the various neighborhoods are; one is more uncertain than the other. If we use your rule and discount more heavily the more uncertain effort, when you have two programs that give you the same benefit streams, you will tend to choose the one which has the more heavily discounted value, and, therefore, the riskier one.

Chairman Proxmire. In some cases you cannot do this, of course. But I do think that an effort to do it would greatly enhance efficiency. Because it would force you to consider what your benefits are, to think deeply about your costs. It would put you in a good position where you would do your best to keep your costs down, and also put you in a position where your decisions would be much more informed and objective. And I think it would be a great rule.

Mr. Zwick. I agree completely with the gentleman's thinking.

Chairman Proxmire. Mr. Zwick, I want to say that I am tremendously impressed. And I spoke to Congressman Bolling and other members of the committee while you were testifying. I think you have done an excellent job. And I am happy that the Budget Bureau has come up with a man of such competence and ability. Because you have one of the most difficult jobs in the Federal Government.

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

(Whereupon, at 12:30 p.m. the committee was recessed, to reconvene at 10 a.m., Wednesday, Feb. 7, 1968.)

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 7, 1968

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

The committee met at 10 a.m., pursuant to notice, in room S–228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Javits, Jordan, and Percy; and Representative Brock.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

Secretary Samuels will proceed. Other Senators and Congressmen will be in as time goes on; that is the way these proceedings operate.

For the third consecutive day we welcome a newly oppointed official of the administration. I believe this is the first time you have appeared before this committee. You have a splendid reputation, not only in New York, but all over the country, as a man of ability and energy and dedication. We are delighted to have you as a witness this morning.

So, you may proceed.

STATEMENT OF HON. HOWARD J. SAMUELS, ACTING SECRETARY OF COMMERCE, ACCOMPANIED BY WILLIAM J. CHARTENER, ASSISTANT SECRETARY OF COMMERCE FOR ECONOMIC AFFAIRS; LAWRENCE E. McQUADE, ASSISTANT SECRETARY OF COMMERCE FOR DOMESTIC AND INTERNATIONAL BUSINESS; JOSEPH BARTLETT, GENERAL COUNSEL, DEPARTMENT OF COMMERCE; WILLIAM H. SHAW, SPECIAL CONSULTANT TO THE SECRETARY; GERALD A. POLLACK, DEPUTY ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS; EDWARD K. SMITH, DEPUTY ASSISTANT SECRETARY FOR ECONOMIC POLICY; LOUIS PARADISO, ASSOCIATE DIRECTOR, OFFICE OF BUSINESS ECONOMICS; JULIUS SHISKIN, CHIEF ECONOMIC STATISTICIAN, BUREAU OF THE CENSUS; AND MAYNARD S. COMIEZ, SENIOR ECONOMIST, OFFICE OF ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS

Mr. SAMUELS. Thank you very much, Senator.

I would like to say that I regret the circumstances that make it impossible for Secretary Trowbridge to be here. But I would like to report to the committee that he is well on the road to recovery and will be back in a week or 10 days and raring to get back to work.

Chairman PROXMIRE. That is good news.

Mr. SAMUELS. I wrote the Secretary that if he did not come back soon I might have to take a bed close to him.

I would like to take this opportunity to introduce some of my associates here. I think one of the most encouraging findings in my 3 months in Washington is the caliber of public servants we have in the Commerce Department and the contribution that they make in every part of the country. We have with us, today, our new public servant, William J. Chartener, who is the new Assistant Secretary for Economic Affairs. He comes from one of our prestigious New York investment houses, and is an outstanding economist. We are very pleased to have Bill here.

Next to Bill Chartener is William H. Shaw, who was our Assistant Secretary for Economic Affairs, and has gone back to the private sector. But in order to help Bill Chartener and myself, he has come back and agreed to give us 30 days of additional service. We are indebted to him.

On my right is Gerald A. Pollack, Deputy Assistant Secretary for Economic Affairs. Jerry is an expert in international trade and finance.

And Lawrence E. McQuade, who is our Assistant Secretary for Domestic and International Business, who, I am sure, will be pleased to answer export questions that may come up during the testimony.

Behind me are other associates of the Department: Ed Smith, who is the leading expert in our Department on fiscal policy and economic development.

Louis Paradiso, who is considered one of the outstanding experts in the country on general business conditions.

Julius Shiskin, who is a great promoter of economic indicators. If the committee has any questions on economic indicators, he is ready to answer them.

And Maynard Comiez, who is our expert on public finance.

And we also have with us Joe Bartlett, who is our general counsel, and who is serving as the Acting Director of the Office of Foreign Direct Investment.

So, if questions come up on this program, we have people available for you, Senator.

The President's Economic Report makes it abundantly clear that this is a critical year in our Nation's history with respect to both domestic and foreign developments Rather than duplicate what is already well covered in the Economic Report and testimony you have already received, I propose to deal selectively with a few major issues of special interest to the Department of Commerce.

At the outset, I should like to say a few words about the most recent economic developments. I should also like to present a brief comment on several aspects of the domestic economic picture which are of concern to all of us.

Our economy at the present time, February 1968, is forging ahead at a strong pace. Incomes of individuals and corporations are expanding. Steel production is climbing and order books of steel firms are being rapidly filled. Automobile production is at the best rate in over a year. Residential construction is headed upward. Retail sales appear to have made a strong showing in January and personal income is continuing strongly upward. And, this month, with the increase in the minimum wage, and the higher social insurance benefits which will come in March, we will increase our income flow by about $5 billion at an annual rate. And this will only be offset by $2 billion in employer and employee social insurance contributions. I think that most of this $3 billion in an additional income which comes from these two areas will be spent, and we can expect a large increase in retail sales in the coming months.

In summation, I think the point that we want to make is that all of these factors point to a very sizable gain in income and employment in the year 1968.

I would like to talk next about what I consider one of the most serious problems in America today, wage-price pressures. As a businessman, I know that profits are the lifeblood of any company. They enable a firm to grow, modernize, launch new products, employ more people, and expand into new markets. Consequently, I am concerned when I see a deterioration in corporate profits or when their value is eroded by inflation.

In 1966 corporate profits before taxes were at a record high of $83.8 billion. They had been rising along with the growth of the economy since 1960. With moderation of the pace of economic activity in 1967, however, corporate profits deteriorated to $80.1 billion, a decline of 4.4 percent. In contrast, the national income in 1967 increased 5.3 percent. The reduction in profits was not due entirely to the loss of business momentum. A large part of the decline may be explained by the strong steady rise in unit labor costs in 1967 resulting from wage rate increases which far exceeded productivity gains.

In manufacturing industries, for example, the 1967 unit labor costs were 5 percent higher than in 1966, in sharp contrast to the years 1960 to 1965 when unit labor costs were relatively unchanged. During these years, wage-rate increases were about equal to productivity gains, and with expanding sales and employment, both wages and profits grew as the economy expanded. So, what we have, Senator, is an entirely new situation facing us, which started really in the middle of 1966; and that is the tremendous pressure of rising unit labor costs.

It seems quite obvious to me that, based on labor contracts which are being written today, new wage settlement patterns are going to be very difficult to reverse. The settlements are much greater than productivity increases warrant. Collective bargaining settlements in 1967 averaged about 5.5 percent, while in the manufacturing sector the rise in output per man-hour was only 1 percent. If we conclude, as I have that such settlements can't generally be absorbed by U.S. industry, we face a dangerous inflationary pattern. I might say, Senator, that if you look at the settlements that are being discussed now in the early part of this year, it is not at all illogical that we could expect wage settlement patterns of 6 percent and possibly as high as 6½ percent.

The Economic Report points out clearly that until 1966 America had performed much better than most nations in the world with respect to price stability. It is also important to recognize that no developed nation in history has been able to maintain full employment and an acceptable level of price change. I do not think that this country wants to accept what has happened in some of the other nations, where 6 to 7 percent unemployment serves as a means of arresting inflation.

How to achieve full employment without runaway inflation is the greatest challenge to the American economy in 1968. In my opinion, there is no more serious economic problem facing this Nation today. We must find the answer and certainly none of us want to find the answer, nor do we believe the answer can be found, in wage and price controls.

But today we are faced with another inflationary factor. In addition to the large increases in unit labor cost, excess demand could put further pressure on prices in 1968. Without an appropriate policy mix, the prospects are likely that in 1968 there will be increased consumer spending, a new surge in capital outlays and rising inventory accumulation, culminating in excessive demand throughout the economy.

Today, our economy is already operating at relatively full resource utilization. This limits our ability to increase output to meet the growth in demand. Any excessive demand stemming from the continued growth in income flows will more likely be translated into higher prices than increased output of goods and services.

So we have a variety of very complex problems. The problem of reconciling these things together is our challenge. The reconciling of the problems of wage price pressures, the pressures of corporate profits, excessive demand, and the need to increase productivity, all require immediate attention. The President in his Economic Report has clearly outlined the essential elements necessary to reconcile these areas of conflict in order to assure a continuation of economic growth and prosperity. I concur wholeheartedly in this program of action.

And I would like to say here again, Senator, that I hope we can enact the temporary income tax surcharge. Certainly the economic situation that we find in this country in February, and the pressures abroad, only reinforce the need for Congress to act on this urgent matter.

In addition, wage-price restraint must be exercised in labor-management relations to keep wage settlements in line with increases in productivity. This is a tremendous challenge to the recently established President's Cabinet Committee on Price Stability which will recommend constructive new measures to promote price stability within our free market economy.

Finally, we must also strive strenuously to seek ways to achieve even larger increases in productivity than in the past in order to insure that our economy will continue to operate at ever-increasing efficiency. The average increase in productivity in the private sector over the postwar period has been 3.2 percent per year. Last year the gain in productivity, excluding agriculture, was a low 1.4 percent; in manufacturing, as I mentioned earlier it was only 1 percent.

There are many ways in which Federal leadership is being exercised to achieve greater productivity in our society. Improved manpower programs, better education, training, and medical care for our labor force, and increased Government efficiencies are some of the elements in this approach.

Senator, you mentioned earlier my active part in State government. And one of the areas that I am most concerned about is the growing unbusinesslike structures and organizations that we find in our expanding State and local governments. Today our State and local governments are growing much more rapidly, as you know, than the

Federal Government. In fact, for fiscal year 1969 it is estimated that the Federal executive branch will only have 23 percent of the total public service employees. The rest will be on the payrolls of State and local governments. I think that new views are required to involve ourselves in a more businesslike approach to State and local governments. This is one of our challenges in the years ahead.

And now, what I would like to do, Senator, is talk about the Commerce Department's involvement in some of these programs, because we are becoming much more deeply involved in some of the social action programs in this country. For a long time the Commerce Department has represented American business interests. Today, in addition to that role, we are aggressively attempting to involve ourselves in being the catalyst for American business involvement in social problem solving and in the other problems of our society.

I think the most significant program that I would like to talk about first is our action in the manpower field. As you know, the President started out early last year by making the Commerce Department very active in a test program in five cities which would serve to put the hard-core unemployed to work. This year, in his manpower message the President gave the country and American business the task of putting 500,000 hard-core unemployed to work by 1971 in 50 of our largest cities; 100,000 is the objective between now and June 1969.

The administration's objectives are very clear: to enable the disadvantaged to make a contribution to our economy and society and to keep them moving up the economic ladder. The potential gains are large; even considering only entry level jobs, employment of 500,000 represents at least $2 billion in additional goods. I might mention that, as you know, the President estimates that it will cost $350 million to put these 500,000 people to work. And, if we reflect on the fact that for $350 million worth of investment we can get approximately a $2 billion return in gross national product, I would certainly say as a businessman that this is a profitable return on an investment, looking simply at the economic advantages, and not even considering the social advantages.

Equally significant, Mr. Chairman, this effort is not primarily a matter of Federal expenditures, but it is a program whose thrust is bringing about a fundamental change in the relationship between the business community and the long neglected hard-core unemployed.

There has been a lot of talk about getting American business involved in social problem solving. But this is not just talk. This is action. Action inspired by the Federal Government.

The Department of Commerce is working in partnership with the Department of Labor and other Government agencies to do Government's share. Mr. Henry Ford II has accepted the leadership of a National Alliance of Businessmen to organize and lead private industry to undertake its responsibility. I do not consider this, I might add, an attempt to make American business perform as a social institution. This is not our dedication and our commitment. What this represents is a marriage between the social needs of our Nation and the economic needs of our Nation, which in this case can be most effectively and most efficiently executed by American business.

Mr. Chairman, I suggest that the Congress watch very closely the operation of this historic experiment. For the first time, an organization of businessmen has taken on the Federal level an operational as well as a policy advisory role. This is not a case of Government assuming more power and responsibility, but rather of Government asking business to assume more responsibility. Government is actually giving up some responsibility. Business has the jobs, and business can perform the task in the most economical and efficient way.

I might say, this is a program to get at the hard core and the disadvantaged. But we also have hard core and disadvantaged American businessmen. American business is disadvantaged to me when it does not employ and make economic use of people that are unemployed at the same time American business has openings. And this is what we have in America today.

American business needs to take a new look at its personnel policies and its supervisory practices, which need to be more flexible.

So, I think I would just mention, Senator, that disadvantaged individuals need not be poor. We have also disadvantaged businessmen who need extra training and who lack motivation.

The New York Times in a recent editorial put forth the President's position well when it said that "rather than Government becoming the employer of last resort, bsuiness must become the employer of first resort." Not only will this add to the GNP, but it will also decrease the growing social costs of the hard-core unemployed.

I would now like to mention, Senator, another area where the Commerce Department is taking some very active interest, and where I feel there is a program that involves the productivity of our society. I want to talk a little about minority enterpreneurship. We must become more responsive to a message coming loud and clear from our inner cities; the urgent call for "a piece of the action" from disaffected Americans. We must make further progress toward a national strategy that will promote and sustain business ownership among members of minority groups.

We must improve our coordination of the many public and private efforts to promote minority entrepreneurship. Principally, Mr. Chairman, this will say to our disaffected, "we want to encorage our entrepreneurial desires and to develop the ways in which you can become full partners in the American economy."

Today it is estimated that we have 5 million businesses in this country, and 46,000, or less than 1 percent, are owned and run by Negroes. Eleven percent of the white labor force are either managers or proprietors. Only 3 percent of the Negro labor force are either managers or proprietors. This is not to mention the problem as it related to other minority groups.

I only mention this to you, Senator, as one of the areas that we in the Commerce Department hope to make a contribution: one of the areas which we think is important to the productivity as well as the social progress of our society.

I would now like to talk a minute about the problems of our cities, and some of the programs and thoughts that we in the Commerce Department have with regard to these problems.

The Council's Economic Report clearly defines this problem. It highlights the patterns of migration and reveals the growing concentration of nonwhites in the central cities of our metropolitan areas, and the suburbanization of middle-class whites and of industries.

Let me spell out still further the economic plight of our central cities.

Between 1960 and 1966 three and a half million whites moved out of our central cities. During this same period, migration and national growth added two and a half million to the nonwhite population of our central cities. At the same time the unskilled migrants were moving into our central cities, there was a movement of manufacturing plants and supporting services to the suburbs. This problem is compounded in our large urban centers where there often is no transportation to easily move these people from the inner cities to where the jobs are in the suburbs and the smaller cities. The result of this is a growing mismatch between the location of the jobs and the location of people.

The problem we face here is a mere prelude in light of what may lie ahead. The source of many of our "ghetto" problems lies, in part, outside the central cities. It lies in the lagging rural areas which spawn poverty. Increasingly, our cities will require economic renewal as well as physical renewal. Programs of economic development are required for our cities as well as for their metropolitan regions. And may I say, Senator, that I have been deeply concerned for a long time with a philosophy in America which tends to look at urban renewal on the basis of physical renewal. Apartment houses and better living conditions do not really serve the need if there are not good jobs and places for these people to work.

I want to mention an analysis that has been made by the Economic Development Administration which suggests that, by 1975, our 25 largest metropolitan centers in this country may well contain pools of unemployment, despite the fact that we could have a strong economy.

So, we face two challenges. In the short run, we must promote the economic development of our large urban centers. In the long run, we must develop a migration strategy which encourages people to locate where the job opportunities exist.

Mr. Chairman, I have only touched on a few of the major domestic problems. In my remaining time I would like to discuss some of our significant international problems. I have indicated to the Senator and to the committee some important new roles of the Commerce Department in the leadership of the solution of those social and economic problems which our Nation faces.

I now would like to mention a few words about the balance of payments. Certainly one of the most critical challenges of 1968 is achieving major improvements in our balance of payments. On January 1 the President announced a comprehensive program designed to yield $3 billion to our international accounts. The necessity of this program was underscored by three developments in 1967.

After several years of improvement, the deficit in 1967 amounted to $3.5 billion, compared to $1.5 billion in 1966.

The second adverse development was Britain's devaluation of the pound last November. Particularly unfortunate was the fact that the deterioration in the U.S. deficit came at a time when the devaluation had already shaken the world monetary system.

This not only contributed to the sharp rise in the U.S. deficit, but also touched off a widespread wave of gold speculation.

Since the devaluation, the United States has lost about $1 billion of gold. Because our reserves are essential to maintaining the confidence abroad in our ability to defend the dollar, this added new concern to an already disturbing situation.

The third development was the continued deterioration of the liquidity position of the United States in 1967. Reflecting the large deficit of 1967, liquid liabilities to foreigners rose further to more than $32 billion, while U.S. monetary reserves declined to around $15 billion. The U.S. asset and investment position abroad is strong, but most of this strength is in private long-term claims on foreigners which are not available for defense of the dollar. And I might say, Senator, like Senator Percy, I have been involved in a growing business. And I know that there are times in a growing business where the liquidity and the relationships that you have with the banks force you to take a look at whether you can continue to expand your investments at the rate which you have in the past.

These are the main factors which prompted President Johnson to announce the new comprehensive program to improve the balance of payments. Of the $3 billion savings required, $1 billion, or one-third, is to be achieved through the mandatory direct investment program.

I would like to emphasize that the establishment of direct controls on foreign investment does not imply that our voluntary program was a failure. On the contrary, through the generous cooperation of the American business community during the past 3 years, voluntary program objectives were achieved and even surpassed.

Under the voluntary program, capital outflows from the United States fell significantly, and yet U.S. corporations were able to proceed with their plans for major overseas expansion. From 1964 to 1966, their plant and equipment expenditures in developed countries increased by around 70 percent. At the same time, capital outflows to these countries, adjusted for the use of funds borrowed abroad, declined by 28 percent. This growth in plant and equipment with smaller adjusted capital outflows was made possible by foreign borrowing by U.S. companies and their foreign affiliates, which increased fivefold from 1964 to 1967.

I might say that in addition to borrowing, the American companies began to sell convertible debentures abroad. I think having our companies owned on a more international basis also is a sound position, and makes a sound contribution to international relations, which I think also is very important. One of the contributions that have come from our balance-of-payments programs is that foreigners are becoming partners in our business.

Mandatory controls were necessitated, therefore, not by the failure of any voluntary program, but by the immediate vital need for larger savings than could be achieved through voluntary means. The voluntary program targets placed ceilings on increases in capital outflows and reinvested earnings. On the other hand, the mandatory program asks for substantial reductions in direct investment transactions in order to obtain balance-of-payments savings of $1 billion. Savings of this magnitude are beyond the scope of a voluntary program.

Like the voluntary program, the new program is aimed not at restricting foreign investment per se, but at reducing the adverse balance-of-payments consequences of that investment. And I certainly think that from what we have seen in January, most American businesses are finding ways of continuing their investment programs abroad.

Thus it limits the use of capital outflows and reinvested earnings for financing overseas ventures and encourages the use of foreign-source funds. An investor may proceed with his plans for expansion abroad without limit to the extent that he can finance his investments with funds borrowed abroad.

For administering the new mandatory program, an Office of Foreign Direct Investment has been established in the Department of Commerce. Under the regulations, three groups of countries have been designated, and allowable direct investment transactions vary from one group to another, depending on their economic circumstances. The less-developed countries are treated liberally, while the greatest burden for achieving balance-of-payments savings falls primarily on continental Western Europe.

The Department has issued a series of clarifying amendments to the initial regulations and one general authorization on foreign borrowing. The authorization permits U.S. companies to make repayments on their foreign borrowing, to guarantee funds borrowed abroad by their foreign affiliates, and to honor guarantees if the affiliates default.

When repayments are made, however, a company must deduct the amount from its present or future allowable direct investment transactions.

Other general authorizations or adjustments are being considered by special task forces set up in the Office of Foreign Direct Investments. Our objective is to insure that the regulations will be equitably and effectively administered with minimum delay. In addition the Secretary has set up a new Advisory Committee on Foreign Direct Investments, consisting of prominent businessmen, to consult with him on problems encountered under the mandatory program.

In the first month of operation, over 5,000 businessmen and lawyers have contacted us to ask how the new regulations would affect them or their clients. We have also received, and are processing, several hundred requests for special authorization or exemption. Many of these have been urgent, involving commitments under binding contracts or work already in process.

Throughout these early days of our new program I am pleased to report we have been impressed by the cooperation of the business community. They recognize America's problem and have indicated every desire to help in its solution.

Now, Mr. Chairman, I would like to talk about the export expansion program. Let me say that from my experience in American business, I think one of the great challenges that we have in the years ahead is to develop a whole new philosophy on export expansion. While we have a trade surplus, and the trade surplus last year was $4.3 billion, the rate of growth of our exports during 1967 was only half of 1966. And while the United States continues to be the world's largest exporter, our share in world markets has been declining at the same time that that of our principal competitors has been rising.

Since 1960, the U.S. ratio of exports to GNP has remained at 4.1 percent. Italy's on the other hand, has grown from 10.8 percent to 13.1 percent, Germany's from 15.4 percent to 16.9 percent, and Japan's from 9.6 percent to 10.1 percent. And so, we have a real new challenge in the Commerce Department, and in this Nation. If we are going to really believe in free trade, and we are going to expand free trade, we must fight to expand a philosophy toward exports which treats them as a part of the market of American industry.

It is obvious, therefore, that exports in the past have not been as important to the U.S. economy as they have to other countries. Nevertheless, it is quite evident that increased exports can be a solution to our balance-of-payments problem. We must strongly encourage U.S. industry to adopt a philosophy of exporting, and to devote the same energy, enthusiasm, and resources to foreign market development as it customarily does to the domestic market. If this can be accomplished exports can be made to grow at a faster rate than the general growth of our economy. It would take only an increase in the proportion of exports to GNP from 4.1 percent to 4.4 percent to add $2.5 billion to the normal growth in export sales. Surely this can be accomplished if business adopts a world marketing philosophy.

How can we achieve this? Our major problem is convincing American firms—and I think to a large extent some of the small firms in this country—to put more effort into selling in relatively unknown foreign markets in contrast with the known markets of the United States. In order to make overseas markets better known and understood by U.S. industry, the Department of Commerce is planning a systematic Government-industry 5-year effort. The President's program projects 5-year funding for Commerce at $200 million for this purpose beginning in fiscal year 1969. This program calls for—

A doubling of our commercial exhibitions in our trade fairs and trade centers overseas, with a trebling of business participation.

A substantial increase in other trade promotion activities such as trade missions and mobile trade fairs.

A new joint export association program to develop markets abroad for American products.

Intensified assistance to U.S. industry for longer range planning of export development.

Improved and expanded foreign commercial information services to provide speedier and more comprehensive techniques for exploiting immediately attractive foreign sales opportunities.

I do not want to suggest to you today that the answers to these problems are purely more money. We in the Commerce Department have to provide new areas of activity and a new stimulus to business to take a more active interest in exports.

But by stimulating the creation of a new export philosophy in America, by providing a system of facts and assistance for successful performance, American industry will have the means to achieve the relatively small but vital reallocation of resources necessary to reach our national export goal. This is the opportunity and the challenge of our new export program.

Let me move from this discussion of our export expansion programs to a brief statement about another key element in our balance-of-payments position and our overall economic situation—travel promotion.

Secretary Fowler has already testified before the House Ways and Means Committee earlier in the week on the President's tax plan to deter travel outside the Western Hemisphere. I wish to emphasize the need to step up our positive efforts to bring foreign visitors to our shores.

We must have in this Nation a new, concerted effort that will put us at the top of the list among nations, not 18th as we are now, in tourist promotion expenditures. The answer is not only more money, for again this is a challenge to the Commerce Department and our Travel Service to provide some creative and dynamic leadership to the utilization of additional funds for travel promotion.

I hope that in the present session Congress will strongly support the Commerce Department's plan for a stepped-up travel promotion program. Our programs in the past have produced outstanding results, as evidenced, for example, by the joint Government-industry visit USA program, a cooperative effort on the part of private industry, travel organizations, and the various States.

I might say that at the same time we are talking about travel expansion, the Budget requirements forced us in the last couple of months to close down in Mexico and in Tokyo, and one other major city in the world, our Travel Service Office all of which I think were serving us very positively.

I think now I can conclude by saying that we have our work cut out for us in the Commerce Department in the year 1968. On the one hand, our economy and our ability to create wealth is growing. No nation in the history of man has ever matched America's ability to create wealth. It should be that no man need suffer from want. But many Americans do suffer from want. The challenge to America—and certainly the challenge to our free enterprise system—is not whether we can create wealth, but whether we can use our wealth wisely. The challenge before us—and which must precede any proper study of the American economy—is, as President Johnson has said, "not how much, but how good; not how fast we are going, but where we are going."

Thank you very much, Senators.

Chairman Proxmire. Thank you, Mr. Secretary.

I want to tell you first that I liked many, many things about this statement. I think it is an excellent statement. I particularly like the emphasis that you made on growth; and your efforts to solve these many problems that we have through a growing economy.

Growth has always been the desire both of Republicans and Democrats without any question. But I think there has been some emphasis lately on restraint, cutting back, so that we get a different impression. And I am very happy that you, as a dynamic successful businessman, represent here in Government the same kind of optimistic view that you exhibited in your business experience.

I understand just a few minutes ago it was announced that the unemployment level fell last month to 3.5 percent, which is the lowest level since the Korean War. And I think it is a cause for rejoicing. I know that many people are deeply concerned. And yet we have to be concerned about its inflationary implications. But it also indicates that our manpower resources are at work as not since the Korean War.

Mr. Samuels. I think it also indicates, Senator, that the manpower training programs that the President initiated, while not all successful, because they are new, are moving strongly in the direction of really providing a way to bring a lot of people into the employment sector. I have never accepted a society that has work to do on the one hand and unemployed people on the other. I am convinced that if we could fill all the jobs that are now open in American industry—and we have no way today of actually putting the numbers on it—we would have little unemployment in this country.

Chairman PROXMIRE. Yes and no. I think the President's programs may have helped some. But I am convinced more and more as time goes on, as I work on this committee trying to study the American economy, that most of the effective training is not done by government, National, State or local; it is done by private industry. And it is done when private industry has to get the people who otherwise would not be employed. I do not see how the President's hard-core unemployed program, no matter how much money the Federal Government spends on it, can work unless we have an atmosphere of high employment, and low unemployment; we just have to have that. And, so, I think that you put it very well when you say the challenge is how to maintain high levels of employment without runaway inflation. This is something that we have to keep in mind primarily—the high level of employment and growth—if we are going to solve these problems that are so very, very difficult.

Let me come to my question here. And I must say that with the latest statistics, although I think they are a reflection in part of forward steel buying and other temporary elements in the economy—I can understand that there is more pressure behind a tax increase—nevertheless, isn't it true that if we have the kind of wage cost pressure in the economy that you so well describe, with relatively no increases in productivity, and very high settlements, that this is the real crux of the inflationary problem? And that, furthermore, if we try to solve through fiscal policies primarily, in order to get a restraint in these 6- to 7-percent wage settlements, you are going to have to have a very restrictive fiscal policy, and you are going to have to go well above 4 percent unemployment if you are going to get these labor unions—although I am very sympathetic with labor and I am happy to help them—if you are going to get labor unions' demands, you are going to have something else?

Mr. SAMUELS. Senator, I cannot accept the position that the only way to approach our inflation problem is to have a large deflation or unemployment. I think this is a problem that we have to solve, and to solve with some new creative ideas and, frankly, with some new understanding between business, Government, and labor. And I hope that this is what we can talk about in this new committee the President has formed.

But, as I mentioned in my presentation, no nation in the world has ever been able to approach this without unemployment. I say this is unacceptable in America. We are committed to a full economy, and we have got to find a way within the commitment to a full employment economy.

Chairman PROXMIRE. I do not see anything in the President's program—with all respect to you, Mr. Secretary, and your great sincerity, and the President's sincerity—I see nothing in the program about this. Certainly this Cabinet formula solves nothing as far as the immediate problem is concerned. It might be helpful in the long run, 5 or 10 years from now, to get at some of the underlying causes. It is a study program. But, they are specifically told not to poke their noses into specific wage and price decisions. So, I do not see how this can really contribute anything substantial to our current problems.

Mr. SAMUELS. I would agree that so far nobody seems to have found the answer to this problem. But, I think the first thing you have to do is recognize that the problem is here. And, really, this problem began in the middle of 1966. And it has really been the last year and a half that this great difference between wage settlements and productivity has become such an important part of the pressure on prices.

Chairman PROXMIRE. In 1966 we started to walk away from the wage price guidelines. I think it was a very hard thing to provide. But, while it was relatively easy in the period 1962 through 1965, and we had relatively little inflation, now it seems to me that we have to cope with a really tough challenge. But, it would seem that if we have have some wage guideline figure, 5 percent, 5½ percent, that at least we have some basis of restraint. Otherwise, as you say so well, the settlements are going to be 6 or 6½ percent, and very possibly more than that. And the Government is not going to contribute anything to moderating that, it would seem to me, by fiscal policy without, as you suggest, an unacceptable amount of unemployment.

Mr. SAMUELS. And the problems are not only in the private sector, Senator. The problems are also in the public sector, where many of the wage settlements are 7 percent or 8 percent; the one being discussed in New York today is 11 percent. So there are additional new inflationary factors which we have to look at which are not all in the private sector, but are also in the public sector; and they create new and more complex problems for us to solve.

Chairman PROXMIRE. You see, what troubles me is that—you know the Phillips concept that Professor Phillips, the English economist, constructed, showing the relationship between unemployed and inflation. And in a society where you have the kind of administered prices that we have in all advanced free enterprise societies today, you do have some level of unemployment, maybe 3½ percent, 3 percent, or maybe 4 percent. And when you get below that level you begin to get a high inflation.

Now, if you are going to move that Phillips curve over, if you are going to get into a position where you can achieve what you so well say is our objective of price—I should say of the lowest possible level of unemployment without runaway inflation—then you cannot do that by fiscal policy: obviously, by definition you have to do that by some kind of wage-price guidelines. And there is not anything, as I say once again, in the President's program, to do this. This is so discouraging.

Mr. SAMUELS. I think, Senator, the President recognizes this, too, and that all nations in the world recognize this. And I think this is our challenge, as I mentioned in my statement.

Chairman PROXMIRE. It is our challenge, but we are not doing anything about the challenge except in the long run. And in the long run the problem may resolve itself, of course, in numerous other ways, especially through inflation, or high unemployment.

Mr. SAMUELS. I do not know of any way it is going to resolve itself. I can see the problem getting worse. And we are going to have it in 1968.

Chairman PROXMIRE. The problem was solved in the 1950's, as you know, by a very high unemployment.

Mr. SAMUELS. I made it very clear, as I said, I think this is an unacceptable solution.

Chairman PROXMIRE. Fine.

Let me move on to something else here. In your balance-of-payments section you contended that we must, temporarily at least, reduce investments abroad.

Mr. SAMUELS. I did not say we would reduce investments, but the transfer of money, abroad. I am hoping, and I think we all are hoping——

Chairman PROXMIRE. I beg your pardon, that is a good correction. We have to reduce the level of funds flowing abroad.

I think in doing that, however, we are going to have to be realistic about it. You are going to have some reduction in investment, although I think that it is good that you recognize the problem, and you are going to try to prevent that. We are not going to increase our investment as rapidly as we have in the past.

Mr. SAMUELS. I do not think we really know that, Senator, I do not think we will know that until really American industry finds out what their borrowing capabilities are and at what rate. Obviously, if the cost of borrowing is too high for them to make the investment, you will get some discouragement. I do not think that we have seen any evidence of that at this stage. But maybe a month or two from now we will be able to act on that a little more constructively.

Chairman PROXMIRE. You see, the difficulty for me, and I think for people in the business community, is that perhaps the brightest jewel in our balance of payments has been our investment abroad. This is the one area where we have had increasing returns. And the returns, as I understand, exceed our investments abroad.

Mr. SAMUELS. By $2 billion.

Chairman PROXMIRE. And this cannot be said, incidentally, I understand, for our trade sector any more. We have a $4.3 billion technical surplus. But if you correct for the offshore procurement from foreign aid and for other Government programs that we have, I understand it is only about $600 million.

Mr. SAMUELS. Yes. I think we could—let me make two comments. One is, you are absolutely right about investment abroad. The net return is $2 billion. We get $5 billion back from abroad from our investments that we have made. Our net investment outlay last year was about $3 billion.

Now, let me take the second question, the question of imports and exports. And your figures there, I think, are absolutely right. And I think that is why we think the great challenge we have in the Department and in this Nation is to increase our exports, because if we believe in free trade, then we are moving more and more in that direction as the Kennedy Round goes into execution. We are going to be importing more. And we had better be exporting more, or the balance of payments could hurt us in the other direction.

Chairman PROXMIRE. My time is up. I will be back shortly.

Senator Javits?

Senator JAVITS. The Under Secretary is from my State, Mr. Chairman. I think this is the first time that he has testified before a committee of which I am a member. I take pleasure in welcoming him to the gauntlet——

Mr. SAMUELS. Thank you, sir.

Senator JAVITS (continuing). Which all top Federal officials run so often.

I apologize, sir, for not being here when your statement was made. But we have a civil rights bill on the floor, and a sanitation strike in New York, and between them I had a lot of other things to do.

I do want to ask you questions along two lines. First, what are the balance-of-payments questions involved in the travel package unveiled by Secretary Fowler on February 5? Secondly, has the Department of Commerce, which is concerned not only with domestic but also with foreign commerce, given any opinion or can it give us any opinion as to the retaliatory effects which are being subsumed in that regard, both in travel as well as in exports, as for example, in the export of American jet aircraft, which we supply to so many foreign nations?

Mr. SAMUELS. I think this is a risk, there is no question about that, but I think that in the presentation that Secretary Fowler made there is an attempt really to have people go abroad but not spend so much money. So, we are trying to balance all of the factors which are both in our interest and in the interest of our friends abroad.

But there is always the possibility, if you try to discourage tourism abroad, that there could be retaliation either from the point of view of tourist travel abroad or also from the point of view of exporting to this country.

We certainly get no indication of that at this stage of the game.

I might say, Senator, it is my feeling that our biggest job is not to stop us moving abroad, but to get more people abroad to come here.

And this is really the challenge that we have this year. And I am hoping we get the support of Congress for a much larger and stronger program of tourism in this country, which I think is long overdue.

Senator JAVITS. You know that Senator Magnuson and I are the authors of the bill on which the USTS functions. And it has been a longstanding complaint of mine why the administration could not go after more money for the USTS. But it never really got after the Congress. It never really asked for very much.

Mr. SAMUELS. We asked for more, Senator.

Senator JAVITS. You asked for \$4.7 million, which is nothing compared to the \$2 billion travel we have.

I have a bill which is sponsored by Senator Percy and 10 other Senators, which sets a minimum budget of \$15 million for USTS. Can you tell me whether the Department has any idea why the President waited 11 months last year to appoint his task force on travel, and then within a month and a half after he appointed it, press the panic button that this was one of the greatest emergencies facing the United States? Why wait eleven and a half months to appoint it, and then press the panic button a month a half thereafter, before it can report?

Mr. SAMUELS. I think there are two answers to that, Senator. First, I want to answer that we have asked for more money every year, and it has been very difficult, as you know, for us to even get the \$4.7 million.

Senator JAVITS. You asked for \$4.7 million. Is that adequate?

Mr. SAMUELS. No, it is not. But I think you have to be realistic in approaching Congress. After you have been knocked down from \$4.7 million to \$3 million, it is difficult to go to \$10 million level. And we appreciate your support in this program.

Senator JAVITS. Mr. Samuels, you are a good enough businessman to know exactly that that is what you do. And I do not say this in a partisan sense, because the previous administration did not even call for a travel agency. So, there is no great gain for Eisenhower's administration, or any before that.

Mr. SAMUELS. Well, I appreciate your sensitivity to this problem, Senator. And I assure you that we recognize that we have a new challenge here.

I might again say that in an area like travel service, ingenuity and creativity can do a lot. And I think our Travel Service with its $3 million budget has done amazingly well.

As I mentioned before you came in today, I think the discouraging thing is that this year we have had to close down in Mexico City, Sydney, I think, and in Tokyo, three areas where we had travel offices, because we could not even finance those. So, we will appreciate your help.

Senator JAVITS. Is the Commerce Department prepared to place before us on behalf of the USTS an optimum program to stimulate tourism into the United States?

Mr. SAMUELS. The Commerce Department has been an active part of the President's Study Group which will report the 19th of this month. And, certainly, from that—and there is a memorandum being written to the White House—we will put together a program on which we certainly hope to get the support of Congress.

Senator JAVITS. What do you think—I am not speaking of you personally, Mr. Samuels, I realize that you are an agent of the Department, and that you are fairly new there, so do not take it to sound invidious, but please answer for the Department if you can—or what would the Department think about deferring travel curbs for 1 year to give an opportunity for your program, the USTS, with more money, I assume, and more initiative and more expertise, et cetera, to succeed? Why not give Discover America, that is the private industry group's recommendations, the Travel Task Force's recommendations, which will be coming from Ambassador McKinney's task force—of which Commerce is a part—a chance to work? What would you say to deferring the whole business of inhibiting travel for a year?

Mr. SAMUELS. Senator, I think that this obviously was considered by Secretary Fowler's committee, on which Mr. Black, from our Travel Service, served. And it certainly would be the easiest thing to do. Unfortunately with the seriousness of the balance of payments, it was decided that we could not risk that this year, and that it was necessary to have a more aggressive program to deter travel abroad. And it was on that basis that it was decided.

And Secretary Fowler I am sure made his decision clear.

Certainly that is a decision that Congress has to make. Certainly the recommendations of our Department are that the administration's program should be supported. But at the same time we should do exactly the things that you have mentioned here.

Senator JAVITS. Mr. Samuels, may I make a request which I would like to have for the record. Will you be good enough to give us what would be the Department's recommendations for a comprehensive travel program to encourage tourism, without any restriction as to what the administration may accept, as to what we should recommend in this committee, if we should decide on an alternative to the laws and regulations that Secretary Fowler asked for yesterday, to wit, for a year? In other words, suppose we say, we are going to take an alternative and wait a year, and really launch a massive program to encourage tourism, can you give us—can you have the USTS give us the prescription for that kind of a massive program?

Mr. SAMUELS. I will, Senator.

Senator JAVITS. Will you do that?

Mr. SAMUELS. Yes, sir.

(The following material was subsequently supplied for the record:)

The U.S. Travel Service has developed plans for an expanded program at both a $10 million and $15 million annual appropriations level. The Department had originally intended to ask for an increase in the present $4.7 million authorization for USTS to permit implementation of these plans, but decided to defer this request pending appointment of the President's Special Industry/Government Task Force on Travel and submission of its report.

The findings and recommendatinos of the Task Force will undoubtedly influence the type of program which the Commerce Department ultimately recommends to the President and Congress. We, therefore, think that publication of our plans at the present stage would be premature, but will be happy to provide the details of our proposals for an expanded travel program as soon as possible after the Task Force reports.

Senator JAVITS. The other thing I have to ask is this: Has there been any discussion in Commerce on an arrangement where we either use counterpart funds, which we have some of, in Israel. India, or other places, or could on a deferred basis borrow local currency from countries which would be disadvantaged by these travel restrictions, so that our tourists would obtain the local currency now and the United States would pay it back at a much later time, in order to avoid the impact of travel expenditures on our balance of payments? Now, there is some talk that McKinney's group is considering that.

Mr. SAMUELS. I think we ought to do that. But I would ask former Assistant Secretary Shaw to answer this, because he is certainly much more knowledgeable about this, Senator, than I am.

Mr. SHAW. I think, Senator, that the total funds involved here are not very large. I think there have been a number of efforts on the part of the Federal Government to do this very thing. It is my understanding that this is being considered further by the McKinney committee. And I would assume that that committee will have the additional recommendations on it.

Senator JAVITS. Thank you, gentlemen. I hope you understand that the only thing that disturbs me is that we did not get on the ball a long time ago and do it with the vigor and judgment that we should have.

I would like to ask you one question now about your statement, Mr. Samuels. You will note that at pages 3, 4 and 6 of your statement you emphasize the critical judgment of restraint in wage-price patterns, and especially you refer to the enigma of what is to be done about the newly negotiated DC's that we entered into this year for labor.

And you speak of wage-price restraint. And you say on page 5:

This is a tremendous challenge to the recently established President's Cabinet Committee on Price Stability which will recommend constructive new measures to promote price stability within our free market economy.

Now, Dr. Ackley told us that this President's Cabinet Committee would deal only with long-range matters, not with this year's con-

...act settlements. I would like to ask you, or the Department can supply it for the record if you cannot answer that—you represent business, that is not often known in this country, just as the Department of Labor represents labor—now, do you have any recommendations how from the Government's viewpoint this wage-price restraint can be effected? Should we have a board, should we have a committee, should the President call everybody in? What should be done about it? We are told that this Cabinet Committee is only dealing with long-term matters. And yet you reinforce my view, and I think that of every member of the committee, that this wage-price problem is likely to be the key to the whole inflationary situation.

Mr. SAMUELS. Senator, it is my feeling—when we talked about long range it was my impression that this Cabinet Committee would deal with the problem this year—and long range would be 1969. As I mentioned in my presentation, this, unfortunately, is a problem that nobody in the world has licked; that is, how to have full employment and at the same time keep inflation under some kind of control. I would hope that out of the Cabinet Committee will come some new ideas and some new approaches—and really, frankly, it must come from a new approach between business and labor and Government—and I think we are kidding ourselves if we think we can do it with the same old patterns that we have used before. They are not working, and they will not work. And I think that out of this committee this leadership must come. And I certainly look forward to, and I think the President looks forward to, this committee coming to grips with the problems in a straightforward way.

Senator JAVITS. Mr. Samuels, you have not told me very much, but I appreciate your good will.

Mr. SAMUELS. Senator, I wish I could tell you more.

(The material which follows was later supplied for the record:)

Wage-price pressures, unless mitigated in 1968, will further intensify the problem of inflation in 1969 and beyond. To meet directly the current problem and to create an economic environment in which wage-price pressures will mount less, the President has asked for Congressional action on a program of fiscal restraint.

In addition, as a vehicle for reconciling price stability with high employment, the President is establishing a Cabinet Committee on Price Stability. Although the Committee will focus on longer term issues rather than current specific wage and price matters, it recognizes that the genesis of such longer term issues lies, in large part, in the wage and price actions to be taken in 1968. The Committee, accordingly, will begin shortly a series of conferences with representatives of business, labor, and the public, so that, cooperatively, programs for private and governmental action can be designed.

The Department of Commerce looks forward to participating in the Committee's work and looks forward to the Committee's contribution of new and workable approaches to wage-price policy.

Chairman PROXMIRE. Our next interrogator would be Congressman Brock. Congressman Brock unfortunately has lost his voice, and I am going to ask the questions for Congressman Brock. And if you would like to followup with another question, that is fine.

Congressman Brock would like you to tell the committee, why has there been no action by the administration on the copper strike which is costing us $1 billion in balance of payments annually?

Mr. SAMUELS. Well, I am sorry that you have lost your voice, Congressman. But I should say that I am very pleased that you can still write.

This really is one of the perplexing labor questions, as we know, that affects our country. And the Secretary of Labor and the Secretary of Commerce have been involved, certainly since I have been here in the last 3 months, in many discussions within the administration on this. As you know, this is a labor question handled by Secretary Wirtz. But the committee which the President appointed should be coming forth with some recommendations, certainly in the next few days. We are certainly looking forward to that. And I cannot, I am sorry to say, Congressman, add anything else to it, except the points that I have made. I can only say that in my own experience, looking at complex labor-management problems, that this is probably the most complex management-labor negotiation question I have ever seen. Certainly the length of the strike is not acceptable to our society. And the problem of balance of payments certainly is great. I look forward to the recommendations of this committee, hoping that they will give us some lead to a settlement.

Chairman PROXMIRE. Why not Taft-Hartley? Have you considered this?

Mr. SAMUELS. I just do not know, and I cannot answer that question, Senator. If I remember, there was a feeling that the Taft-Hartley would be unsuccessful here. There would be almost nothing to be gained by the Taft-Hartley. That is the only reason that I know—I am sure there are more—and I am sorry that in the short period I have been here I have not been involved in the copper question, and therefore cannot present any different answer than that.

Chairman PROXMIRE. Could I ask, Mr. Secretary, if any other members of your staff wish to comment?

Mr. SAMUELS. Yes.

Is anybody here prepared to talk about that?

I did not expect this question today, and I did not bring the people from that section.

Mr. McQuade, do you have any comment you would like to make on it?

Mr. McQUADE. No, I do not.

Mr. SAMUELS. Mr. Shaw?

Mr. SHAW. Mr. Chairman, I think, as you know, under Taft-Hartley it is necessary to find a state of national emergency. And it is my understanding that the evidence to date does not suggest that there is enough damage being done to the economy. Now, I recognize this balance-of-payments problem is a very major problem. But that by itself is apparently not enough to meet all of the criteria of the Taft-Hartley Act.

Chairman PROXMIRE. Is that a legal opinion?

Mr. SHAW. I do not pretend to be a lawyer, Mr. Chairman.

Chairman PROXMIRE. If you have any further observations, or some other members of your staff have, perhaps when you correct the record you might want to add them.

Mr. SAMUELS. We will do that, Mr. Chairman.

Chairman PROXMIRE. Senator Jordan.

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Samuels, I specially liked the reference you made in your statement to the bringing in of the private sector in manpower training not only for run-of-the-mill applicants for jobs, but for the hard-core as well. You just put the emphasis on the area that needs to be explored, and fully emphasized to the utmost. And I think we could have a solution to much of our manpower problems if we could properly engage the private sector in it. Do you agree with that?

Mr. SAMUELS. Yes. I agree with that. And I might say that this has been enthusiastically accepted by the business people that have been brought in. Two weeks ago we had a meeting with the President and the 14 members of the executive committee about this. Last week each of them sent in one of their key people who will work full time on this. And I have never seen so much commitment by any organization. American business leadership, I am confident, Senator, is ready to do this providing we give them a mechanism where we can operate in a businesslike way. This is what the national business alliance will do. It becomes part of the structure, so that American business is helping run something they can operate effectively with the Government as a partner. I again suggest to all of you that you watch this, because it can be a pattern for American business involvement in other problems of our times in an effective way.

Senator JORDAN. Thank you. I am glad to hear you say that.

If I understood you correctly, some place in your statement you implied that inflation and full employment just go hand in hand; that is, you could not have full employment without having some inflation. Now, a news release has just reached us that unemployment has reached the lowest level in a good many years, 3.5 percent. Yet we know we have inflation of about the same percentage, 3.5 percent, or higher. What, in your opinion, is a tolerable limit of inflation to accomplish a full-employment goal?

Mr. SAMUELS. First of all, Senator, I would like to say that no inflation is my tolerable limit of inflation, because it has such a complex effect on all elements, on all interrelationships, in our society. But I can only go back now into the history of how other countries have done in this, and what we ourselves have accomplished. No country in the world has been able to really control inflation at any reasonable level, which is maybe a percent and a half or 2 percent a year, and still have a full-employment economy. Other nations have gone to deflation, and have had their unemployment levels go to 6 to 7 percent in order to stop the inflationary rise. I think this is an unacceptable thing for our country. Our country is committed to full employment. I mention this as the greatest challenge this year. I am sorry to say, I do not have an answer to it.

Senator JORDAN. It is a great challenge. But you do not have an exact figure in your mind that would be a tolerable rate of inflation to provide full employment?

Mr. SAMUELS. I again say that I certainly found that in the years up until the last 2 years, when inflation was a percent and a half, and 2 percent, I considered this something that we could live with in this country. When it gets to 3 and 3½ percent, I think we are reaching a point of real danger. The problem that I see is that it can get worse. And, again, Senator, I say we not only have the inflation caused by the rise of our unit labor costs, but we do have, and will have inflation, caused by excess demand. And we again ask that you consider the tax increase as a factor in decreasing demand at this stage.

Senator JORDAN. Turning to another subject, you stated that voluntary controls on overseas investment were successful and surpassed their objectives. And yet we come now to a program of mandatory controls in order to balance—to get a more favorable balance of payments. And yet, earlier in your statement, you abhor having to use the mandatory price and wage controls.

Why is it desirable to have mandatory controls in respect to the balance of payments and not so with respect to prices and wages?

Mr. SAMUELS. First of all, the seriousness of our situation abroad forced the mandatory controls on the President of the United States. I am sure it was the last thing he wanted to do. And I again pointed out in my statement that voluntary controls had worked well. But, we just came up against, frankly, fresh pressure at the end of the year on the dollar. And so, the President had no alternative.

I abhor mandatory controls and I hope that we can quickly move away from mandatory controls. And I certainly hope that that will happen soon. And I abhor them internationally.

And I would feel the same about them on wage-price. I just cannot see this country controlling prices and wages. And I think this is something that we are all committed not to do. But on the other hand, we have got to find ways of controlling the inflation without direct controls.

Senator JORDAN. What, in your opinion, are the principal reasons for the decline in our share of the world's market for the past several years? Has the administration's existing program of export expansion been a failure?

Mr. SAMUELS. As I mentioned, I think American industry has such a tremendous market here that we have not really been export oriented, particularly the smaller independent industries in America. Countries like Japan and Germany and Italy have been export oriented. And I think this is our job in the Commerce Department and our job in American industry, to recognize the potential that export expansion has, not only for the individual industries but for the country as a whole. And I hope, Senator, we will have your support in expanding our activity here. Other countries do considerably more in this field than we do, and perform more services for their industries than we do. And I think we just have to understand this as a new responsibility.

Senator JORDAN. Could it be that wage increases over and above the productivity of labor have been a contributing factor in pricing us out of the world market?

Mr. SAMUELS. There is no question that inflation works against us in an attempt to increase our share of world markets.

Senator JORDAN. Could it be that an increase in taxes which becomes a direct cost in the manufacture of goods for export would be a contributing factor?

Mr. SAMUELS. I do not think that the tax that the President is asking for would. It is a tax that we are asked to take for a year and a half. And I do not think that this would be passed on or could be passed on in price increases.

Senator JORDAN. You have already pointed out in your statement that corporate profits before taxes are on the decline. Will not the addition of more Federal taxes work adversely?

Mr. SAMUELS. There is no question about that, Senator. But on the other hand, I think corporations, like American individuals, must pay the cost of what we are doing in the world, and our responsibilities as we accept them in the world. And this is again only an increase over a year and a half. I think American corporations are willing to accept this and make this contribution to the needs of balancing our budget, which I think the American corporations are very anxious that we do. I think the failure to have a reasonable balance in our budget has an effect psychologically on our balance-of-payments situation, and I think that that is very important to us at this time. It is a psychological thing, but very important.

Senator JORDAN. Thank you.

Mr. SAMUELS. Thank you, Senator.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. Mr. Samuels, I am very pleased to see you and your colleagues here this morning. I hope our lopsided attendance here this morning is not an indication that only the Republicans are interested in the Commerce Department or American business.

Chairman PROXMIRE. If the Senator would yield, I would just point out that the Democrats are taking advantage of the Lincoln Day recess.

Senator PERCY. I have found a great deal in your statement with which I agree. I certainly agree with your objectives for economic growth, and I think the Commerce Department can play a very important role. And I think we should emphasize that private industry is the source of employment of first resort, and that is where the emphasis ought to be. We should do everything we can to encourage the private economy. So in those areas where we totally agree, I would not waste your time in just talking about them.

In looking at the areas where we possibly would disagree, I would like to pick up first on page 4 the strong statement that you make, that we have a tremendous problem in connection with inflation in this country. You say that there is no more serious economic problem facing this Nation today than inflation. You say we must find the answer, and then you say, "The answer is not to be found in wage and price controls." I agree firmly with you. This would undercut the great strength that our economy has if we resort to an attempt to regulate what is best regulated by the free market.

We have to get at this problem some other way.

Then we turn around to the balance-of-payments problem. I agree this is a great problem, and we have to do something about it. But for some reason or other the Government now says the whole series of regulations and controls are needed in this area. They really think—for instance, after failing to control agriculture for 30 years effectively—they really think they can go into this area and start to put in controls.

My first question is whether or not these mandatory controls on investment abroad will not ultimately do irreparable damage to the economy of this country, to America's position in world trade, and to the continuing growth of American industry, if those restrictions are kept on for any period of time?

Mr. SAMUELS. Well, I think, Senator, that your "if" is the answer. If they are kept on for a long period of time, and if they actually decrease American investment abroad, which we have no indication that they are doing today, then obviously that there is a damage, and and a long-range damage, to the American economy and position around the world, which I think would be unfortunate.

Senator PERCY. Could we say, that to the extent that the voluntary controls have worked—and they have worked—can you say they have effectively reduced investment abroad, and affected prudent, wise decisions based on return on investment which comes back ultimately to this country? Isn't it true that having restrained and withheld investments by American industry to the tune of hundreds of millions or even billions of dollars, we have already done damage, considerable damage. You certainly cannot go back and remake those investments.

Mr. SAMUELS. Senator, we did not say that in the statement. In the statement we pointed out that despite the fact that we had voluntary controls, that we had a 70-percent increase in investment. That is, American industry did find ways to borrow abroad. And today they are doing that. If you take a look at our increased borrowing abroad, I think you will see that we will be able to continue to increase our investment abroad without taking more money out of this country, and be able to do it by either borrowing or selling convertible debentures abroad. And as I mentioned I think before you came in, Senator, this not only involves us abroad, but makes our friends abroad partners in our business, which I think is essential.

Senator PERCY. Are you trying to say that it is a good thing as a matter of public policy for us to have such restrictions?

Mr. SAMUELS. No; it is not a good thing as part of public policy. But I am saying that sometimes things that you do as public policy that you would ordinarily not like to do have some ancillary benefits. And I think in this particular case there is an ancillary benefit. And I, like you Senator, am looking forward to the time, and the President of the United States also looks forward to the time when we get rid of these controls.

Senator PERCY. There I agree.

In the area of our determining export trade, which we certainly must do, you give a dissertation on pages 14 and 15, beginning with the fact that the trade surplus of $4.3 billion has been a saving grace for us, but our shares in the market abroad and in the world have been declining. You state that we must encourage U.S. industry to adopt a philosophy of exporting, and devote the same energy and enthusiasm to developing foreign markets as domestic. And then you say that the major problem lies in convincing American firms to put more effort into selling in the relatively unknown foreign markets. How are American businessmen going to know those markets until they travel abroad? Can they learn them by reading books? Isn't it in our interest to encourage them, American businessmen, to go abroad to develop these markets which ultimately will add to this huge trade surplus we had, and which is the only thing keeping us from utter disaster now?

Mr. SAMUELS. Senator, I think that American businessmen who want to travel abroad in the interest of business should not be discouraged, and there is nothing in our program to discourage them. We want to discourage nonessential foreign travel. The President wants at least the tourists to "See America First" this year, given the needs of our country. There is nothing in our travel program, nothing in the

Commerce Department's commitment here, that does not say, Mr. Businessman pick yourself up and learn the international markets.

Senator PERCY. Now, the purpose of the per diem tax on travel abroad, for instance—I have no objection to your 5-percent tax on carriers to equate it with domestic travel—but don't you think that the per diem tax would discourage businessmen just coming into the export field? A mere handful of corporations do 95 percent of our export business—do you really think that tax would discourage them from continuing to travel?

Mr. SAMUELS. No.

Senator PERCY. No, I do not, either. But where we have the greatest area of growth is that 95 percent of corporations in this country that do about 5 percent of our export business. Many of them are small businesses. Do you think that a small businessman whom we have been encouraging, and the Commerce Department has been encouraging, to go abroad and see these markets, do you think if he gets a tax averaging, say, 20 to 25 percent of his per diem costs, that that would discourage him from going abroad and developing the very markets that you are trying to say you are encouraging him to try to go abroad and develop?

Mr. SAMUELS. Senator, I do not think that in reality the tax that the small businessman is going to have to pay is going to make a difference in whether he goes abroad. Certainly it is not an encouraging factor, but I do not think it will discourage even the small businessman from his trip.

Senator PERCY. If we are not discouraging the big businessman or the small businessman, what are we putting a tax on it for?

Mr. SAMUELS. I think generally the purpose is to get at the tourists who have some flexibility on where they go this year, and ask them to use that flexibility in seeing America first. And this is what the President is attempting to do, and certainly what our encouragement is here.

Senator PERCY. Do you feel though, that to discourage students and teachers, who might travel abroad—don't you feel that these people going abroad learning what the world is all about, understanding cultures abroad, understanding people abroad, then coming back and mainly going into international divisions, if they are young men who have their eyes opened as a result of travel, don't you think that that is an investment of their time that in the end is going to be very valuable for us?

Mr. SAMUELS. Yes.

Senator PERCY. In other words, the President says, I will exempt Congressmen and Senators from going abroad on business; I will exempt Government employees from going abroad, but somehow or other we are saying that they are more important, they are doing more important work for our country than the businessman, than the student and the teacher. Aren't we getting into a situation where it is really impossible to start to discriminate now?

Mr. SAMUELS. First of all, Senator, let me point out that this is the reason for the $7-a-day figure—for the students and the people who can afford it the least, for those who are making the trip at some sacrifice, and who are spending the least. We certainly hope that this tax will not deter them. And certainly there is nothing in this program that disagrees with the basic philosophy that the growth of international travel is important to our country. And I again reiterate the Commerce Department's feeling that we take the positive position. The positive position is what is important to this country. It is to get abroad and develop our own tourism program and get people abroad to see America. We have merchandised everything in this country, but we have not merchandised America abroad. And I think this is really the task that we have and which we hope to make some contribution to. And with Senator Javits' support and with the support of other people, we hope to get the support of Congress for some additional funds that we need. I think this is really where we hope to play the role.

Senator PERCY. We certainly do support that. I like the positive tone of your testimony this morning. I think that is where we ought to put the emphasis. I just want to make it eminently clear that I think this travel ban is going to be impossible to administer. It is going to be discriminatory, and in the long run it is not going to be worth it. It is going to be looked upon in retrospect as a backward step. It is going to weaken confidence in the American dollar rather than strengthening it. I think to propose it—much less enact it—was a very ill-advised move. And I hope the President and the administration are really not going to press it too hard.

Chairman PROXMIRE. May I ask you, Mr. Samuels, if there has been any group in the administration or in your Department, which is experienced in the area of balance of payments, and making a study of what seems to be a growing sentiment in the economic profession in favor of relaxing on our gold loss and accepting the notion of letting the dollar float? In testimony before the Banking and Currency Committee on the gold cover bill, we had Dr. Milton Friedman of the University of Chicago and Dr. Charles Kindelberger of MIT and they indicated that there was this growing sentiment in the economic fraternity. And they felt that a lot of the drive to protect the dollar was just hocus-pocus, mumbo-jumbo holdover from the old superstitions. They were reminding me of something I mentioned before, that the British Chancelor of the Exchequer is said to have observed that the reason that the British had no balance-of-payments problem in the 19th century is that they had no balance-of-payments statistics. So that if we could simply get away from this paralysis feeling that if we lose our gold the world has come to an end—and I don't necessarily share the view of Dr. Friedman; I do not know enough about it, but I am trying to learn more about it—but I would like to know if you are at least studying this, so that we can get away from the kind of thing that Senator Javits and Senator Percy have hit so hard and so well this morning.

Mr. SAMUELS. First of all, let me say that I am as confused by all this as you are, and all the interpretations of the economist. When he quoted the balance-of-payments figure the other day, somebody mentioned to me, it is more than a truth, it is a fact—which I think, was Al Penner's expression.

I think the President is committed to the defense of the dollar.

Mr. Shaw, would you like to comment?

Mr. SHAW. I would like to speak very generally, and then Mr. Pollack, who is our technical expert in the international area, will speak.

I think generally our records will show that where floating exchange controls have been adopted they have not succeeded. I think if you will go back 10, 20, 30, 40 years, you will find that that is essentially an historical fact.

Chairman PROXMIRE. Does the historical record establish anything in the case of a dominant currency of the kind the dollar is now? Has there even been a precedent for this kind of thing? It is one thing if you try to float your currency when it is a relatively minor factor. It is another thing when the dominant currency in the world is permitted to float.

Mr. SHAW. Mr. Pollack will answer that, Mr. Chairman.

Mr. POLLACK. Mr. Chairman, one of the basic difficulties with the application——

Chairman PROXMIRE. And, once again, I do not want to interrupt Dr. Pollack, who is a very highly respected former member of this staff, he did a superb job here, and we know how expert he is in this area, but I want to make sure that he understands the thrust of my question; whether you are studying this, whether you have a competent group in the Department of Commerce or any other place in the administration that is really considering this in detail and coming up with some thoughtful conclusions on it?

Mr. POLLACK. Mr. Chairman, the administration is well aware of the argumentation that has been made on this score. But it is firmly opposed to the idea of flexible exchange rates. One of the basic problems is the nature of the present international monetary system in which dollars form so large a part of the international reserves of other countries. Others might be hesitant to hold as reserves an asset with a fluctuating value, that unless we keep our commitment to maintain the dollar at its present value, there could be a great rush to eliminate dollars as a reserve asset. They no longer would be regarded as a safe store of value.

Chairman PROXMIRE. What would they rely on? The thrust of my point is that if we can cut off from the gold, who is going to be the world banker? Can France take over? Would it be the franc, or the mark? In other words, if we no longer have gold as a monetary medium—and it seems to me, maybe I am wrong about it, we pretty much make that decision—would not they gravitate to the currency of by far the most powerful country in the world that backs its currency with this marvelous productive economic system?

Mr. POLLACK. Advocates of the flexible exchange rate system claim as one of its advantages that it does away with the need for large reserves, since fluctuations in exchange rates rather than reserves, would absorb pressures on the balance of payments.

But I think the one general thing that can be said is that proponents of the flexible exchange rate system and the administration do not agree on the likely consequences if it were adopted. The administration is concerned that if exchange rates were to be flexible, there might be wide fluctuations in exchange rates, extreme speculation in currencies, and severe disruption in flows of international capital and movements of goods and services. The proponents argue that these consequences are not likely to occur. But it is only when the situation is put to a test that we will really know. And the administration, which has the real responsibility in this matter, necessarily has to tread a prudent path.

Chairman PROXMIRE. That is a very satisfactory answer, I think. But I would hope that the administration would consider making a study and getting as many of the most competent experts in this particular field that it can to work on it. I am most impressed by its growing support among people who have a splendid reputation. They are very able people, and they seem to feel that "float" may be an answer.

I would like to ask you, Mr. Secretary, once again—this is the final question I will have in this area—once again about the inflation situation. It seems to me that the inflation problem can become very bad in the next few months, and is not really subject to moderation by fiscal action. And I say that because when you look at the figures between July and December, we had a rise in all commodities except food at a 4-percent rate. Food went up very little; food went up at an annual rate of only four-tenths of 1 percent.

Now, we are just beginning to get this increase in farm prices and food. When that is cranked in, as you pointed out so emphatically this morning, you are getting wage settlements far above productivity increases, a discrepancy of 4 or 5 percent. It seems to me we are laying the groundwork for a terrific inflation, unless the administration has some kind of a program—and I think from the response to Senator Javits and myself this morning it is pretty clear that Government has no program, no program that is going to hold down the wage increases, no program that is going to do anything about the price increases. We had a program from 1962 to 1965. We have no program now. There was a feeling on the part of Gardner Ackley, who was most emphatic about it, and it is shared by many Members of Congress, that in no circumstances are we going to adopt controls. So it seems to me that we are pretty much headed for very, very serious inflation.

Mr. SAMUELS. First of all, there is a program. The tax increase is an essential part.

Chairman PROXMIRE. I started out by saying that it would appear that fiscal policy is going to be handicapped by the cost-plus element in this.

Mr. SAMUELS. I think we agree with you, Senator, that the inflationary question—and that is why I brought it up first today and was very emphatic about it—I think that the inflation problem is the biggest economic problem that we have—I think our people feel that the inflation could go over 3½ percent this year, if there is not a tax rise, and if the effect on demand is felt throughout our economy. And that is one of the important reasons, Senator, why we hope Congress will give some consideration to the tax rise this year, because we have this deep concern. I do not think any of us here can really predict this with other than our best judgment. But our best judgment at the Commerce Department is that without a tax rise there will be further inflation over the 3 to 3½ percent that we see. And it could be more of a problem as far as the effect on our whole economy in the future is concerned.

Chairman PROXMIRE. Of course, we all favor restraints of one kind or another, either a tax increase or a sharp spending reduction which is equivalent to a tax increase.

My time is up. But I would like to get the committee's permission to ask one question for Congressman Curtis who could not be here this morning.

He is very concerned, as the other members of the committee are, about the travel tax. He has a little different approach which he feels is well stressed by an editorial in this morning's New York Times.

The article referred to follows:

[From the New York Times, Feb. 7, 1968]

TOURIST TAX

The Administration's program for reducing the $2 billion drain generated by American tourists may have been devised with the best of intentions, to interfere as little as possible with the traditional freedom of travel, to avoid penalizing students and teachers and yet to cut down on the excessive outlays of those who have plenty of money to spend and have been spending it freely abroad. But despite some good features, this ingenious and complicated proposal seems so full of holes that it looks more like something hastily devised to help get the White House off the balance-of-payments hook than as legislation it seriously expects Congress to adopt.

The 5 per cent excise tax on all airline fares and a similar tax on all ship tickets outside the Western Hemisphere, as well as a lowering of the duty-free allowance to a nominal $10, are reasonable and practical proposals. But the more important part of the plan, that imposing temporary taxes on spending abroad, appears to be neither reasonable nor practical.

While it certainly has its faults, the American tax system has proved more successful than most because of the excellent record of voluntary compliance of taxpayers. The proposed new tourist taxes would make a mockery out of the established principle of voluntary compliance. If Americans are to be asked to estimate their travel expenses and are subject to spot checks to determine just how much money they are taking with them, they will inevitably fall into the kind of evasive practices that have become almost normal in some other countries. Such a result could thoroughly undermine taxpayer morale and morality.

The Administration's proposal would be expensive and ineffective as well; it would almost surely result in retaliation by other countries. There is also the danger that Americans would be tempted to place funds abroad, adding to the outflow instead of reducing it.

While the 5 per cent transportation tax and the lowering of the duty-free limit are worth adopting, the Administration would be wise to place far greater emphasis than it has yet done on programs to attract foreign visitors to the United States. Here is a virtually untapped source of dollars, embodying the positive principle of encouragement to travel instead of the negative approach thus far adopted.

Mr. SAMUELS. First of all, regarding the question of taxation, I think the Treasury Department would be in a better position to answer that than I. I brought this question up, Senator, at a meeting of the administration. And there was a feeling in the administration that we would get compliance the same as we do on the business program. And the procedures are not really complex. And I think this was looked at by Treasury. And I certainly would suggest that Congressman Curtis could probably get more articulation of that from the Treasury Department. I am not trying to duck the question, but on the other hand, I do not feel confident to talk for the administration on this field.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Samuels, I have one other question to ask you about travel. Let us take the average American who likes to cooperate with the Government. Do we understand the tax proposals made by

Secretary Fowler mean that if an American is willing to pay the tax, he is perfectly free to travel, and he is not unpatriotic if he does? On the other hand, does the administration want him to do both? It does not want him to travel at all to Europe, but if he does travel, then he must pay the tax?

Mr. SAMUELS. I think, Senator, the administration's program is that if he travels they want him to spend less money abroad. And I think this is where the impact of the administration's program is meant to be felt.

Senator JAVITS. So he is not unpatriotic if he travels providing he pays the tax?

Mr. SAMUELS. I think the question of patriotism here, Senator, is a much more complex one to answer, because I think the President asked people to consider traveling in this country, to travel in America this year. And I would hope that many people would give consideration to that, whether it is a question of patriotism or a commitment to the national interest. I do not want to draw that line. But certainly this is an attempt to balance the retaliation potentials abroad, and an attempt to decrease the amount of money that people spend in traveling abroad. And the program obviously is a mixture of all of these factors together.

Senator JAVITS. Mr. Secretary, you are going to have to get more specific than that before you are through with the Congress. The American people have either got to know that this country does not wish them to travel abroad—that it is voluntary, we are asking them to voluntarily restrain themselves——

Mr. SAMUELS. The President said that, Senator, he said it very specifically.

Senator JAVITS. I know, he said it before he submitted his travel tax program. Now he has submitted his tax program and the people have a right to know whether or not he still wants them not to travel, or whether he says it is still OK to travel so long as you pay the tax. That is very important, and will determine the decision of many people. Frankly, I think you are going to get a lot more out of this by the voluntary restraint on travel than you will via the tax, which is going to be pretty mischievous, and, in my judgment, discriminates against people of modest means. But be that as it may, I think you are really going to have to lay that down. You might as well do it in a department that is encouraging travel to the United States rather than have the taxpayers do it.

Mr. SAMUELS. I appreciate your comment very much.

Senator JAVITS. I would ask you, Mr. Secretary, in the interest of the people of the Nation who wish to support their Government, to inquire of Secretary Trowbridge and the administration whether or not they wish to make some expression within the context of this hearing on that subject from the Department of Commerce whose duty it is to encourage two-way travel.

Mr. SAMUELS. Thank you, Senator.

Senator JAVITS. I ask unanimous consent that should they decide to do anything that it go in the record.

Chairman PROXMIRE. Very well. Without objection it may go in.

(The following material was subsequently supplied for the record:)

The object of the administration's balance of payments program in the area of international travel is to achieve a $500 million reduction in last year's deficit in the tourism account—both by increasing earnings and by cutting back expenditures. In accomplishing the latter, we seek to reduce travel spending, not travel itself, and the proposals recently submitted to Congress by the Secretary of the Treasury are tailored to that purpose. However, until these proposals can be implemented, the President has asked the American people voluntarily to reduce excessive spending overseas by deferring all non-essential travel outside the Western Hemisphere.

Senator JAVITS. There is another thing I would like to ask you about.

I notice with great interest your concern about deep economic questions like encouragement of the movement of people to where job opportunities are, and the problem of rural poverty. I might say, parenthetically, that the multi-billion-dollar agricultural subsidy program seems to benefit all the commercial farms and it never seems to deal with the problems of rural poverty and those for whom it is intended. So, you have got the one problem of bringing people to where jobs are, and you have got the other problem of danger of the rural areas being pockets of poverty and people deserting them in droves, or subsisting on a very unfortunate level.

Now, I know a great deal about what is going on in the poverty program. But I think it would be very useful if Commerce would give us a little brief on what is going on all over the Department in this matter. How do these programs tie together? As I say, I know all about the poverty program, as I am a ranking member of that committee, and I am in that up to my ears. But I think we ought to know what is being done about that in the various other agencies of the Government.

(The material appearing below was also subsequently supplied for record:

FEDERAL PROGRAMS FOR INVESTMENT IN PEOPLE AND COMMUNITIES

There is a vast network of Federal assistance programs relating to poverty and economic developments. These programs are listed and described in several existing publications: *Hearings before the Subcommittee on Intergovernmental Relations* (November 19, 1966), *The Catalog of Federal Assistance Programs* compiled by the Office of Economic Opportunity, and the *Handbook for Local Officials*, prepared under the aegis of Vice-President Humphrey.

The *Hearings before the Subcommittee on Intergovernmental Relations* lists, for example, 25 programs dealing with job creation and economic development, 40 programs to help farmers, 44 programs to provide technical and financial assistance to industry and commerce, and 52 programs for economic aid to State and local governments, nonprofit organizations, and small businesses.

Mr. SAMUELS. Senator, I have a very strong feeling about some of the cities that you and I are very familiar with. And what concerns me in areas like Bedford-Stuyvesant is that we get a continuation of the rural poor moving into these areas and a continuation in the large urban centers like New York and Chicago of industry moving out, and no really adequate transportation. What I have tried to point out here is that this is a new problem for us in the Commerce Department and the Nation. You cannot talk about economic development without talking about the economic development of our inner cities, and particularly in our large urban centers. I just want you to know that in the Economic Development Administration, which is part of the Commerce Department, we are really doing some studies in this area, and hope to make some considerations into suggested programs.

Senator JAVITS. I hope you are. And I hope you will make them if you can for this record. The EDA, as you know, is not in the big cities; it is not in the big city cores, by the text of the law itself.

Now, the problems are not new to us. They may be new to the Department of Commerce. But the antipoverty legislation this year, upon the insistence of myself and Senator Kennedy, provides money precisely for the purpose of bringing the job to the man and to the man nearest to the job, including transportation. It is very specifically set up. And I have fought an enormous fight to get Commerce to keep that authority for small business. But I unfortunately lost. So you are tied into it, but not as directly as I wanted.

So I think we ought to know from you just exactly what is the pattern, and whether you have any legislation recommendations for us.

But bear in mind what I told you, that the poverty program, the new poverty bill, is very specific in coverage on that particular subject.

Mr. SAMUELS. Senator, I do not think it is very human to encourage the rural poor to move to an area of society where their future in economic dignity does not exist. And I think this is what is happening in our large urban centers throughout the Nation. And the flight of American industry and service organizations out of the big cities like New York, I think is going faster than our data yet shows us. The transportation, the cost of land, the growing mistrust between black and white, the difference in welfare programs, all of these are encouraging movements in our country which I think are against the national interest over a period of time. And I think that we must start to consider new views and new approaches.

Senator JAVITS. Give us some of your thinking on that.

Mr. SAMUELS. We certainly will, sir.

Senator JAVITS. Talking about small business, you said:

> We must make further progress toward a national strategy that will promote and sustain business ownership among members of the minority groups.

We are deeply persuaded on that. And again the poverty bill carries a provision which has a specific program. Unfortunately the budget does not give a great deal of money, a few million dollars. It is in the SBA instead of the Department of Commerce, but you are tied in it. So give us if you will the——

Mr. SAMUELS. I think, Senator, that this is one of the areas of challenge for us. It is not all money. What we find is that throughout the country there are programs, some of them operated by private people, and private organizations, to help the development of minority entrepreneurism. And I think we have the responsibility, being the relatives of business, to form a synergism here between what needs to be done in all of the agencies in Government and all the private and public agencies across the country and to provide some leadership to this. I think this is important to the country. And I hope that the Commerce Department can make a contribution to this in 1968.

Senator JAVITS. I tried very hard to get you this authority, because of what you say. We also made some suggestions to a lot of sponsors in Congress for an economic opportunity corporation, as an instrument of business, and for a domestic development bank. I invite your attention to these. But we would like to have for the record whatever creative thinking, in view of all these programs which are around, not actually tied together, of the Department along the lines that you have mentioned.

Mr. SAMUELS. Thank you, Senator.

(The following material was later supplied by the Department for the record:)

ECONOMIC DEVELOPMENT AND THE PROBLEM OF RURAL-URBAN BALANCE

It has become increasingly apparent that the problems of urban poverty and those of rural poverty are inextricably intertwined; that the roots of much of the poverty in the metropolitan North are traceable to the rural South. It has been found, for example, that the crucial connecting link is the pattern of migration from the rural areas to the large metropolitan areas: from 1950 to 1960 over 10 million people migrated from the countryside to major cities.

An EDA analysis has shown that, even holding the population of our major urban areas including the neighboring suburbs constant, a 4 percent unemployment rate will require a net outmigration of 6.3 percent of the population from our 10 largest urban complexes and a 4.8 percent outmigration from our 29 largest complexes from 1960 to 1975.

Other EDA studies have shown that the rural poor will continue to go to the major cities. When one realizes that this migrant group is also the least prepared to cope with the economic and social conditions of the urban problem of survival, the true magnitude of the problem comes into focus. To this should be added the fact that the relief rolls of the cities are swelling at bankrupting speed, the school systems are breaking down, the traffic is clogging, and the slums are overflowing.

What are the solutions to the problem? They seem to be three-pronged.

First, we can allow the migration to continue and concentrate on central city solutions. Many of the programs listed in the *Hearings before the Subcommittee on Intergovernmental Relations* do just this. The immediate need is for more public housing, more direct dollars for the needy, more training programs for the people streaming into town unskilled and often illiterate, inducements to attract industry to the city core, dispersal of the poverty area of the city by jobs and housing in the suburbs, transportation subsidies for poorer workers, etc. These needs are being met, in part by OEO and HUD programs, and where appropriate under EDA programs.

Existing programs are largely curative, not preventive, and the probability is that unless preventive measures are taken at the source, the migratory problem will get worse. The second alternative, therefore, is that while pursuing the curative program in the cities, we must also develop policies to provide alternatives for the people in the rural areas. The agricultural technological revolution and simply the modern way of life have meant that the underemployed and unemployed in rural areas are outside the market economy. There is danger, however, that over-emphasis on rural agricultural programs might aggravate the problem. Beyond this, urbanization is a basic trend in our economy, reversing such flows is impossible, but slowing them and making more efficient flows is not.

A third alternative is therefore open, concentrating not on reversing the migration stream but rather on re-directing and channeling it. This policy accepts the fact that urbanization is a basic trend but strives to create a better urban-rural balance through the creation of urban alternatives.

One approach that has been suggested is the creation of New Towns. However, these are expensive to create and unproven. Given our limited funds, they appear presently unsuitable as tools of economic development. Another alternative that has been suggested is the economic growth center approach.

While the Economic Development Administration expects to participate—as fully as its program tools and limited resources permit—in programs to bring jobs to the inner city, it will also try to pursue a program of presenting a range of urban alternatives for the people who are still to migrate from the rural economy. One of EDA's major tools for building solid growth foundations for ecnomically lagging communities is the multicounty economic development district, in which under-developed counties are linked with healthy counties containing a regional growth center. This is a functioning program. During fiscal year 1967, EDA has been working with 95 designated and developing districts in 35 states, providing planning support and direct assistance for economic development projects. By providing the economic districts with an urban alternative, through the growth center, it is hoped that the growth center will help the economy of the depressed area. The growth center will do this by providing an economically efficient marketing and servicing center for surrounding counties, by providing job opportunities for depressed area residents who could commute to jobs, and by encouraging those rural area residents who do migrate to move to the growth center to obtain jobs (migration alternative). Through this interaction the Districts will provide a greater capacity for growth and economic development than could a single county. It is our hope that these growth centers will provide definite and worthwhile migration alternatives within the urbanization trend and that they will contribute to a greatly improved rural-urban balance. This program is a preventive measure and an effort to increase the size of the economic pie through regional economic growth. It calls upon private enterprise and local initiative to design and implement community redevelopment in partnership with the government. EDA's program aims at relieving the pressure on the big cities through urban alternatives while at the same time lifting the rural areas by the bootstraps.

It is the Department of Commerce's position therefore that while curative measures are important we should actively be engaged in preventive measures as well. Efforts should be devoted to improving urban development policy through a comprehensive growth center strategy. A growth center is large enough to permit balanced economic expansion; it has sufficient facilities to provide a framework for assimilating the migrant in-flow. A growth center implies that job opportunities can be easily induced—growth factors are already present even though the community may be located in a low-income area. A program could attempt to induce the flow of migrants to these urban growth centers through a combination of forces including jobs, schools, transportation systems, social amenities and improved equal opportunity programs.

We can achieve more concerted effort by combining our Federal program resources. EDA's industrial growth center or business development strategy can be linked with parallel programs for settlement assistance and manpower training and development to assist the rural migrant to adjust to the urban employment environment.

Chairman PROXMIRE. I will ask a question on behalf of Congressman Brock once again. This question relates to whether the balance-of-payments program which was announced by the President will have an adverse effect on other nations, and whether in self-defense they will impose similar measures to reduce their flow to the United States. What guarantee do you have that this will not happen?

Mr. SAMUELS. We have no guarantee, Congressman. And this is a risk. There is enough capital abroad, as we look at the year 1968, for us to feel that we can borrow and make use of foreign capital for the expansions that are planned. But there is a risk. And if we dry up the foreign capital, there could be some retaliation by foreign nations to this program.

My associates also wanted me to add that other nations understand our problems here and have been very cooperative in our approach to the problem abroad. But I certainly think it is a constructive question that you are asking. And we will just have to watch as time goes by.

Chairman PROXMIRE. Congressman Brock follows it up by asking, Has any study been made to determine the degree of the adverse effect such actions will have?

Mr. SAMUELS. I do not think we have seen any adverse effect.

Chairman PROXMIRE. Yes, but any study that anticipates—in other words—a study to indicate what the adverse effects might be, or what possibly the countries which are not as cooperative and friendly, France, for example, and the others might do.

Mr. SAMUELS. Mr. Shaw said he would like to answer that.

Mr. SHAW. Mr. Chairman, there were no studies as you would define studies. Nevertheless, there have been a series of actions intended to determine the degree of retaliation, if any. These actions have included the sending of missions abroad to Europe and Japan. And these actions have included discussions with various representatives of countries with problems, who come in.

I would again reaffirm what the Acting Secretary has said, that to date, at any rate, we have no indication of any significant amount of possible retaliation.

Chairman PROXMIRE. Now, I would like to ask you, Mr. Secretary, even if a tax like—a tax hike combined with a spending cut and sharp restraint, would in effect arrest our price rise, slow it down, reduce it, as the Council of Economic Advisers thinks it might, from a 4-percent rise to a 3-percent rise, why would that necessarily contribute constructively to our balance-of-payments problem? What strikes me is that there is a theory here, but the theory does not seem to work out in practice. For the last 7 years, this country has had the best inflation record of any advanced country of any of our significant trading partners. For the last 2 years, we have had a better anti-inflation record than any of them except France and Germany. And the country which has been most vigorous and successful as a trader has the worst inflation—Japan. There is a country that really many people feel is going to grow more rapidly and succeed more economically than the others, and they have rising wages, costs, and rising prices that greatly exceed ours. Now, recognizing the apparent benefit we should get from a lesser inflation here, why should we assume that if we simply slow down our rise by 1 percent the balance-of-payments problem will be solved in this more important area?

Mr. SAMUELS. Well, I do not think we expect to solve it by the tax increase alone. There are several things—first of all, the psychological fact or which is also a part of the balance-of-payments problem, and a drain on our gold, and certainly by decreasing our deficit we are going to indicate to the world that we are willing to put our house in sounder order——

Chairman PROXMIRE. If I may interrupt at this point, my question is, Will we reduce our balance-of-payments deficit by simply improving our inflationary posture? I agree that for domestic reasons we want to do all we can. But, I am just wondering if this is the fundamental answer on the balance-of-payments sector in view of the experience of the countries that have worse inflation and are doing so well as traders?

Mr. SAMUELS. I think by great inflation here we encourage our imports, Senator. I think this is a major factor that could affect our balance of payments with greater inflationary pressures here.

Chairman PROXMIRE. I think that may well be the case. But once again I am just struck by the contradiction that the countries that have suffered inflation have done very well as world traders. Our main competition in many areas now is Japan.

Mr. SAMUELS. But I think Japan's great success has been their technical success, and their great investment in human capital which has given them a technology comparable, frankly, to the United States in many fields.

Chairman PROXMIRE. That should be reflected in their prices, and it should enable them to keep their prices under control.

Mr. SAMUELS. They are having an inflation. But still their wage rates are considerably below ours today. And I think over a period of time there will be a balance.

Chairman PROXMIRE. But their wage rates have been rising more rapidly, and their prices have been going up. So that whereas it seems to me our advantage should be gaining, that actually our trade advantage is deteriorating.

Mr. SAMUELS. I do not have any easy answer to that, Senator. My staff tells me that Japan also has a very serious balance-of-payments problem. And I might also say that I think the Japanese have been much more aggressive in their export program than we have in this country. And I think this is one of the reasons I suggested that as one of our main challenges.

Chairman PROXMIRE. The staff has suggested to me that the balance-of-payments problem seemed to be largely a—it might well be at least largely—a temporary problem. Inasmuch as we know there was a one-half billion dollar liquidation of British securities, and a substantial borrowing by U.S. banks in the Euro-dollar market, these are financial short-term developments. Why, therefore, do we not put more emphasis on financial measures rather than restraints on travel and long-term investment? In other words, why not restrain banks, more than we are, from borrowing in the Euro-dollar market?

Mr. SAMUELS. First, there is restriction on banks. And I just think the President felt the problem was so serious that we had to do all of these things. And that is what we have attempted to do. We have gone along with this problem for a good number of years now. We feel from the point of view of the prestige of the American economic system and the world we just had to show that we are willing to take all steps concurrently. And that is what we are doing.

Chairman PROXMIRE. Would you tend to agree with the analysis that has been implied by the question, that these are short-term movements, largely?

Mr. SAMUELS. I think, Senator, that we had some short-term movements certainly in the last half of 1967——

Chairman PROXMIRE. What really seemed to energize the administration and make them decide to put these in effect is what happened in December. I know I was briefed, as were some other Members of the Congress, by the Treasury Department. They came up and they said the balance of payments has really deteriorated terribly in the last couple of months, and we are going to have to have these measures. If its deterioration is the result of short-term financial movements, it seems to me that long-term measures directing travel, trade, our own fiscal policy, and so forth, would seem less pertinent than short-term financial measures.

Mr. SAMUELS. Senator, I think that was discussed, obviously, before the President called you together, the question of whether this was short term or long term. And I think there were some differences of opinion within the administration. But I think there was one agreement, and that is that the thing was serious enough that national action was required, and it was too great a risk to wait and see and be sure that these things were going to be corrected easily.

Chairman PROXMIRE. I suppose some of those were because the so-called longer actions would have a good psychological effect?

Mr. SAMUELS. Well, I think that is important to the balance of payments. It is certainly important to the flow of gold. So I think that was one of the factors.

Chairman PROXMIRE. This fine publication of yours, Survey of Current Business, in the September issue, has an article that shows a sharp decline in the rate of return on direct investments in Europe, whereas the return rate in the U.S. domestic investment is rising. I understand the returns on the European investments have fallen to 11 percent by the end of 1966, and domestic returns are 15 percent. Now, this good, solid, free enterprise and free world factor—shouldn't that help solve our problem, and perhaps even lower decisively and definitely the restraints? If return is greater here than abroad, people should be investing here, including the Europeans.

Mr. SAMUELS. I do not think there is any question, Senator, that one one of the large reasons for the investments abroad in the years up to the last couple of years was the great return on equity and the great leverage we could have for our money. That is what encouraged American industry to move abroad. This is more equal now than it was.

Chairman PROXMIRE. This analysis in your article suggested that it was not only equal, it is in our favor, 15 percent average here, 11 percent abroad.

Mr. SAMUELS. That is on the total investment.

Chairman PROXMIRE. That is my understanding; yes.

Mr. SHAW. May I make a comment on that?

I think one has to consider the economic climate in each of the areas. And you may recollect that in 1966 when we were in an unusually exuberant economic climate in the United States, in Europe, at least in some countries, we are beginning to see some easing.

Another point I would like to make in connection with the comparison of these——

Chairman PROXMIRE. May I interrupt at that point, Dr. Shaw? You are apparently familiar with this article. And I wonder if you could tell us if this is continued in 1967; this advantage in favor of the American investment?

Mr. SHAW. We do not have any firm figures on that, Mr. Chairman. I would speculate that, insofar as the return on investment in Europe is concerned, it may well be a little lower in 1967 than in 1966, first, for the reason that I just mentioned, that we have had some business uncertainty in Europe; and second, for a reason I was about to mention, that we have had, of course, a very large surge in investment in Europe. In the early years of that investment coming onstream you have heavy startup expenses. So there is still hope and question as to whether these lower rates that we have been experiencing in 1966 and possibly in 1967 reflect the longer picture in our investment.

Chairman PROXMIRE. Certainly if anyone in the country knows about return on American investment in 1969, it should be you. Can you speculate on what is happening here?

Mr. SHAW. I could only speculate. I do not have affirmation on this either, that at least in the first half of 1967, because of the slowing of our advance, the return on investment surely went down.

Chairman PROXMIRE. Doesn't the pickup in the last half, and especially the last quarter of the year, suggest that if there was a deterioration in the first part of the year that it may have been improved in the latter part?

Mr. SHAW. I was just about to say that I thought that the last quarter certainly changed the direction of the turn in investment. I would not be prepared to say for the year 1967 as a whole that it was higher or lower than in 1966.

Mr. SAMUELS. Senator, I would like to call to your attention something that I mentioned regarding corporate profits in my presentation. Sometimes we tend to look at corporate profits as a total figure instead of a return on something that is more meaningful, such as stockholders' equity. If you look at what has happened to corporate profits, as a return on stockholders' equity, they are actually lower, and lower as a return on sales, then they were in the last part of the forties, and are not much different than they were in the fifties. And this is one of the reasons that I mentioned that corporate profits are not high enough to absorb large wage increases without having a dire effect on the kind of free enterprise system that is part of our country. Sometimes the figures on return on equity and return on sales—return on equity being the most important—are lost when we just look at total corporate profits, not recognizing that while the pie gets bigger every year, the equity also gets bigger every year.

Chairman PROXMIRE. Of course, that raises two points. One is that maybe I am a victim of my own propaganda, but as a Democratic Senator who has spoken so often for other Democratic candidates and for myself, I have talked about this terrific increase in corporate profits we have enjoyed in the last 7 years, outpacing everything in our economy, wages, personal income, and things of that kind. Corporate profit has been the biggest gainer. It has gone up 80 percent, very greatly since 1960.

Mr. SAMUELS. But so has the equity.

Chairman PROXMIRE. And it seems strange to hear now, especially from a representative of the administration, that corporate profits are too low. Now, it may well be that they are.

Mr. SAMUELS. I did not say that they were too low, Senator; I said that I wanted to call to your attention that it looked like the return on stockholder equity for the first three quarters of last year expressed at an annual rate was 11.4 percent, and in the 1950's, when we considered profits very low, they were 11.1 percent. But, what we have to recognize is that certainly corporate profits have gone up, but the investment has gone up tremendously. And, the return on sales, which was 5 percent——

Chairman PROXMIRE. You may very well be right. I do not want to argue that particular point. But, once again, it emphasizes the fact that if we are going to have an opportunity to expand, and corporate profits are essential for that kind of expansion, if we are going to have an opportunity to expand, we need the incentive that stimulation of corporate profits represent. We are going to have, it appears, more inflation, because you have low productivity and high increase in wages. And, if you do not have an increase in prices, you are going to have a really serious squeeze on profits. So, it appears more and more as if prices, unfortunately, are going to rise sharply, And, as a matter of fact, if they do not rise, you have another very serious problem in the profit squeeze.

Mr. SAMUELS. That is the message, Senator.

Chairman PROXMIRE. Thank you very much, Secretary Samuels. You have done a superlative job. And I would like to ask you, if you could, to answer a few other questions that we have typed up here for the record.

Mr. SAMUELS. Certainly. And I want to say to you, Senator, that I appreciate the courtesy that you and the committee have extended to me and my associates here today.

Chairman PROXMIRE. You have been mighty impressive with your testimony.

The hearing reconvenes on Wednesday next, the 14th, in this room, when we hear from the Chairman of the Federal Reserve Board.

Without objection I would like to submit additional questions for the record.

The committee stands in recess until 10 a.m., on February 14.

(Whereupon, at 12:15 p.m., the committee was recessed, to reconvene at 10 a.m., Wednesday, Feb. 14, 1968.)

(The questions above referred to by Chairman Proxmire and the answers received follow:)

THE UNDER SECRETARY OF COMMERCE,
Washington, D.C., February 19, 1968.

Hon. WILLIAM PROXMIRE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PROXMIRE: Attached are the responses to the eight questions forwarded to me by Mr. John R. Stark on February 8, in connection with my testimony before the Joint Economic Committee on February 7.

Sincerely yours,

HOWARD J. SAMUELS.

Question 1

Q. How much more would prices rise without the proposed surcharge than with it? Which prices will be most affected by the decision regarding the proposed surcharge?

A. There is every likelihood of higher prices without the surcharge, though it is not possible to say how much. The extent of a price rise depends on such factors as monetary policy, Federal spending, the course of the Vietnam War, and consumer and business psychology. Basically, without the surcharge, consumers and businesses would have greater spending power at a time when there are pressures on productive resources, especially labor. Moreover, failure to enact the surcharge might promote an inflation psychology based on the public belief that the Government is not responsibly accepting its part in combatting inflation.

The most likely price to rise without the surcharge is the price of money. In addition, prices face a strong upward push in industries with a high income elasticity of demand and in those with the ability to pass along cost increases. Prices of personal services are among those most likely to rise.

Question 2

Q. Won't the surcharge make it more difficult, if not impossible, to implement the program to put 500,000 hard-core or disadvantaged to work?

A. The Council's projection of a $61 billion increase in GNP reflects a *real* growth rate of somewhat more than 4 percent in 1968. This projection is based on the assumption that the President's proposed tax surcharge is enacted. With this rate of real growth, it will be possible to maintain the level of unemployment at or below 4 percent during the current year. This means that the employment situation for 1968 will be as good as, if not better than, it was in 1967.

The maintenance of overall effective demand in the economy is an essential ingredient to a strong economy and high employment. Basically, however, the 500,000 hard-core or disadvantaged that we are talking about reflect a structural unemployment problem rather than one of insufficient effective demand. In spite of an unemployment rate of 4 percent or less during most of 1967, the unemployment rate was 6.0 percent among all Negroes, 23.9 percent among male Negroes 16–19 years of age, and 8.0 percent among Negro males 20–24 years of age. It is likely that these and other hard-core or disadvantaged workers will be more directly and favorably affected by the Government's various manpower programs than by small changes in the level of aggregate demand.

Question 3

Q. Would the application of specific guidepost figures for wage and price decisions do more to reduce inflationary pressures than merely the general appeal for "wage-price restraint"—which has probably been included in almost every annual Report?

A. In 1968 the economy faces continuing upward pressures of labor cost, aggregate demand, and prices. Modification of these pressures, to move toward price stability, would require, in addition to enactment of the surcharge, average wage settlements below the 5½ percent average of 1967 and price restraint.

The application of specific wage-price targets would not, in itself, reduce inflationary pressures. A low guidepost figure would be meaningless; a high guidepost figure would condone continuing inflationary pressures; and exceptions and qualifications would become difficult to deal with. The guideposts appeared to perform well in years—1962 to 1965—when the general economic environment posed a much smaller challenge to moderation in wage settlements than in the case in 1968.

Question 4

Q. Last year, numerous firms increased prices in the face of substantial excess capacity. This was true in steel, autos, television, and chemicals—to name just a few examples. How do you account for this type of behavior?

A. Price adjustments last year within the industries cited in the question reflect a combination of market and cost factors. In particular, sharp rises in unit labor costs in excess of productivity in 1967 undoubtedly played a major role in price increases during the year.

Selective adjustments in steel prices occurred in 1967 as a consequence of several forces. The increase in the costs of making steel must be underscored as an important element. Rising factor costs—both labor and input materials—contributed to a lower profit per unit of output. The prospect of improving markets for steel in late 1967 encouraged steel producers to post price increases that many of them had felt warranted on cost grounds for several years.

In the first half of 1967 automobile prices as measured in the Wholesale Price Index were at about the level of the 1957–59 base period. Price increases for the 1968 model cars reflected rising costs such as a substantial wage settlement and higher material costs for copper, nickel, and steel, as well as new safety features. In addition, the industry's price policy reflected an anticipated recovery in consumer spending for automobiles.

Following a strong consumer demand in early 1966, the television industry went through a period of readjustment in late 1966 and 1967. With the moderation of consumer spending, sales of television receiving units—particularly color sets—never reached early sales expectations. The general price pattern of the television industry reflects these and other forces. As demand softened, selective promotional decreases became common in the industry. With the strengthening of consumer spending in the latter part of the year, price adjustments in specific model lines occurred. However, despite these price movements, the Wholesale Price Index for television receivers remains below the 1957–1959 average. In fact, the price of color television receivers in the Wholesale Price Index for calendar year 1967 declined by about 3 percent from the preceding year.

The general price performance in the chemical industry is complicated by the fact that there are thousands of individual chemicals whose prices continuously fluctuate in the market, often directly in response to excesses or shortages in capacity. In spite of these fluctuations, the Wholesale Price Index for all chemicals and allied products at 98.4 in December 1967 (1957–59=100) was virtually unchanged from the level a year earlier.

Upward price pressure was particularly severe in the case of inorganic chemicals derived from sulfur. Presently, there is a world shortage of sulfur. On the other hand, excess capacity put severe downward pressure on synthetic fiber prices in late 1966 and early 1967. The recovery of demand for polyesters and other synthetic fibers in late 1967 permitted only partial restoration of early 1966 prices.

Question 5

Q. The Committee has been under the general impression that there are some major industries where prices have not declined commensurate with their rapid advances in output per man-hour. The Council's Report analyzes developments in major sectors, for example, manufacturing, and transportation. Could you supplement that section by providing information relating to productivity, unit-labor costs, and prices for industries in which prices have not fallen commensurate with rapid advances in labor productivity?

A. Data on productivity, unit labor costs, and prices—which are supplied by BLS—are available only at the one digit level of aggregation shown in the Council's Report. While BLS does derive productivity data for selected industries, it does not have corresponding price data. Consequently, currently available data do not permit identification of productivity-price movements in specific major industries to substantiate the Committee's impression. So far as 1967 is concerned, with less than 1 percent increase in productivity in the private nonfarm economy and a 5.8 percent increase in average hourly compensation, it is doubtful if any industries had productivity gains sufficient both to absorb wage increases and to cut prices.

Question 6

Q. What has been the functional distribution of income between labor and capital in the corporate sector during the past decade?

A.

LABOR AND CAPITAL SHARES OF GROSS CORPORATE PRODUCT, 1958-67

[In percent]

Year	Employee compensation	Corporate profits before taxes	Corporate profits after taxes
1958	66.3	16.0	8.3
1959	65.1	18.2	9.7
1960	65.9	16.7	8.7
1961	65.6	16.4	8.5
1962	64.9	16.6	9.0
1963	64.6	17.0	9.1
1964	64.1	17.6	9.9
1965	63.6	18.7	10.7
1966	64.2	18.8	10.7
1967—I	65.5	17.1	9.8
II	65.4	17.1	9.7
III	65.5	16.8	9.6
IV	(1)	(1)	(1)

1 Not available.

Source: Department of Commerce, Office of Business Economics.

The table above shows the functional distribution of income between labor and capital in the corporate sector.

During the early years of the present expansion, labor's share of the gross corporate product declined slightly. However, since 1965, the labor share has moved upward as wage rates have risen more rapidly and profit margins have been under pressure. For the past decade, as a whole, the labor share in the corporate sector has been relatively stable, averaging about 65 percent.

Corporate profits after taxes moved upward, although irregularly, from 1958 to 1965–1966 when they peaked at 10.7 percent of gross corporate product. The rise in after-tax profits in 1964 and 1965 was in part the result of the two-stage reduction in the corporate tax rate. By the third quarter of 1967, however, the corporate profit share had declined to 9.6 percent as labor and material costs continued to rise sharply. Corporate profits after taxes in 1967 expressed as a share of the gross corporate product were higher than in any other year in the past decade except the 1964–1966 period. However, this relative share was less than in 1955 (11.3 percent) and 1956 (10.5 percent) and considerably less than in the immediate post-World War II years when the average share was about 14.6 percent.

Question 7

Q. Could you furnish more detailed information on the forecasts referred to in your statement, which indicate that by 1975 "our 25 largest metropolitan centers may be pools of unemployment?"

A. The statement concerning unemployment in our 25 largest metropolitan centers outside of California was based on projections which were made early in 1967 for the EDA Program Memorandum of March 1967. When the potential for unemployment in the major cities was originally outlined, it was also estimated that between 80 and 90 percent of this potential unemployment problem would be eliminated by the normal workings of the private economy. Since that time, these projections have been refined to incorporate more recent data and better estimates of migration. The latest projections indicate that the 25 largest metropolitan complexes outside of California will have an estimated aggregate unemployment rate of 3.98 percent in 1975, if the national unemployment rate is 4.00 percent. The central cities of these urban complexes are expected to have the somewhat higher unemployment rate of 4.29 percent.

However, overall averages such as these mask a number of severe problems for individual areas. For example, eleven of the central cities are expected to have unemployment rates greater than the group average of 4.29 percent, and seven are expected to have unemployment rates of 5.00 percent or more. Furthermore, four of these central cities, with a total estimated population of more than 5 million in 1975, are expected to have unemployment rates of at least 7.00 percent, which is almost double the projected national average.

If central cities continue to attract Negroes in large numbers, the percentage of unemployment in the core areas will run much higher than in the city as a whole. These are the areas where "pools of unemployment" threaten to become a serious economic and social problem.

Question 8

Q. What policies might be adopted which would "encourage the movement of people to where job opportunities are located" and which would constitute a "migration strategy" as referred to in your statement?

A. The paper which Under Secretary Samuels used as the basis for the statement contains a very complete answer to Question Eight. The relevant portion follows:

"It isn't how much, but how good. It isn't how much wealth we create, but what kind of wealth. It isn't how fast we are going, but where we are going."

* * *

If we plan to cure our cities, then surely we must *prevent* them from growing haphazardly. The rising tide of migration must not be allowed to swallow progressive social gains.

* * *

If we really believe in a racially integrated society, then surely we must recognize that such a society requires economic integration as well.

* * *

What specific national policies suggest themselves as possible courses of action to develop a rational migration policy?

1. *First, we must develop our rural areas and identify future growth centers.*—These growth centers are usually defined as representing an urban or community nucleus of approximately 50,000 to 500,000 population. The Public Works and Economic Development Act of 1965 made a major beginning in recognizing our need to provide economic development assistance to smaller areas. We must expand this aid and encourage the movement of jobs to areas with strong growth potential.

2. *A system of relocation loans or allowances* can be provided, as is done in many European nations. In England, the government provides incentives to make it profitable for industry to relocate wherever people are. In Sweden, the government provides moving allowances, so that people can move to where the jobs are. Of course, America's problem is not as simple because of the nature of our multiracial society.

3. *Expansion of the Federal-State Employment Service to provide a national job vacancy information system.*—This must include improved job counseling, training, and improved coordination of job information in each State.

4. *Provision for more loans and grants to cities and areas where you want to encourage people to move.*—This would allow for more comprehensive local planning, improvement of public facilities, more public housing and rent supplements, and major planned industrial and commercial development.

5. *An end to housing discrimination in suburban or growth center areas.*—This must entail more public housing in the suburbs. If race is truly one of the key impediments to the free mobility of our people, then to be relevant we must break down the housing barriers. If industry is moving to suburban areas, then we must make it possible for the unskilled and semi-skilled to move there also.

6. *A movement towards national education standards.*—As long as many of our rural areas continue to invest half or one-third of what our urban areas do for education, we are locking ourselves into failure. Because of migration, Mississippi's education failures of today are destined to become New York's social and economic costs of tomorrow. This year 66,000 rural Mississippians will migrate North. Because economically poor Mississippi is spending a higher percentage of its personal income for education than more affluent New York State, more Federal assistance, as well as higher education standards, will be necessary.

7. *A movement towards national welfare standards.*—Until we have adequate levels of welfare support throughout America, those Northern urban areas which provide more benefits will continue to serve as an attraction to the rural poor (even though it can surely be said that the social welfare system in every Northern city is woefully inadequate). This will be one of the major concerns of President Johnson's recently appointed commission to study welfare.

To truly reverse the migration trends and channel them in a planned way will mean creating a positive attraction for the potential migrant in designated growth areas. It cannot be left to local communities to assume this burden. To be honest, we must recognize that it is often in the narrow self-interest of such communities to export their poor. The poor are more expensive because they need extra social services.

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 14, 1968

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

The committee met at 10 a.m., pursuant to adjournment, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Symington, Javits, and Miller; and Representatives Patman and Curtis.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority staff economist.

Chairman PROXMIRE. The committee will come to order. We have as our witness this morning the distinguished Chairman of the Federal Reserve Board, William McChesney Martin, an extraordinarily able man who has won support not only of the overwhelming majority of Members of the House and Senate but also of the American people. He has always been most frank, forthright, and helpful in his statements, and there is no exception this morning.

With the permission of the Chairman, I would like to call on our vice chairman and former and future chairman of this committee, the Honorable Wright Patman, who has a statement which he will make at this point and then we would like to hear from you, Mr. Chairman.

STATEMENT OF REPRESENTATIVE WRIGHT PATMAN (DEMOCRAT, TEXAS), VICE-CHAIRMAN OF THE JOINT ECONOMIC COMMITTEE

Representative PATMAN. Mr. Chairman, Chairman Martin, I would like for you to answer as much of this as possible when you present your statement, and then after you conclude, I hope to have the opportunity of asking questions that are not answered in your reply, if you please.

During normal times, our economy can and does tolerate almost any kind of economic mistake. It is a tribute to our strength and prosperity that our economy keeps going despite misguided monetary policies. Our general prosperity papers over the huge cracks that develop from 19th-century policies of the Federal Reserve System.

It is in time of crises—such as we now face with the war in Vietnam—that the facade of infallibility begins to crumble from the Federal Reserve. The test of any governmental institution is what it can do for the country and its people during times of extreme difficulty and economic crisis.

Mr. Martin, I submit that your agency—the Federal Reserve—has failed miserably, and is continuing to fail, in meeting its obligations to the economy in a wartime period. Outside of the Vietcong, I do not know of any institution that has done more damage to the American economy in the past few years.

Sometimes, Mr. Martin, I suspect that you think that your Federal Reserve Board is the only Federal Reserve Board that has ever existed. But let me remind you that we have had other Federal Reserve Boards and we have had other wartime periods.

I have never been too happy with the overall operation of the Federal Reserve System, but no Federal Reserve Board has failed the American people as thoroughly as the William McChesney Martin board. Mr. Martin, you have allowed runaway profiteering and runaway interest rates throughout this Vietnamese crisis. You have not held the line in the area of the economy over which you have responsibility—interest rates and monetary policy.

Today, we have the highest interest rates of this century—in fact, some are higher than they have been in 100 years. The Federal Government is in the disgraceful position of paying around 6 percent on securities that are fully backed by the credit of this great Nation.

Municipalities, school districts, and county governments have been choked off from funds and are paying record interest costs because of the profiteering policies of the Federal Reserve. Corporate bonds are out of sight, and the consumer, the farmer, and the small businessman are being gouged unmercifully by these record high interest rates. The taxpayers will be forced to pay $15.5 billion in interest charges on the national debt this year—about $8 billion more than would have been the case had you, Mr. Martin, kept interest rates at the levels existing when you took office in 1951.

As I mentioned a minute ago, we have had other wars and we have had responsible members of the Federal Reserve Board. Throughout World War II—at a time of tremendous expenditures—the Federal Reserve Board, under Marriner Eccles, kept interest rates on long-term Government bonds below 2½ percent. In fact, short-term rates were as low as three-eighths of 1 percent during this period. This action saved the American people billions of dollars. And I do not think anyone—not even the bankers—suffered from this fact.

During a wartime period, we expect all agencies of Government to put up the maximum effort to support our national policies. We expect the agencies of the Federal Government to conserve resources, to hold down prices, and to make every effort to keep the economy going despite heavy war expenditures. Today, this is generally true throughout the Government, but it is not the case at the Federal Reserve.

Mr. Martin, if any other executive of this Government had failed as thoroughly as you to hold down prices, they would have long since been retired from Government service.

Mr. Martin, I hope you will have some explanation for this committee, and for the American public, about these runaway interest rates that you have engineered by your Federal Reserve System. And in answering, let me ask you not to trot out your old bromide about the marketplace setting the interest rates.

As you know quite well, the Federal Reserve, through its Open Market Committee, has the full power to set interest rates at any level it chooses. But just to refresh your memory, let me quote from a former colleague of yours, Mr. Allan Sproul, who was president of the Federal Reserve Bank of New York. Here is what he had to say about the fallacy of the marketplace setting interest rates:

So far as "free markets" are concerned, I think we are all attracted by the phrase. It suits our habit of mind. But we haven't had a free market in money and credit, at least since the Federal Reserve System was established, and we haven't had a free market in Government securities, and therefore a wholly free securities market, since the Government debt climbed to the higher magnitudes, and open market operations by the Federal Reserve System came to be used as a principal instrument of credit policy. (The American Banker, Friday, May 7, 1954.)

The session this morning is not long enough to go into all of the failures of the Federal Reserve System over the past few years. However, the Federal Reserve's destructive nature is nowhere more evident than in the housing field. Mr. Martin, your policies have reversed the dictates of bipartisan public policy designed to provide decent housing for all Americans.

Your fellow Governor on the Federal Reserve Board, Sherman Maisel, conceded before the Senate Banking and Currency Committee on June 12, 1967, that 70 percent of the tight money policies had, in effect, fallen on the housing market. We lost 500,000 housing starts in 1966 and every one can be attributed to the Federal Reserve policies. The figures for December 1967 show that we are building new homes at the annual rate of 1,256,000—when we should be building them at a rate of between 2 and 2½ million per year.

Now, many times, Mr. Martin, you have appeared before the Banking and Currency Committee and said that you would do whatever the Congress directed you to do. You have always denied that you were defiant of the wishes of the Congress.

With this in mind, Mr. Martin, I want to call your attention to Public Law 89–597, which was passed by the 89th Congress and which became law on September 21, 1966. This act was again renewed on September 21, 1967. So, it has been passed twice by the Congress and twice signed by the President.

Section 6 of the act specifically gives the Federal Reserve, through its Open Market Committee, the authority to buy and sell in the open market "any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States."

As you know, from the legislative history, this section was put into the act for the specific purpose of giving the Federal Reserve the authority to buy paper of the Federal National Mortgage Association ("Fannie Mae") and the Federal home loan bank system.

This was a specific and clear directive from the Congress for the Federal Reserve to support the housing market and to inject large blocks of money into this market through the purchase of housing mortgages.

Mr. Martin, I have, in recent weeks searched through the bulletins and reports of the Federal Reserve System and I do not find any instance in which you have carried out this directive of the Congress. You have, of course, engaged in a handful of repurchase arrangements with bond dealers on agency paper. In most cases, this paper has been bought one month and sold the next, apparently to accommodate bond dealers, or to make your yearend financial statements appear that you are complying with law.

Quite obviously, this repurchase operation has not met—in any substantial way—the directive of the Congress for you to support the housing market.

When we were considering this act—Public Law 89–597—there was some concern on the Banking and Currency Committee that you would not carry out the law. In fact, this very question was raised during the hearings concerning the purchase of housing paper by the Federal Reserve. In answer to the implication that you would not obey the law, you quickly responded in emphatic tones: "Well, if the Congress directs us to do this, as I have indicated, we will carry out whatever the Congress legislates." (P. 550, hearings on H.R. 14026 before the House Banking and Currency Committee, June 16, 1966.)

Despite this statement, Mr. Martin, you have obviously not done what you told the Congress you would do. Because of your failure to support the housing market as directed by Public Law 89–597, the Congress today is faced with proposals to lift the interest rate ceiling on FHA and VA mortgages. Because of your defiance of the law, the Congress is being asked to impose a fantastically high interest rate burden on home buyers. We are being asked to price millions of prospective home buyers out of the market simply because the Federal Reserve refuses to follow the dictates of Public Law 89–597.

Through Public Law 89–597, you have the full authority to buy housing paper in quantities which would put the housing industry back on its feet and which would lower the interest rates to home buyers. It could be done now.

Again, let me remind you, Mr. Martin, that this provision has been passed by the Congress twice. It has been signed by the President twice. Each time it has been supported by the Budget Bureau, the Secretary of the Treasury, the Federal Home Loan Bank Board, and the Secretary of Housing and Urban Development.

Everyone in the Government has supported this provision. But despite your promises, Mr. Martin, you have failed to carry out this act.

Mr. Martin, your failure to carry out this act—particularly in view of your promises to the House Banking and Currency Committee—represents malfeasance and nonfeasance in office. It is your malfeasance that is adding to our slums, to the high price for housing, to our crises in the cities as well as in our rural areas.

It is the cruelest kind of malfeasance and I hope you have some explanation for the Congress.

Quite frankly, I am of the opinion that you and the Federal Reserve System should be required to obey the law before we even consider imposing higher FHA and VA interest rates on home buyers. Surely that is not asking too much.

William McChesney Martin's Promise To Carry Out Public Law 89–597 To Support The Housing Market

(Rep. Johnson of Pennsylvania questioning Mr. Martin): "Do I understand that this Hanna bill would authorize the Federal Reserve Board to purchase up to $5 billion worth of obligations of the Home Loan Bank Board, and so that you would be injected into the situation?

Mr. Martin: "I think that is what the intention is.

Mr. Johnson: "If you had $5 billion right now. authorized to spend, would you go to the open market and buy up a good number of these securities which would free money to go into the savings and loan?

Mr. Martin: "I definitely would not. I won't say that there may not be a later period in which I would want to consider this, but at the present time, on the basis of all of the evidence I personally have been able to accumulate, I would not want the Federal Reserve to go into the market to purchase these securities.

Mr. Johnson: "Then we would be doing a vain thing if we passed this bill today, giving you this $5 billion authority . . .

Mr. Martin: "Well, if the Congress directs us to do this, as I have indicated, we will carry out whatever the Congress legislates. There has never been any question about that at any time, as Mr. Patman well knows. Whatever law you pass here, we will do our best to carry it out, Mr. Chairman.

The Chairman (Mr. Patman): "If the law directs you to do it, that is your point?

Mr. Martin: "That is correct."

(Excerpt from Hearings on H.R. 14026 before the House Banking and Currency Committee, June 16, 1966, p. 550.)

PUBLIC LAW 89–597 (SECTION F)

"Section 14(b) of the Federal Reserve Act (12 U.S.C. 355) is amended by inserting "(1)" immediately after "(b)" and by adding the following new paragraph at the end:

"(2) To buy and sell in the open market, under the direction and regulations of the Federal Open Market Committee, any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States."

Chairman PROXMIRE. Thank you, Congressman Patman.

Mr. MARTIN. Should I start by addressing my answer?

Chairman PROXMIRE. Yes, indeed.

Senator SYMINGTON. Mr. Chairman?

Chairman PROXMIRE. Senator Symington.

Senator SYMINGTON. Before Chairman Martin makes a statement, I would ask unanimous consent that at this point he be permitted to file any reply he considers advisable with respect to the statement just read by my good friend, the able Congressman from Texas.

Chairman PROXMIRE. Without objection it is so ordered.

Representative PATMAN. Mr. Chairman, may I also have permission to extend my remarks and insert such statements as I consider germane and appropriate?

Chairman PROXMIRE. Yes, indeed.

(The following was supplied by Vice Chairman Patman:)

SEVERE INJURY TO HOUSING CAUSED BY FEDERAL RESERVE POLICIES AND FAILURE TO HEED CLEAR INTENT OF CONGRESS IN ENACTING PUBLIC LAW 88–597

In early December, 1965, the Federal Reserve Board increased drastically the Regulation "Q" limitations on the maximum rates of interest payable by commercial banks on time deposits. As the then vice-chairman of the Federal Reserve Board testified before this committee on December 14, 1965, the purpose was to bail out a few large money market banks faced with large deposit withdrawals:

Mr. BALDERSTON. Mr. Chairman, I would like to remind you that passbook savings may be withdrawn almost immediately. In a practical sense they are withdrawn immediately. That is not true of CD's. Now you have referred to the matter of the negotiable CD's that were coming due in December. They amounted to $3.5 billion. Of those, $1,854 million were outside of New York and Chicago.

Chairman PATMAN. How much?

Mr. BALDERSTON. $1,854 million.

Chairman PATMAN. Out of the $16 billion?

Mr. BALDERSTON. Out of the $3.5 billion coming due in the month of December. Our concern, of course, was that if those $3.5 billion were withdrawn from the banks, and the banks were placed in a severe enough bind, the impact upon the economy of this country right at a time of seasonal need, might have been very bad indeed.

After all, we don't want to have loans called just because the needs of the economy and of the banking system are not accommodated.

Chairman PATMAN. You felt like more interest should be allowed for that reason?

Mr. BALDERSTON. Unless they were allowed to bid a sufficiently high rate of interest to hold the CD's in the face of the declining flow of funds in our corporations you might have had the bind that I referred to. After all, December 15 is not only a tax date but the approach of dividend dates.

Chairman PATMAN. Thank you very much. You have proved my point.

Mr. BALDERSTON. I am glad you understand, sir.

(Hearings before the Joint Economic Committee, part I, pp. 230–231, Dec. 14, 1965.)

While the Board made no change in the maximum rates permitted to be paid the ordinary saver, the top rate on time deposits of less than 90 days was increased from 4% to 5½%, a percentage rise of 37½%. As recently as November 23, 1964, that same rate had been as low as 1%.

The predictable results included a drying up of savings inflows for thrift institutions, the major source of conventional home loans, and a massive inflow of time deposits for commercial banks. These funds were in turn loaned by the banks to industrial customers who so heavily invested in new plants and equipment that price rises and shortages resulted, making it necessary to temporarily suspend the 7% investment tax credit. Large sums were also invested by the banks in tax-exempt bonds. At the same time, market rates of interest rose to 40 year highs, brought on by the Federal Reserve Board's now-famous tight money "crunch" of 1966. The drop in housing starts to an annual rate of less than 1 million units for the year simply devastated the industry.

This increase in the Regulation "Q" limits to 5½% on larger time deposits and 5% on the smaller caused a rush of funds away from the mortgage markets. Along with capital debentures issued by banks at rates in excess of present Regulation "Q" ceilings, devices such as the so-called "Golden Passbook" accounts—clearly a device intended to circumvent the 4% interest ceiling on savings accounts—and very aggressive bank advertising which, according to the Chairman of the Securities and Exchange Commission, frequently contains false and misleading representations, are still severely harming the mortgage market. The main cause remains, of course, the Federal Reserve's high interst rate policy and refusal to furnish liquidity to the mortgage market through meaningful purchases of F.N.M.A. and Federal Home Loan Bank obligations.

The following statistics are most enlightening and cover the two years following the Board's increase in Regulation Q and interest rates generally:

DIVERSION OF FUNDS FROM MORTGAGE MARKET TO COMMERCIAL BANK HOLDINGS OF TAX-EXEMPT BONDS

[In billions of dollars]

	1966	1967	Total 2-year increase
Commercial banks:			
Increase in time and savings deposits	12.9	25.2	38.1
Increase in mortgage loans, 1- to 4-family residences			4.1
Increase in holdings of tax exempt securities			15.8
Total holdings mortgage loans, 1- to 4-family residences, Dec. 31, 1967			34.5
Total holdings tax exempt securities, Dec. 31, 1967			60.4
Savings and loan associations:			
Increase in savings capital	3.6	10.7	14.3
Increase in 1- to 4-family residential mortgage loans (plus repayment of advances)			10.9

Source: Federal Reserve Board.

It is clear that the Federal Reserve System has refused to heed the clear legislative mandate contained in the Act of September 21, 1966 that action be taken to bring about the reduction of interest rates, and that the System assist the housing market by purchasing obligatons of the F.N.M.A. and the Federal Home Loan Bank System. Reports of both the House of Representatives and the Senate on this legislation, H.R. 14026, contain clear expressions of legislative intent that the Federal Reserve Board take action to stem the diversion of funds away from the thrift institutions and the home building industry by commercial banks.

The following excerpts from the House and Senate Banking and Currency Committee reports on H.R. 14026 (Public Law 89–597) clearly confirm the intent of the Congress that the Federal Reserve System take steps to restore to health a devastated home mortgage market which had resulted from its extremely tight monetary policies and from lifting the Regulation "Q" ceiling:

The House Committee Report:

"THREAT TO HOUSING

"Your committee is convinced, however, that the greatest immediate injury to the average citizen lies in the drying up of the mortgage market and the threat to the building industry. Our thrift institutions have long been a primary source of mortgage loans, limited by law as they are to this type of investment. Commercial banks enjoy virtually unrestricted freedom in rates, terms, types, and other conditions with respect to loans and investments, and have never been relied upon as a primary source for home loans, even FHA and VA loans. Exceptions do exist, but in the present state of development within our financial community, thrift institutions are a vastly more important generator and lender of funds in this field.

"Outflows of funds from thrift institutions caused in large part by the growing popularity of high rate consumer CD's have intensified in recent months. For instance, in April 1966, insured savings and loan associations suffered net withdrawals of $770 million, compared to only $99 million in April 1965. Savings banks lost an additional $250 million in April. The Federal Home Loan Bank Board estimates that for July 1966 insured savings and loan associations alone will lose approximately $1 billion in net savings outflows. The evidence is quite strong that these outflows resulted from excessive interest rate competition by commercial banks.

"With the savings flow lower, loan commitments and mortgage loans by these institutions have both been declining. June 1966 loan commitments declined 21 percent from March 1966 and declined about the same amount from June 1965. In June 1966, $1,575 million of mortgage loans were made. This represents a decline of about one-third from the year ago level of $2,345 million. The sharp decline in June relative to last year is indicative of the developing trend that can be expected to persist in coming months.

"With less mortgage loans being made, mortgage portfolios of insured savings and loans associations have naturally been rising less rapidly. In the first 6 months of 1966, mortgage portfolios rose by $3,257 million, down 26 percent from $4,420 million last year. But the month of June showed a rise in mortgage portfolios of only $252 million, compared with $977 million in June 1965. This represents a decline of 74 percent in mortgage loan expansion. It is reliably predicted that housing starts in 1966 will fall to 1.2 million, down from 1.5 million in 1965, in contrast to the figure of 2 million recently advanced as a minimum if this Nation is to end the acute shortage of decent housing, both urban and rural.

"If this trend persists, 1966 will prove a disastrous year for the long-established public policy encouraging homeownership in this country. Mortgage money is both scarce and expensive, with large discounts the rule rather than the exception. Those people less able to afford it are the hardest hit, and their prospects for homeownership are poor indeed. Furthermore, unless substantial relief is granted to the housing market, the impending devastation in homebuilding and related industries could trigger a general recession throughout the economy. The present unemployment rate in homebuilding industry in the midst of the peak building season is at an abnormally high rate of 9 percent and the industry is at a 5-year low . . ."

"Your committee strongly urges prompt enactment of these temporary emergency measures providing all the necessary tools, as well as a great degree of flexibility in their application. This bill would effectively stop the outflow of funds from thrift institutions, thereby making more funds available for satisfying the Nation's legitimate housing needs than would otherwise accrue. It is felt, however, that permanent legislation may well be necessary and your committee is prepared to consider carefully in the near future the broader question of the respective roles of our financial institutions and their relationship to the overall economy and public policy goals.

"TREND IN INTEREST RATES

"Your committee deplores the continuing upward trend in interest rates that is pervading the entire economy. The current situation as far as our public policies are concerned is substantially comparable to that which existed during World War II. At that time, specific measures were taken to prevent profiteering from discriminatory high interest rates while meeting the tremendous demands of war upon the economy. Specifically, interest rates were maintained at reasonable levels in order to pay for the war by the fairest and most economical means.

"Your committee, recognizing the similarity between that time and the present, strongly believes, that interest rates should again be held to reasonable limits. and not allowed to increase at current unprecedented rates. Furthermore, your committee is in favor of reversing this trend. Lower interest rates will not only reduce the monumental burden of carrying the public debt, but will, in addition, provide for appropriate and proper resource allocation which has been disrupted in large part due to the current rate war involving various financial institutions engaged in unsound competition for savings and time deposits. Substantial sentiment exists within the committee for action by the Federal Reserve Board to move in an expeditious and orderly manner toward lower interest rates.

"While the committee took no action to lower the maximum rate of interest payable on time deposits in amounts of $100,000 and above, it is the firm hope of your committee that this rate, and all others soon will be reduced so as to reestablish stable competitive relationships among financial institutions, and to eliminate the discrimination that always occurs in our economy within the consumer, business, and public sectors when interest rates rise sharply." H. Rept. No. 1777, 89th Cong., 2d sess., pp. 5–7.

The Senate Committee Report:

"During the past 5 years, the ceilings on rates payable by banks on time deposits have been gradually raised to levels at which the banks could be more effectively competitive with other institutions and forms of investment. The volume of time deposits at banks has grown rapidly, and in the past year or more their growth has exceeded that of other deposit-type savings institutions as shown in the following table. At the same time, interest rates on other types of investment have increased even more rapidly. As a result, savings and loan associations, with large volumes of assets acquired when interest rates were lower, have been in a less favorable competitive position. Partly because of the importance of such associations in supplying mortgage funds, as well as because of strong competing demands from other types of borrowers, the volume of funds available for home mortgages has sharply diminished in the past year.

"SAVINGS IN SELECTED MEDIA

[In billions of dollars]

End of year	Total [1]	Savings associations	Mutual savings banks	Commercial banks [2]
1945	98.9	7.4	15.3	29.9
1950	122.7	14.0	20.0	35.2
1955	161.1	32.1	28.1	46.3
1960	217.0	62.1	36.3	67.1
1964	321.4	101.8	48.8	113.2
1965	353.3	110.3	52.7	131.0
1966, June 30 [3]	362.0	111.5	53.5	137.5
Increases:				
1945–64	222.0	94.0	33.0	83.0
1965	31.0	9.0	4.0	18.0
1966, 1st half [3]	9.0	1.0	1.0	6.0

[1] Includes credit unions, U.S. savings bonds, and postal savings, not shown separately.
[2] Time and savings deposits of individuals, partnerships, and corporations.
[3] Preliminary estimate

"This situation and its threat to the availability of funds for maintaining an adequate volume of homebuilding has necessitated a review of regulations and legislation affecting the distribution of savings among the various types of investment demands. Under existing conditions with tendencies toward expansion of demands in excess of productive capacity and consequent inflation of prices, it is not advisable or feasible to meet all unsatisfied credit demands through monetary expansion. The problem of maintaining stable economic growth, with equitable distribution of resources among various demands, involves restraints on excessive expansion along with structural arrangements for allocating available supplies of credit. This task may be accomplished in large part through the operation of the interacting market forces of demand, supply, and price changes. To some extent, however, legislative changes are needed to facilitate desirable structural adjustments and avoid undesirable changes.

"The aim of this bill is to facilitate needed changes and to discourage undesirable shifts in the volume and flow of savings in meeting credit demands." S. Rept. No. 601, 89th Cong., 2d sess., pp. 3–4.

Senator SYMINGTON. Of all the people in Washington today the business and banking community in my State think of Mr. Martin more highly than anyone involved in the financial problems of this Government.

It is clear that we face serious fiscal and monetary problems. Unfortunately, one of the chief reasons for that condition results from the fact that instead of attacking this situation from a fiscal standpoint, we try to cure it entirely from a monetary standpoint. Then we are free in our criticisms of the efforts of the Federal Reserve Board to help on a monetary basis, without any fiscal responsibility coming in as support.

I have just had a report from the Senate Appropriations Committee staff as to the estimated cost of the Vietnam war in 1969. That estimated cost is over $32 billion. Much of our problem was summed by the Secretary of Defense in his statement before the Senate Armed Services Committee, last week, in which the Secretary said the United States could fight this war on the present basis, take care of its other problems abroad, handle the problem of poverty in the United States, and also handle the problems of poverty and sickness all over the world. I don't think this economy, or any economy, can continue to finance this percentage of the free world and defend this percentage of the free world, largely by itself.

I am glad my friend and constituent is the Chairman of the Federal Reserve Board, because things are not healthy. He is one of the few people left in Government with the confidence of business and banking and labor, all of whom have had something to do with the building of this country. We would be in a much worse financial situation today if it wasn't for his dedicated patriotism and his wisdom in these matters, expressed over the years as Chairman of the Federal Reserve Board.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Senator Symington.

I believe Mr. Martin is ready to begin.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, ACCOMPANIED BY DANIEL H. BRILL, SENIOR ADVISER TO THE BOARD, AND ROBERT SOLOMON, ADVISER TO THE BOARD

Mr. MARTIN. Mr. Chairman, I appreciate those comments by Senator Symington, and I welcome the opportunity to file a detailed response to Mr. Patman's charges.

(Mr. Martin subsequently supplied the following for the record:)

Mr. Patman has stressed that interest rates are high, and that high interest rates tend to discourage housing starts. I have repeatedly expressed my concern on both points, urging that action be taken to relieve the pressure on interest rates by reducing the deficit so that the Federal Government will borrow less, leaving more funds available to finance housing.

The view that section 6 of Public Law 89–597 "was a specific and clear directive from the Congress for the Federal Reserve to support the housing market and to inject large blocks of money into this market through the purchase of housing mortgages" is not supported by the record. Section 6 broadened the authority of the Reserve Banks to purchase and sell Federal agency issues in the open market. Before section 6 was enacted, this authority covered only issues guaranteed as to principal and interest by the United States, and that limitation in practice excluded the major agency issues traded in the market.

In its report on the bill that became Public Law 89–597, the Senate Banking and Currency Committee included the following comments concerning section 6 (S. Rept. 1601, 89th Congress, 2d session, September 14, 1966, p. 8):

"Making all agency issues eligible for System purchase or sale would increase the potential flexibility of open market transactions and could also serve to make these securities somewhat more attractive to investors. While public acceptance and understanding of these issues has grown, there may still be a lingering public hesitation in some cases to acquire and hold some of these issues because of diverse and complex legal and administrative factors. If all the issues were eligible for System operations, this could act as something of a common denominator of market acceptability and would tend to establish a more uniform market background for the various agency issues.

"By authorizing System transactions in agency issues, the bill would place them on the same footing as direct obligations of the U.S. Government so far as System open market operations are concerned. As with direct Treasury debt, System decisions as to whether, when, and how much to buy or sell of agency issues would have to be made with a view to the need for supplying or absorbing reserves as indicated by the stance of monetary policy and in light of developments in the markets, including the need to cope with disorderly market conditions, should they emerge. In any event, it would be important, as at present, to avoid any semblance of 'rigging' the markets or 'pegging' the interest rates for any particular issues, for such actions would give rise to official dominance of the markets that would run counter to many of the broader objectives of Federal financial policies and might in fact harm rather than aid the propitious functioning of the market for such securities."

These two paragraphs of the Committee report were consistent with Vice Chairman Robertson's testimony before the Committee regarding the proposal. In addition, Mr. Robertson testified as follows regarding repurchase agreements (Hearings, "Interest Rates and Mortgage Credit," Senate Banking and Currency Committee, August 4, 1966, p. 18):

"If and as the market conditions surrounding Agency issues develop to the point where Federal Reserve operations would be appropriate, it might prove desirable for the System to conduct such operations in the form of repurchase agreements rather than, or in addition to, outright purchases and sales. The authority to undertake outright transactions in an issue is required in order for that issue to be eligible for repurchase agreements. The use of such agreements would tend to reduce the risk of undesired System market dominance associated with sizable outright transactions by the System, while at the same time it would enhance the development of markets in Agency issues by making it more attractive for dealers to position the securities."

There is nothing in the House Banking and Currency Committee's report in conflict with the quoted material; the bill reported by the House Committee included a provision to authorize purchase of obligations issued by the Federal National Mortgage Association and the Federal Home Loan Banks, if requested by the Secretary of the Treasury. The discussion of this provision in the Committee report was brief, adding nothing to the language of the provision itself, except to stress that purchases and sales of the two issues could be undertaken only at the request of the Secretary of the Treasury, "but such a request would not require that they be made." (H. Rept. 1777, 89th Congress, 2d session, July 28, 1966, pp. 3 and 11). The House voted, instead, to accept the Stephens amendment, which incorporated the language of section 6 as it now reads; and that is the version to which the Senate Committee report was addressed.

Mr. Patman, himself, told the House that the Stephens amendment (the language finally enacted) did not constitute a directive to support the housing market. In comparing the Committee bill with the Stephens amendment, Mr. Patman made the following remarks on the House floor:

"The homebuilders are opposed to the Stephens amendment for an additional reason. That reason is that the committee bill asks the Federal Reserve to give particular attention to the mortgage market in its open market operations, while the Stephens language confuses the issue by making all Government obligations eligible for Federal Reserve open market purchases. Not that this is necessarily bad, but as a legal matter it destroys the expression of congressional intent that special consideration be given to housing and the mortgage market." (Congressional Record, vol. 112, part 16, p. 21962, Sept. 7, 1966.)

In its activities, the Federal Reserve has carried out the intent of the Congress to assist the development of agency markets, and broaden the flexibility of open market operations, by entering into repurchase agreements with dealers in agency securities. Since December 1966, gross System repurchase agreements in agency issues have aggregated $964 million, with a little more than half of these in debt of the two agencies that provide credit to housing markets. And a special study of agency markets is under way, as part of a comprehensive review of the operations of Government securities markets, to determine the feasibility of System outright purchase and sale operations in light of the availability of a trading supply of securities by maturity area, and of the frequency, timing, and size of new agency issues.

Now, I have debated with Mr. Patman through the years on these questions, and I don't really think he believes that I am engaged in malfeasance in office. This, I think, is not really an issue here, although there may be different interpretations of statutory provisions. I am sure you are sincere about your interpretations, Mr. Patman, but I am sure you don't really believe there is any malfeasance in office in what I have been trying to do.

If you will look at the record of the legislation authorizing these agency purchases, you will see in both the House and the Senate reports I think—and I have not had the chance to go over them in detail, but I am familiar with them from last year—that there was no mandate of any sort given to the Federal Reserve Board with respect to what we should do on these securities. We were given blanket authority and discretion to utilize it as we saw fit, and we have utilized it.

Now, I just want to make one general comment. You referred to the old bromides about the marketplace. I happen to believe that the marketplace is still a very vital element in our economy. In fact, I think it is the bulwark of our economy. But if we want moderate interest rates—lower interest rates than we have had recently—the way to get them is by responsible fiscal management. We have to recognize that we have two deficits today that are intolerable, the balance-of-payments deficit that is way beyond anything we can expect to run continuously, and the domestic deficit which has to be reduced to more manageable proportions.

Your colleague, Senator Proxmire, has very rightly chided us on several occasions for being too easy on monetary policy recently, and I think we have erred, if we have erred in any way, on that side. Interest rates would have been a whole lot higher if we had not been as easy as we were. But I think that we are facing a general situation where we have to recognize that what has happened in many South American countries can happen in this country, too, that if we run into perpetual deficit financing, we will end up with the highest interest rates that have ever been seen.

A number of years ago one of my South American friends said to me that "If you really want to get high interest rates, the way to do it is to just continue on an absolutely easy money policy." I think that this is a very serious and dangerous situation that we are facing at the present time with our balance of payments and our domestic deficit, and I can assure you that the Federal Reserve is going to do everything in its power to help to find a useful means of stabilizing the economy.

Our desire, as I have repeatedly said to you, Mr. Patman, is for as low interest rates as it is possible to have without having inflation, but inflation will always get us into trouble in the long run, because it will end up in a deflation.

Now, that is my general answer, Mr. Chairman, to Mr. Patman. I just want to reiterate I know because I have had many very pleasant exchanges with him that I am sure he is not serious about malfeasance in office.

Representative PATMAN. Only with respect to housing do I make that statement, Mr. Martin, and I feel very strongly about it.

Mr. MARTIN. I am sure you do, and I respect your feeling, but I don't think it is warranted. May I go on with my prepared statement, then, Mr. Chairman?

Chairman PROXMIRE. Yes, indeed; go right ahead, Mr. Chairman.

Mr. MARTIN. I appreciate the opportunity of meeting again with this committee to discuss the state of the economy. It was just about a year ago that we last met, then in a quite different economic context. At that time, economic activity was faltering; businessmen were adjusting production schedules to reduce excessive inventories, investment in new plant facilities was falling and consumer spending for durable goods was declining. Many doubted that the economy had sufficient resiliency to absorb a massive adjustment of inventories without a serious recession.

Today we meet in a far different situation. The economy is advancing at a rapid pace, labor resources are under strain, and costs and prices are moving up swiftly. In short, we are in the midst of inflation and, of course, we are also in the midst of war. We musn't forget that.

The avoidance of recession in 1967—the fact that we experienced only a pause, and not a reversal in economic expansion—was, in large measure, the result of prompt and vigorous application of the tools of stabilization policy. As early as the fall of 1966, when it first became evident that pressures in the economy were abating, monetary policy shifted away from restraint and toward ease. Throughout the first half of 1967, policy provided a monetary climate that facilitated the orderly adjustment of business inventories and the recovery in homebuilding activity. At the same time, fiscal policy became increasingly stimulative. The rise in Federal spending was maintained, and the Federal deficit in the first half of 1967 reached the highest level since World War II.

The combined monetary and fiscal stimulus helped the economy to absorb a major decline in inventory investment, from a rate of over $18 billion in the fourth quarter of 1966 to less than $1 billion in the second quarter of 1967, with minimal effects on production and employment. Industrial output dropped by less than 3 percent over the first half of the year, and unemployment remained below 4 percent for most of the period. The resilience of our economy, and the timely use of stabilization policies, were amply demonstrated in the first half of 1967.

Unfortunately, there is less reason to be proud of the performance of the economy, or of stabilization policies, since mid-1967. The zeal with which policies were adopted to deal with a flagging economy has not been matched by commensurate zeal in coping with the emergence of economic overheating. The continuing large Federal deficit, in a period of rebounding private demands on resources, has intensified the strains on markets for labor, commodities and financial capital.

Since the middle of last year, prices have risen at about a 4 percent annual rate, almost twice as rapidly as earlier in the year. With labor markets tight—unemployment has fallen to the lowest levels since the Korean War—the rise in prices is being translated into wage demands about twice as large as the longrun gains in productivity. And the rise in our costs and prices has been an important factor in aggravating an already serious balance-of-payments deficit. As a matter of fact, wage increases have been more than twice the rise in productivity in a good many instances, but I am referring here to the overall averages of productivity gains and wage settlements.

The resurgence in economic activity and in inflationary pressures after midyear 1967 did not come as a surprise. Anticipating these developments, early in the year the President recommended a fiscal program to insure that the rebound in activity would not reach an excessive pace. In my appearance before this committee a year ago, I urged the immediate adoption of the President's proposals, in order that the Government could enter the period of renewed expansion in an appropriate fiscal posture.

Delay in getting our budgetary deficit under control has been costly. The failure to exercise prudence in fiscal management before the forces of inflation gathered momentum has resulted in major setbacks in achieving both our domestic and our international economic goals.

Even now, with costs and prices advancing rapidly, we still are hestitating about taking tax measures to restrain demands. Some fear that demand restrictions cannot curb an inflation stemming from "cost-push." Others argue that nothing *should* be done about the current inflation, because a recession lurks around the corner.

Let me address myself first to the economics of cost-push and demand-pull. It seems to me that cost and price developments last year demonstrated once again how cost-push and demand-pull pressures interact to produce inflation. In the first half of 1967, costs rose rapidly, as wages continued to rise, and with production dipping, overhead costs had to be spread over a smaller output. Unit labor costs in manufacturing, for example, increased at an annual rate of almost 5½ percent, about twice as rapidly as in the preceding year. Nevertheless, with overall demands leveling off, the rise in costs was *not* translated into higher prices. Industrial commodity prices were stable from February through July, and the advance in consumer prices slowed significantly.

But with the resurgence in aggregate demands after midyear, prices responded very rapidly, even though the rise in unit labor costs moderated as production facilities began to be used more intensively. As soon as markets improved, past—and, indeed, prospective—cost increases were passed through the structure of production and distribution. The swift pace at which aggregate demands rose in the third and fourth quarters of last year provided a climate in which costs could more easily be passed on in the form of higher industrial and consumer prices. The rise in prices has fueled higher wage demands, laying the groundwork for another round of cost increases. And as long as overall demands continue to rise too rapidly, further cost pressures will be reflected in further increases in prices of industrial and consumer goods.

As for the issue of the economy's capability of absorbing a tax increase, even a cautious appraisal of economic prospects suggests a continued increase in demand pressures this year. The basic strength of expansionary forces in the economy has become evident since the termination of major work stoppages. For a few months, earlier in the fall, strikes in the auto and other industries had held back the recovery in production and sales, resulting in economic statistics that appeared to buttress the case of those who saw more weakness than strength in the economic outlook. When production rebounded at the end of the strikes, attention shifted to the apparent sluggishness of retail sales around the Christmas period. The latest figures, however, reveal that consumer spending is picking up rapidly, and unemployment has fallen sharply. Now attention is shifting to the possibility of weakness developing next summer.

At any point in time, there will be some economic measures out of joint. And there will always be legitimate concern about the economic future. Forecasting economic developments is still an art, not yet a science, and no one can pretend to certainty about the future. Let me just interject here, Mr. Chairman, if I may, that I don't believe economics can ever be a coldly analytical science, because the subject of economics is human choice, and human nature plays a predominant role in determining the course the economy will take.

At this point in time, however, the great weight of the evidence is on the side of expectations for continued strong expansion in demands. Even if consumers should continue to save a high proportion of their after-tax incomes, consumer spending would rise substantially as incomes accelerate. Some reduction in business inventory accumulation is likely next summer, particularly in the stockpiling of steel. But the adjustment in steel inventories after the conclusion of wage negotiations in 1965 had little effect in retarding expansion then, and there is no more reason to expect a serious impact on overall economic activity from this source in 1968. Moreover, even with a tax increase and restraint on Government spending, the Federal budget would still be providing a signficant net stimulus to the economy. We certainly need no splurge in retail sales, or boom in investment spending, or excessive runup in business inventories, to avert a recession this year.

Indeed, the greater risk is that expansionary forces will accelerate too rapidly and add further to inflationary pressures. Consumers' spending propensities are more likely to rise than to fall, as incomes accelerate and the workweek lengthens. Business plans to increase capital outlays, now modest, are more likely to be revised upward than downward, if the increase in final demands and in prices continue untrammeled. And, as Budget Director Zwick noted to this committee last week, the risks are obviously in the direction of higher, rather than lower Federal spending, particularly in light of recent developments in the Far East.

The risks, therefore, are almost all, in my judgment, on the side of too much demand, rather than too little. And the greatest danger to sustained expansion throughout the year is not that the economy might be too weak to absorb a tax increase, but that inflation will result in the excesses and distortions that inevitably lead to economic setbacks.

A failure to exercise firm fiscal restraint will create an economic climate conducive to excessive inventory building and excessive plant expansion, only to be followed by cutbacks in output and employment as businessmen have to restore balance in their stocks, labor force, and capacity. It will encourage inflationary wage settlements that can be accommodated only by further price increases, diminishing both the potential for domestic sales and the possibility of regaining export markets, while attracting imports of foreign goods. And if the Government is forced to continue borrowing vast sums in financial markets to finance another large deficit, the availability of funds to sustain homebuilding at a high level will be seriously curtailed.

The financing of home construction is in a somewhat better position to compete for funds than in 1966, for the liquidity position of thrift institutions improved considerably last year. But home financing cannot be insulated from strong financial market forces. The pressure of corporate and Federal financing demands has already begun to pinch the flow of funds to mortgage lenders. Savings inflows at thrift institutions have been reduced, growth in the volume of commitments for future mortgage lending has slowed appreciably, and interest rates on mortgages have returned to the peaks of 1966.

Increases in the cost of mortgage financing and mounting pressures on the availability of mortgage funds recurred last year even though monetary policy remained expansive through the summer and early fall. Monetary ease was maintained, despite the reemergence of inflationary pressures during the summer, to avoid a premature curtailment of the recovery in housing and aggravation of the strains in domestic and international financial markets resulting from the record volume of Treasury borrowing accompanied by a record volume of capital market financing by corporations and State and local governments. Moreover, the fiscal restraint program submitted by the President in early August offered the best prospect of relief from the tensions developing in financial markets and from the inflationary effects of growing demand pressures on real resources.

But with fiscal restraint held in abeyance, with inflationary pressures accentuating following termination of strikes in the auto and other industries, and with pressure on the internationl position of the dollar mounting after the devaluation of sterling, a shift was made later in the fall to a less expansive monetary policy. The initial step—a one-half point increase in the discount rate following the British devaluation—was a modest precautionary move in a situation of grave uncertainties; in fact, some in the System expressed a preference for a larger move to restraint at the time. In December, as prices continued to advance rapidly, gold losses mounted, and our international trade balance diminished, an increase in member bank reserve requirements was announced, and open market operations were adjusted to support this less expansionary policy.

These moderate moves toward monetary restraint were initially accompanied by some easing of tensions in financial markets, partly as a result of seasonal and other temporary factors. More recently, however, pressures have returned to financial markets, interest rates on market securities have been rising, and the flow of funds to institutions specializing in housing finance is once again being threatened.

In the absence of fiscal restraint, it may well prove impossible to avoid a contraction in the availability of credit to those sectors of the economy least capable of withstanding competitive pressures for funds. Housing finance, in particular, continues to be hampered by rigidities and imperfections that cannot swiftly be removed, and difficulties could be faced by many municipal and small business borrowers. Financing a continuing large Government deficit would absorb a disproportionate share of financial savings. And with real resources strained, prices increasing, and our balance of payments in difficulty, monetary policy could not irresponsively permit the creation of credit on a scale that would accommodate all the private financing demands that inflation would generate.

To permit inflationary pressures to continue unchecked would dissipate the opportunity that the new balance-of-payments program is intended to provide; namely, the time to effect fundamental corrections in our position. How much we need an improvement in our international competitiveness was illustrated dramatically by the behavior of the U.S. trade balance during 1967. The rise in imports had halted in early 1967, as aggregate demands in our economy leveled off, but with the resurgence in activity, imports spurted to a new high by yearend. For the year, as a whole, our merchandise imports were up 5½ percent over the preceding year, and almost half again as large as in 1964.

Our exports last year did not do as well as we had hoped they would. They rose only 4½ percent for the year as a whole, and actually declined in the last quarter. Our merchandise trade balance, which had reached nearly $7 billion in 1964, dwindled to less than $4 billion in 1967.

Factors operating to dampen the demand for our exports were particularly important last year—such as the recession in Germany and the effects of the slack conditions in leading European countries on demands in many parts of the world. It is gratifying, therefore, that several European countries are using monetary and fiscal policies aimed at encouraging domestic expansion. Growth in economic activity and maintenance of relatively easy credit conditions in Europe are vital complements to the President's program to reduce the U.S. balance-of-payments deficit. But economic expansion abroad will not, by itself, be sufficient to produce a better balance in the pattern of international payments. We must temper the rise in demands here, in order to avoid surges in imports and to keep our exports competitive.

Serious as is the deterioration in our international trading position, it was on the capital side of the payments balance that worsening was most acute last year. Shifts in capital flows accounted for most of the change from a balance-of-payments deficit of about $1½ billion in 1966, on the liquidity basis, to one of about $3½ billion in 1967.

In 1966, an unusual constellation of factors had held down the net outflow of capital. Taut financial market conditions in this country pulled in a large amount of foreign private liquid funds in 1966. There was still a net inward flow of such funds in 1967, but not on so large a scale, and there was a moderate outflow of bank loans and credits last year, reversing the inflows of such funds in 1965 and 1966. Also, net liquidation of foreign equity securities by U.S. investors, in response to the interest equalization tax, came to an end in 1967. Thus, after the temporary favorable circumstances affecting capital flows in 1966 were gone, a large overall deficit reemerged in 1967.

In the context of a large and persistent deficit in the U.S. balance of payments, the devaluation of steering last November unsettled gold and foreign exchange markets. Nevertheless, we have no evidence of any large flight out of dollars into either gold or foreign currencies. In fact, foreign private holdings of liquid dollar assets in the United States continued to show a net increase during the fourth quarter of 1967. A great deal of the purchasing of gold in recent months was done, we think, by people who were shifting out of sterling or out of continental currencies, rather than out of dollars.

Over the longer pull, however, we cannot depend on retaining the confidence of foreign holders of dollar assets unless we conduct our economic affairs in such a way as to deserve confidence. The new balance-of-payments program announced on New Year's Day by the President is addressed principally to reducing certain types of capital outflows, particularly direct investment outflows and bank lending. But such restrictions on particular types of international transactions cannot be relied on in the long run to assure sustained equilibrium in the overall U.S. payments position. Public and private restraint in demands on our resources will be an essential element in the success of the United States in correcting its balance-of-payments problem.

To summarize this brief review of the key developments and problems in public policy formulation over the past year, it is clear that we have, as a nation, greater readiness to combat recession than to cope with inflation, despite the grave consequences that failure to restrain inflation could have for our economy, both domestically and internationally. The Congress should act now to provide the fiscal restraint we need to sustain a balanced expansion and to protect the value of the dollar at home and abroad.

Chairman PROXMIRE. Thank you very much, Chairman Martin, for a fine statement.

I am going to yield first to Representative Patman, who is anxious to follow up on his statement.

Representative PATMAN. Mr. Chairman, according to last night's news broadcast, Assistant Secretary of the Treasury Wallace, who works in Detroit, announced that he, and apparently the administration, expects a business recession within the next 16 months. This announcement is consistent with the recent policy of the monetary authorities to contract the money supply. Mr. Martin, how much longer are you, as representative of the monetary authorities, willing to contract the money supply?

Mr. MARTIN. Mr. Patman, I can't forecast monetary policy. I am not familiar with Secretary Wallace's forecast, but I have tried to emphasize in this statement that our judgment at the moment is that the risks of inflation are greater than the risks of recession. We will be alert always and try to operate monetary policy responsibly to deal with whichever situation develops.

Representative PATMAN. You admit now that you are contracting the money supply; do you not?

Mr. MARTIN. We are following a less expansionary monetary policy than we followed early in the year.

Representative PATMAN. So, that adds up to the fact that you are contracting it.

Mr. MARTIN. Yes, relatively speaking. As we said to this committee a year ago, with the overhang of inventory that was developing, we thought that an expansionary policy was warranted. We may have overstayed our time on this easy monetary policy, but recently we have gradually moved in the direction of less ease.

Representative PATMAN. Not so long ago I was very much encouraged when you used raising of commercial bank reserve requirements as a means of controlling the money supply, but only recently I noticed where you were again selling Government bonds to contract the money supply; is that correct?

Mr. MARTIN. We buy and sell bonds continually.

Representative PATMAN. I know, but you are not answering my question, Mr. Martin. Respectfully, I ask you to do that. You are selling bonds now and have been in the very recent past to contract the money supply.

Mr. MARTIN. Recently we have been following a less expansive policy.

Representative PATMAN. That means really that we are paying for our bonds two or three times depending upon the time that they are sold and then bought back. You have already used the Government's credit once to buy these bonds, and they were paid for once, to which you have testified a number of times, and to which other officials of the Federal Reserve System have testified a number of times. But then, when you take those bonds and then you sell them back into the market, then if you buy them back, you pay for them again, don't you?

Mr. MARTIN. Mr. Patman, we have been over this repeatedly. I do not agree with you that we are paying for them twice. This is the normal way in which the bonds are issued. When we buy them we increase bank reserves. When we sell them we absorb reserves. But I simply cannot follow your reasoning where there is any two-time purchase of these securities. We are using the Government's credit, to be sure.

Representative PATMAN. I am sure you are sincere in your statements, but I don't think there can be any doubt about it that you have paid for these bonds once with Government money, and both bonds and money should not remain outstanding if the one should be canceled, and when you take those bonds that have been paid for once, and you have testified they have been paid for once—you remember that, don't you, testifying that they have been paid for once?

Mr. MARTIN. I think that is probably——

Representative PATMAN. You remember that?

Mr. MARTIN. Yes.

Representative PATMAN. OK. Now then, when you sell them back into the market and then you buy them back, you create more obligation to the Government. That is a part I will not go into now because as you say, we have gone over it.

The following quotes of exchanges between Mr. Patman and Mr. Marriner Eccles, former Chairman and member of the Federal Reserve Board, and Mr. Martin, Chairman of the Federal Reserve Board, clearly prove that when the Federal Open Market Committee purchases Government securities in the open market they trade one form of Government obligation (Federal Reserve notes or credit on the Federal Reserve books) which is noninterest bearing for another form of Government security (Federal Government marketable securities such as Treasury bills, notes, and/or bonds) which is interest bearing. Since, then, these securities purchased in the open market have been paid for in either Federal Reserve notes or credit on the Federal Reserve books, the interest-

bearing Federal securities should be canceled since the debt has been paid once.

The following quotes extend over a period of time from 1941 to 1965 and in each instance the same conclusion as above is reached.

TESTIMONY OF MARINER ECCLES REGARDING TRANSFER OF NONINTEREST GOVERNMENT OBLIGATION FOR INTEREST BEARING [1]

"Mr. ECCLES. The Open Market Committee can buy either those bonds or any other bonds either from the bank that you indicate or from a dealer or from any other bank.

"Mr. PATMAN. I am just giving that as an illustration, not as a specific case.

"Mr. ECCLES. But the System does not operate that way. No Reserve bank buys Government bonds from any bank. The Open Market Committee does the purchasing, and they do the purchasing in the open market because the law requires that they do the purchasing in the open market, and requires that they cannot buy directly.

"Mr. PATMAN. Of course I am not taking that into consideration, but the effect of it is the same. If the bank sold a million dollars in bonds, although it was through the open market, the effect is the same. You have transferred——

"Mr. ECCLES. Credit. As a practical matter, the bank that sold the bonds would sell those bonds in the market.

"Mr. PATMAN. In the open market; that is right.

"Mr. ECCLES. And would get credit either at the Reserve bank or at a correspondent bank, for which they could get Federal Reserve notes if they wanted them.

"Mr. PATMAN. So if the statement that you are transferring one Government obligation that is noninterest bearing for another Government obligation that is interest bearing is correct, then you continue to draw interest until those bonds are due and payable?

"Mr. ECCLES. That is correct; yes, sir."

* * * * * * *

FEDERAL RESERVE NOTES A GOVERNMENT OBLIGATION THE SAME AS INTEREST-BEARING GOVERNMENT SECURITIES [2]

"Mr. PATMAN. Now, I want to ask you about these Federal Reserve notes. You consider them obligations of the U.S. Government, do you not, Governor Eccles?

"Mr. ECCLES. I do.

"Mr. PATMAN. They are just as much an obligation of the Government as a Treasury bond or any security that is issued by the Government?

"Mr. ECCLES. They are just as much an obligation as, say, the silver certificates or what we speak of as the greenbacks, of which some are still out.

"Mr. PATMAN. Or the bonds that have coupons on them that you clip?

"Mr. ECCLES. That is right. They are just a little different form of obligation.

"Mr. PATMAN. I understand they are a different form of obligation, but at the same time they are Government obligations and a Government responsibility?

"Mr. ECCLES. That is right."

* * * * * * *

COMMERCIAL BANKS USE CREATED MONEY TO BUY GOVERNMENT BONDS [3]

"Mr. PATMAN. Governor, in regard to the excess reserves, it is not contemplated that you expect to change these reserves so that the larger banks can buy more Government bonds? You do not have that in mind now?

"Mr. ECCLES. Well, it is not done, I would say, for that purpose, primarily or specifically. If we wanted to enable the banks to buy a lot of bonds we could.

"Mr. PATMAN. By lowering the reserve requirements?

"Mr. ECCLES. By lowering the reserve requirements, yes; or we could step up and buy a lot of bonds directly by the Fed itself, and put more reserves in by open-market purchases.

[1] Hearings before the Banking and Currency Committee of the House of Representatives, June 21, 23, 24, 25, 1941, on S. 1471, p. 78.
[2] Op. cit., p. 74.
[3] Op. cit., p. 68.

"Mr. PATMAN. * * * Any way, the commercial banks, when they buy bonds or anything else, create the money, so to speak, to buy them with?

"Mr. ECCLES. That is right."

*   *   *   *   *   *   *

"Further testimony of Mr. Eccles:[4]

"Mr. PATMAN. Those Federal Reserve notes, as we have often discussed, are obligations of the U.S. Government?

"Mr. ECCLES. That is right.

"Mr. PATMAN. Then you use those Government obligations to buy interest-bearing Government obligations and you place them with the Federal Reserve banks, 12 of them?

"Mr. ECCLES. That is right.

"Mr. PATMAN. And they would continue to receive interest on those Government obligations as long as they were outstanding?

"Mr. ECCLES. That is right.

"Mr. PATMAN. So the result is the Government's credit has been used and the Government has gotten nothing for the use of that credit; the Federal Reserve banks are using it free, are they not?

"Mr. ECCLES. Well, the Government in effect, for all practical purposes, owns the Federal Reserve banks." (See pp. 25–26.)

*   *   *   *   *   *   *

COLLOQUY OF MR. ECCLES AND REPRESENTATIVE CHARLES S. DEWEY (REPUBLICAN, ILLINOIS): FED CREATES CREDIT WHEN FOMC BUYS BONDS[5]

"Mr. ECCLES. Whenever the Federal Reserve System buys Government securities in the open market or buys them direct from the Treasury, either one, that is what it does——

"Mr. DEWEY. What are you going to use to buy them with?

"Mr. ECCLES. What is who going to use?

"Mr. DEWEY. The Federal Reserve bank to make these purchases.

"Mr. ECCLES. What do they always use?

"Mr. DEWEY. You are going to create credit?

"Mr. ECCLES. That is all we have ever done. That is the way the Federal Reserve System operates. The Federal Reserve System creates money. It is a bank of issue."

*   *   *   *   *   *   *

"FEDERAL RESERVE NOTES ARE AN OBLIGATION OF GOVERNMENT AS ARE GOVERNMENT BONDS: FROM STATEMENT OF CHAIRMAN MARTIN AT HEARING ON MONETARY POLICY, BEFORE THE SUBCOMMITTEE ON ECONOMIC STABILIZATION OF THE JOINT ECONOMIC COMMITTEE, 1956

"Mr. PATMAN. You have $24 billion worth of bonds. Now, those bonds were bought by giving Federal Reserve notes in exchange for the bonds; were they not?

"Mr. MARTIN. Well, Federal Reserve credit.

"Mr. PATMAN. What is that?

"Mr. MARTIN. Federal Reserve credit. They were not specific——

"Mr. PATMAN. That is what I mean. But everyone of them is an obligation of the U.S. Government; is it not?

"Mr. MARTIN. That is correct.

"Mr. PATMAN. That is what makes it good.

"Mr. MARTIN. That is right."

*   *   *   *   *   *   *

EXCERPTS FROM STATEMENT OF MR. MARTIN, JULY 15, 1957, BEFORE THE BANKING AND CURRENCY COMMITTEE OF THE HOUSE ON S. 1415

"Mr. PATMAN. Now then, Mr. Martin, isn't it a fact that these Federal Reserve notes that you issue and exchange for these bonds are obligations of the U.S. Government, just as are the bonds?

[4] Hearings before the Banking and Currency Committee of the House of Representatives, June 17, 19, 1942, on H.R. 7158, pp. 25–26.

[5] Op. cit., p. 21.

"Mr. MARTIN. That is right.

"Mr. PATMAN. In other words, each note says on its face: 'The United States promises to pay to bearer on demand so many dollars.' That is just as much a Government obligation as a U.S. bond maturing 10 years from now, isn't it?

"Mr. MARTIN. It is money.

"Mr. PATMAN. It is an obligation of the Government."

QUESTION BY CHAIRMAN WRIGHT PATMAN AND ANSWER BY WILLIAM McCHESNEY MARTIN, CHAIRMAN

[Taken in testimony on H.R. 7601, a bill to provide for the retirement of $30 billion of interest-bearing obligations of the United States held by the 12 Federal Reserve banks, on July 7, 1965, pp. 78–80 of the transcript]

The CHAIRMAN (Mr. Patman). I want to clarify this for the record one more time, Mr. Martin. How in the world can you insist that bonds that are paid for once should continue in existence with the taxpayers having to pay interest on them after they have been paid for once? Now, of course, you claim that these bonds have to be there to back up Federal Reserve notes. But that does not conform with your reasoning in 1959 when you presented to Congress a bill, and it was passed on by this committee, which said that you wanted the power to lower reserve requirements and count vault cash as reserves; and that, if you got that power, you would transfer $15 billion of the then portfolio of $24 billion to the private banks. You further stated that the private banks needed the income from these bonds, and that the Federal Reserve does not need it. You do not need the $15 billion. The remaining $9 billion in the portfolio, as you stated in a staff report, would provide enough flexibility for you to operate. Now then, when the Open Market Committee owns $38.5 billion worth of bonds—which of course is about $14.5 billion more than it was then, you insist that it is impossible for those bonds to be canceled, although $15 billion under the same circumstances could be given to the private banks, after giving them (through reducing reserves) the reserves to buy the bonds.

The Fed pays nothing for them; it merely creates new reserves. Then it continues to get interest on those bonds, and then when the bonds become due, they can collect the principal again.

I cannot get the reasoning there at all, Mr. Martin. If that makes sense, I am unable to comprehend it. Of course, there may be something in my background—lack of knowledge—that would account for it, but I do know this: No one should be compelled to pay his debts more than once, but in this instance you would compel the Government to pay its debts more than once. You would compel the Government to continue to pay interest on bonds that have already been paid for. When you bought these bonds, you paid for them. You will admit that, will you not, Mr. Martin?

Mr. MARTIN. The bonds were paid for in the normal course of business.

The CHAIRMAN. That is right.

Mr. MARTIN. And that is the only time they were paid for.

The CHAIRMAN. Just like we pay debts with checks and credits.

Mr. MARTIN. Exactly.

The CHAIRMAN. In the normal course they were paid for once, you will admit that, will you not?

Mr. MARTIN. They were paid for once, and that is all.

The CHAIRMAN. That is right.

Mr. MARTIN. I will be glad to file another statement of the process as we see it at the Board.

(Mr. Martin supplied the following for the record:)

The following is a copy of a statement which I furnished to the House Banking and Currency Committee on August 19, 1965, in connection with hearings on H.R. 7601, a bill to provide for the retirement of $30 billion of Government obligations held by the Federal Reserve System. The statement discusses the question of whether transactions by the System in such obligations involve double payment.

DOUBLE PAYMENT OF PUBLIC DEBT?

The contention has been made that when the Federal Reserve System buys Government securities such securities are subject to "double payment" by the Government and, hence, should be canceled.

This conclusion apparently is reached by reasoning along the following lines:

(1) If the holder of a Government security decided to exchange that security for another—with a different maturity date, for example, as he could in an advance refunding offer—he would have to turn in the original security to the Treasury in order to get the new security. Under such circumstances, the Treasury would cancel the original security and no further interest payments would be made on it.

(2) The Federal Reserve System uses Federal Reserve notes to pay for its Open Market purchases of Government securities.

(3) Federal Reserve notes by statute are an obligation of the United States Government. Therefore, when the Federal Reserve System uses Federal Reserve notes to acquire Government securities, it is merely exchanging one form of Government obligation for another.

(4) This exchange is similar to that described in paragraph (1) and, accordingly, to avoid double obligation by the United States on the same debt, Government securities acquired by the Federal Reserve System in exchange for Federal Reserve notes should be canceled.

This line of reasoning involves two basic misunderstandings.

The first misunderstanding is that Open Market purchases of Government securities by the Federal Reserve System are paid for with Federal Reserve notes. Actually, the payments are made through immediate credit in the reserve accounts of member banks designated by the dealer from whom the securities are purchased.

The System's open market transactions are handled through 19 dealers, of whom 7 are banks. The nonbank dealers have standing arrangements that when they sell securities to the Federal Reserve System the Federal Reserve Bank of New York will credit the reserve account of a designated member bank and that bank will credit the dealer's account.

The point to be noted here is that, while Federal Reserve notes, by statute, are "obligations of the United States," balances in reserve accounts of member banks are not. When the Federal Reserve System purchases a Government security and pays for it by a credit in the reserve account of a member bank, it has become a holder in due course and there has not been in any sense a payment by the United States.

The difference between paying for System purchases of Government securities by issuing Federal Reserve notes or by giving credit in member bank reserve accounts is not merely a bookkeeping matter. An important difference in objectives is involved. Federal Reserve notes are put into and retired from circulation as the needs of the public for hand-to-hand currency rise and fall. These needs fluctuate in response to factors that are different from—sometimes in conflict with—the factors that lead to purchases or sales of Government securities, which are made to implement monetary policy.

The second of the two misundertsandings I mentioned earlier is with respect to the effect the statutory provision that Federal Reserve notes are obligations of the United States has on operating procedures. The cause of concern apparently stems from an assumption that Federal Reserve notes are like any other Government obligation except that they bear no interest.

The fact is that Federal Reserve notes are not like other Government obligations. The financial operations of the Treasury are not affected by redemptions of Federal Reserve notes, because the Treasury does not pay for them. The Reserve Banks themselves pay for such redemptions, usually by assuming a deposit liability for which the Treasury has no obligation.

As stated in the Circulation Statement of United States Money published by the Treasury Department, "Federal Reserve notes are contingent liabilities of the United States." The only exception to this—the only instance in which the Treasury has direct liability for redeeming Federal Reserve notes—results from the Old Series Currency Adjustment Act, approved June 30, 1961. Under that Act, the Federal Reserve Banks paid into the Treasury about $36 million, the amount then outstanding of Federal Reserve notes issued before July 1, 1929 (the old large-size bills). Under section 5 of the Old Series Currency Act, this payment transferred to the Treasury the liability for redeeming the notes. Section 2 of H.R. 7601 similarly provides that the liability for $30 billion in Federal Reserve notes would be transferred "on the books of the Treasury, from contingent liability on Federal Reserve notes to direct currency liability." These examples confirm that in the first instance Federal Reserve notes are a liability of the Reserve Bank that issues them, and that an Act of Congress is required if this primary liability is to be transferred to the Treasury.

Let us now consider the present statutory provisions governing liability on Federal Reserve notes. Paragraph 1 of section 16 of the Federal Reserve Act provides that Federal Reserve notes "shall be obligations of the United States. . . ." In addition, however, paragraph 2 of the same section provides that, before Federal Reserve notes can be issued to a Reserve Bank, the applying Bank must tender "collateral in an amount equal to the sum of the Federal Reserve notes thus applied for . . ."; paragraph 4 of the same section provides that "Federal Reserve notes issued to any such bank shall, upon delivery, . . . become a first and paramount lien on the assets of such bank"; and paragraph 2 of section 7 provides that should "a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States. . . ."

When all of these provisions are considered together, it seems clear that their intent is—

(1) To provide assurance that the current liability for Federal Reserve notes could always be met by the collateral required to cover such notes.

(2) To put the statutory obligation of the United States for Federal Reserve notes in the form of a contingent liability that would only materialize in the extremely unlikely event of a Federal Reserve Bank being liquidated under such conditions as to make the assets of such Bank, including the collateral behind its Federal Reserve notes, insufficient to meet its liability for such notes.

Since the Treasury has no current liability for the redemption of Federal Reserve notes, it likewise seems clear that no double payment by the Treasury would be involved even if the System used Federal Reserve notes in paying for Government securities purchased in the open market.

A step-by-step illustration of these transactions follows:

ILLUSTRATION

(1) Treasury announces a new bond issue, and Community Bank of Cooperstown, N.Y., wishing to invest idle funds, sends to the Federal Reserve Bank of New York ("New York Fed") an instruction to subscribe for $100,000 of new bond issue. New York Fed issues the $100,000 bond to Community Bank as agent for Treasury, and transfers $100,000 from the reserve account of the Community Bank to the account of the Treasurer of the United States.

(2) Community Bank, seeking funds to make business loans, sells the $100,000 bond to ABC Securities Co., a security dealer in New York. In payment, ABC sends to Community Bank a check drawn on the Metropolis Bank, New York City. The collection of the check results in Community's reserve account at New York Fed being increased $100,000, and Metropolis' reserve account at New York Fed being decreased $100,000.

(3) New York Fed, as agent for the Federal Open Market Committee, buys the $100,000 bond from ABC Securities Co. (In actual practice this bond would be one of a package usually totaling several hundred thousand dollars or more. For simplicity's sake, let us assume the bond is allocated to N.Y. Fed rather than one of the other Reserve Banks.) This transaction increases reserve account at New York Fed being increased $100,000, and Metropolis' reserve account at the New York Fed by the same amount.

(4) The $100,000 bond matures and is paid off out of the Treasury's account at the New York Fed. The cancelled bond is removed from the assets of the New York Fed.

(5) Community Bank requisitions $100,000 in Federal Reserve notes from New York Fed and authorizes the Fed to charge its reserve account for these notes.

(6) Community Bank turns in to the New York Fed for redemption $100,000 in Federal Reserve notes so worn from usage that they are not fit to continue in circulation. This deposit is credited to Community's reserve account, and thus the Fed reduces its liability for Federal Reserve notes outstanding and increases its deposit liability.

RECAPITULATION

[In thousands of dollars]

Transaction No.	Effect of transaction	Increase or decrease in— Assets	Liabilities
	TREASURY		
1	Increased bond debt		+100
	Increased balance with Fed	+100	
4	Decreased bond debt		−100
	Decreased balance with Fed	−100	
	Net change		
	NEW YORK RESERVE BANK		
1	Decreased balance due Community		−100
	Increased balance due Treasury		+100
2	Increased balance due Community		+100
	Decreased balance due Metropolis		−100
3	Acquired Government bond	+100	
	Increased balance due Metropolis		+100
4	Gave up Government bond	−100	
	Decreased balance due Treasury		−100
5	Increased Federal Reserve notes outstanding		+100
	Decreased balance due Community		−100
6	Decreased Federal Reserve notes outstanding		−100
	Increased balance due Community		+100
	Net change		
	COMMUNITY BANK		
1	Decreased reserve balance	−100	
	Acquired Government bond	+100	
2	Gave up Government bond	−100	
	Increased reserve balance	+100	
5	Decreased reserve balance	−100	
	Acquired Federal Reserve notes	+100	
6	Gave up Federal Reserve notes	−100	
	Increased reserve balance	+100	
	Net change		
	ABC SECURITIES CO.		
2	Decreased balance with Metropolis	−100	
	Acquired Government bond	+100	
3	Gave up bond	−100	
	Increased balance with Metropolis	+100	
	Net change		
	METROPOLIS BANK		
2	Decreased balance due ABC		−100
	Decreased reserve balance	−100	
3	Increased balance due ABC		+100
	Increased reserve balance	+100	
	Net change		

Representative PATMAN. That is fine. I just want to call your attention to the fact that I am placing in the record a 14-year history from 1939 to 1952 of interest rates, of long-term interest rates. Then I will place in the record the 14 years subsequent, from 1953 to 1966, with the interest rates, and then I will place the same information as to yields on Treasury bills for those 14 years and the 14 years subsequent to that time. The information is rather staggering. It is showing that we are paying so much more in interest rates over that 14-year period when it was the worst time in the history of our Nation. We had the worst depression, we had the longest lines of people in want and need. We had starvation. We had wars, we had inflation, we had everything during those 14 years. You could not picture any 14 years in the history of our Nation that were worse. Yet, the Federal Reserve Board kept long-term interest rates at 2½ percent and under. In fact, it was so successful that when you joined the Federal Reserve Board you agreed with President Truman not to let interest rates go above 2½ percent, and you carried out your word, I will say that for you. In 1952, while Mr. Truman was in, even in 1953, after the administration changed, Government bonds were sold at 2⅜ percent interest. You remember that, don't you?

Mr. MARTIN. I do.

Representative PATMAN. And one issue at 2½ percent, so the low-interest period lasted not only during the 14 years, but carried over to the new administration that came in, so it shows it could be done. I just can't understand why you insist on just keeping on raising interest rates on the people when it is the second largest single item in the budget today. According to these tables that I place in the record, we are paying $8 billion more this year for interest rates than we should be paying and when we translate the new increases into the refunding of issues that are not drawing as much as the present rates, and it is affected clear across the board in our national debt, we will be paying $21 billion a year interest.

(The tables referred to follow:)

Comparison of interest rates—14-year period from 1939 to 1952 compared with 14-year period from 1953 to 1966

I. YIELDS ON LONG-TERM GOVERNMENT BONDS, 1939 TO PRESENT

[*Percent per annum*]

Year:	*Yield*	Year:	*Yield*
1939	2.36	1953	2.94
1940	2.21	1954	2.56
1941	1.95	1955	2.84
1942	2.46	1956	3.08
1943	2.47	1957	3.47
1944	2.48	1958	3.43
1945	2.37	1959	4.08
1946	2.19	1960	4.02
1947	2.25	1961	3.90
1948	2.44	1962	3.95
1949	2.31	1963	4.00
1950	2.32	1964	4.15
1951	2.57	1965	4.12
1952	2.68	1966	4.65
Average for 14-year period (1939–52)	2.36	Average for 14-year period (1953–66)	3.65

II. AVERAGE ANNUAL YIELD ON 91-DAY TREASURY BILLS, 1939 TO PRESENT

Year:	Yield	Year:	Yield
1939	0.023	1953	1.931
1940	.014	1954	.953
1941	.103	1955	1.753
1942	.326	1956	2.658
1943	.373	1957	3.267
1944	.375	1958	1.839
1945	.375	1959	3.405
1946	.375	1960	2.928
1947	.594	1961	2.378
1948	1.040	1962	2.778
1949	1.102	1963	3.157
1950	1.218	1964	3.549
1951	1.552	1965	3.954
1952	1.766	1966	4.811
Average yield (14-year period)	.645	Average yield (14-year period)	2.797

Comparison of Interest Costs

I. NET PUBLIC AND PRIVATE DEBT, TOTAL INTEREST PAID, AND AVERAGE RATE OF INTEREST IN THE UNITED STATES, 1951-66

Year (1)	Total debt (billions) (2)	Interest paid (billions) (3)	Computed average interest paid (3÷2) (4)	Interest costs figured at 1951 computed rate (5)
1951	$524.0	$17.8	3.397	$17.8
1952	555.2	19.7	3.548	18.9
1953	586.5	21.9	3.734	19.9
1954	612.0	23.7	3.873	20.8
1955	672.3	26.0	3.867	22.8
1956	707.5	29.8	4.212	24.0
1957	738.9	34.0	4.601	25.1
1958	782.6	36.0	4.600	26.6
1959	846.2	40.8	4.821	28.7
1960	890.8	45.7	5.134	30.2
1961	947.7	48.4	5.107	32.2
1962	1,019.3	53.4	5.238	34.6
1963	1,096.9	59.8	5.452	37.3
1964	1,174.3	66.5	5.663	39.9
1965	1,270.3	74.0	5.825	43.2
1966 (estimated)	1,368.3	82.7	6.044	46.5
Total		680.2		468.5

Note: See the following table:	Billions
Total, col. 3	$680.2
Less total, col. 5	−468.5
Excess cost	211.7

Source: Economic Report of the President, 1967.

II. TOTAL FEDERAL DEBT AND INTEREST PAID, FISCAL 1951-68

[Dollar amounts in billions]

Fiscal year	Total Federal debt	Total interest paid	Computed annual interest rates	Computed interest cost at 1951 rate
1951	$255.3	$5.7	2.233	$5.7
1952	259.2	5.9	2.276	5.8
1953	266.1	6.6	2.480	5.9
1954	271.3	6.5	2.396	6.1
1955	274.4	6.4	2.332	6.1
1956	272.8	6.8	2.493	6.1
1957	270.6	7.3	2.698	6.0
1958	276.4	7.7	2.786	6.2
1959	284.8	7.7	2.704	6.4
1960	286.5	9.3	3.246	6.4
1961	289.2	9.0	3.112	6.5
1962	298.6	9.2	3.081	6.7
1963	306.5	10.0	3.263	6.8
1964	312.5	10.7	3.424	7.0
1965	317.9	11.4	3.586	7.1
1966	320.4	12.1	3.777	7.2
1967 [1]	327.3	13.5	4.125	7.3
1968 [1]	335.4	14.2	4.234	7.5
Total		160.0		116.8

[1] Estimated.

Source: Economic Report of the President, 1967.

Representative PATMAN. Don't you think the time will come, Mr. Martin, when, if we keep on doing this, paying these unnecessary, exorbitant rates, that we will not have the money left, after we have paid the interest charges, which come off the top, that we will not even have the money to carry out the commitments to the veterans, our fighting men in a war today and their dependents, and for other public programs? We will not even have the money to carry on all the necessary functions of modern government. Have you considered, Mr. Martin, on your deliberations, our commitments to the fighting men to give them the same benefits that we gave the Korean veterans and the veterans of World War II and other veterans?

Now then, if you propose to raise the interest rates on them, you will certainly make them pay a lot more money for the homes that they buy and for the other loans they get, so we are breaking our commitment to the veterans right there. But, the bad thing, looking into the future, is that if we don't stop this increase in interest, our interest burden is going to be so great that we can't carry on the necessary functions of Government, and not have enough for preparedness of war, much less for the legitimate wants and needs of the public in peacetime.

What are your comments on that? Don't you think we ought to stop it at some point?

Mr. MARTIN. Mr. Patman, I have commented on this a number of times, and I want to say that I sincerely believe that we are overextended and overcommitted as a country today. We have been trying to do too much too fast, and if we do not get our budgetary situation and our fiscal and debt management and wage-cost-price situation into a better condition, we are going to find that we are not going to be able to keep a lot of our commitments.

Representative PATMAN. But that is not your duty. Mr. Martin.

Mr. MARTIN. And that is exactly what I am trying to deal with. What?

Representative PATMAN. You are talking about something that is not your duty. You are not elected by the people.

Mr. MARTIN. What is that?

Representative PATMAN. You are not elected by the people. You are not charged with the duties of administering the affairs of this Government. You are not charged with fiscal affairs.

Mr. MARTIN. I have never run for election, I am sorry to say—or glad to say—but I do try to discharge my responsibilities.

Representative PATMAN. Well, if you just do that I think we would be a little bit happier. I want to say again that the malfeasance that I put in there, was with respect to housing. There are other charges of malfeasance that if the time is ever appropriate to do so I shall enumerate them but, Mr. Chairman, I will not take up any more time.

Chairman PROXMIRE. Mr. Martin, I want to congratulate you on your good temper as well as the wisdom and thoughtfulness of your replies.

In your statement you may seem to be going beyond the administration on proposing fiscal restraint when you say: "Even with a tax increase and restraint on Government spending, the Federal budget would still be providing a significant net stimulus to the economy." Your analysis seems to imply that we shouldn't have a stimulus from the Federal Government. No. 1, do you argue that the $186 billion budget proposed by the Federal Government does provide for restraint on Government spending?

Mr. MARTIN. It doesn't provide for as much restraint as I would like to see. It does provide for some restraint. And as I have indicated several times here, I would like to see a further reduction in expenditures, and I wouldn't object to a larger tax increase than the current tax increase, because I think we have——

Chairman PROXMIRE. You have no fear of overkill?

Mr. MARTIN. I think that the danger of overkill is not nearly so great as the danger of building up too much. I think you have to weigh these risks. But we are late, you see, Senator. In my judgment we are late.

Going back to my testimony of a year ago, I think we would be much better off if we had moved more quickly in this area than we have. I am not saying that the Federal Reserve has been perfect during this period, either, but we have let these forces get ahead of us, and when they get ahead of you, it is very difficult to pull them back.

Therefore, I am not as worried about overkill today—as I indicated in the statement. Here I am stepping out of my field a little bit, because it is not for me to estimate what defense expenditures are going to be, and I am sure the Budget Bureau has done a very good job of projecting what they may be. But, as I see the world today, we are not in a whole lot different position than we were in 1965. The chances are greater, in my judgment, that we will have an increase in expenditures for defense than the reverse.

Now, I am not trying to get into the Defense Department's area there, I am just trying to weigh the risks.

Chairman PROXMIRE. Without pinning you down to a specific recommendation—which I am sure you would not want to make—but asking what your general feeling is about the kind of proposals we have in the Congress, and the Congress will be called upon to vote on proposals that would both limit spending to the last year level of $176 billion, and would also provide for a substantial tax increase, do you think in general that this kind of approach would be wise for our economy now?

Mr. MARTIN. Without passing on the specific level, I think "Yes." I think that we need restraint.

Chairman PROXMIRE. This seems to be based on two things. There are only two specific elements of increased demand that I could find in your message, and perhaps I missed others. You indicated business plans to increase outlay may go higher than they are presently estimated, and you also indicate that the Far East military developments may require more Federal spending. So far as business plans are concerned, as I understand it, we are operating even now, with the most recent figure we have, at 85 percent of capacity. There have been rare occasions in the past where business has substantially increased its development in plant and equipment when we have operated at that low a level. It has happened, but it has been rare.

Then in addition, the big stimulation we have gotten in the last few years has come from: No. 1, substantial tax cuts and we are not getting that, No. 2, a very, very sharp and dramatic Vietnam escalation, which increased the number of jobs by 3 million in the economy in 1965 through 1966, No. 3, a huge increase in business investment in plant and equipment in 1964, 1965, 1966, and, No. 4, a relatively high productivity increase and the relatively low wage settlements during the period of 1962 to 1967, that is, stable wage costs.

Now, as you point out in your very good paper, we are not going to get any of that stimulation in the coming year. Productivity is low, wage settlements are high. This seems to me to be a discouraging and restraining force on the economy rather than an expansive force. Businessmen who look forward to this kind of situation, it seems to me, are less likely to be optimistic either in making investment or in expanding activity in any other way. So, under these circumstances it would seem that whereas we do have a strong fourth quarter of 1967 and a good January, that we may very well be moving into a situation where the economy may not expand so much.

Just one other point I would like to make. You do rightly cite the very low unemployment figure, the lowest in 15 years. But, I would like to call your attention to the fact that hidden in that figure is a drop in the number of hours worked from 40.8 to 40.5. That 40.5 figure is as low as the hours worked in our plants in the last 6 years, the lowest since 1962. It seems to me that this may be a more sensitive future indicator of activity than the unemployment figure which, as we know, has distortions in it.

Mr. MARTIN. Well, I think all of those are valid points. Let me just make one or two comments on them. As to the plant and equipment situation, I doubt that the utilization figure—85 or 86 percent, wherever it is—is very precise, but I think that about 90 is regarded as the optimum. We are in a period of remarkable technological advance, and we have to weigh the efficiency of plant and equipment, and I think that to keep up technologically with the advances that are going on in areas like electronics and so forth and so on, that you have to recognize that plant and equipment very quickly becomes inefficient and obsolete and needs to be weeded out. These figures, in my judgment, really reflect the efficient plant and equipment capacity that is being utilized.

Chairman PROXMIRE. You say that even though we have this perfectly enormous increase, as you know, compounded.

Mr. MARTIN. Yes.

Chairman PROXMIRE. The percentage increase has been astonishing. In 1964 it was 14 or 15 percent; about the same percentage in 1965 and 1966; and then we have been going on at this level; 1967 didn't increase much but it was at that extraordinarily high level; and this year it will continue at this very, very high level. We might possibly be moving into the kind of capital goods overbuilding that in the past has been followed by periods of unemployment and recession.

Mr. MARTIN. I agree with that, but I think this is a judgment area. I am just trying to point out the overall problem here of weighing what is actually happening in the economy.

Now, on productivity and wage settlements, when you have productivity of, let's say, 3 percent, just taking a figure, and you have wage settlements of 6, 7 or 8 percent, you have a gap here that is difficult to adjust. We adjusted the overhang in inventory that developed in the economy when inflation got ahead of us in 1966, by the stimulus of monetary policy and some fiscal stimulus. During that period, inventory accumulation went from about an $18 billion rate down to virtually zero. But, you can't repeat that continuously, and we are up against a budgetary problem that has gotten persistently worse.

Chairman PROXMIRE. I think your analysis makes a great deal of sense, if we could assume that what has happened in the last 3 or 4 months is going to continue. You see, what troubles me very much is the timing of this thing. As I see it, I don't think we are going to adopt or enact a tax increase until the middle of the year. It is not going to have much effect in my view until 1969 because the effect on spending patterns is gradual, and now is the time when we need our restraint rather than later in the year when the forward steel buying, for example, will stop and they may be unloading steel inventory. As you know, there is a large amount of forward steel buying because of the anticipation of a possible steel strike. Most economists argue that the latter half of the year will be slower than the first half of the year. Under these circumstances a tax increase that would freeze us into that position becomes very hard to repeal. I have found nobody that can give me an example of a tax that has been repealed before its expiration date, and most have been continued after. It seems to me to be a fiscal policy far less desirable than spending reductions which could be restored perhaps more easily.

Mr. MARTIN. I agree that it is late, and timing is always the critical problem in any of these policy decisions, but I don't think it is too late.

I think we are up against the point that we discussed at the Senate Banking Committee the other day. The world is looking at the United States today to see whether we will take responsible action with respect to restraint as well as with respect to stimulation. We continue to have a budget deficit in a period of general affluence for the country, when we have gotten employment to the level that very few people will say is not full employment, and when we have pretty well utilized plant and equipment resources. If during that sort of a period you can't move toward budget balance, if we are going to move in a period like that to increasing deficits, I think that a great many people have a right to look at us and say, "Well, perhaps expenditures are getting out of control." The normal cyclical force of extravagance and inefficiency and incompetence that are always at work in any economy will come to a point where you will get a decline in business, not necessarily of large magnitude, but certainly a decline, and then with a budget deficit that has been progressively growing larger in good times, when you have this little lean year, you will suddenly find a budget deficit that has become colossal.

This is what happened to us in the early stages of the Eisenhower administration era. The economy every now and then comes to a turning point and all of a sudden you are late in having taken stabilization actions. You haven't used your opportunities for stabilizing when times were good, and now the only way you can stabilize is go in for more spending, and going in for more spending just doubles or triples your deficit. You tend then to have perpetual deficits, and this is what worries me very much about the course we have been following today.

Chairman PROXMIRE. My time is up but I also point out that you may get to a point, too, where you cannot reduce your deficit much by increasing taxes depending on the nature of the economy.

Mr. MARTIN. Exactly, I realize that, but I think this is the risk we have to weigh, you see, here. But the only point I would make—I am not trying to debate this, I am just trying to lay my view before you—is that we have been saying for quite awhile that we can't take any action of restraint with this current budget deficit because we might have a decline in business, and then over the year the deficit has enlarged further, and we are losing every opportunity that we have had to move in and we can't expect always that the economy is going steadily up.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Martin, there are two points I would like to ask you about. One is primarily the tax. There is enormous opposition in this country to a tax increase. It seems to me that the administration is not recognizing that adequately. The enormous bulk of the mail, the visits, everything that brings the public influence to bear on a legislator—and we have to vote, this is nothing the President can do—is against the tax increase. And to reduce expenditures.

Now I have just come from an interesting experience with your colleague, Secretary Fowler, who is seeking to sustain the administration's position before the Appropriations Committee, and he says that it takes $18 billion in expenditure cuts to deal with the problem if you do not want to have a tax increase, and he says it is impossible. It won't be done. It cannot be done.

Now, you are a pretty conservative fellow, and you are pretty independent. What do you say about it?

Mr. MARTIN. I say that I do not know, Senator. I have really not studied the budget in the sense of where it could be cut further. I have confidence in the people that have worked on it, including the President whom I have had the privilege of visiting with on this, I know that they have made efforts to do this, and whether it is feasible to go any further or not I do not honestly know.

I simply say that we are, in my judgment, as I reiterate what I said earlier, that we are overextended and overcommitted today, that we have got to get priorities on these things or we are going to have a continuous, perpetual budget deficit that will eventually undermine our currency, and lead people generally into more trouble than they want to see.

Now, I get mail, too. My mail is not in favor of a tax increase, but most of my mail that comes in is very upset for one reason or another, and does seem to indicate that a lot of people think we are overextended and overcommitted.

Now, I am not against any of the programs basically. I am not against antipoverty activities. I am just saying that they have got to be put into some range of priorities so that we can get this budget deficit more manageable than it is today.

The pressure on our money market today has not really subsided. I was talking earlier with Mr. Patman about interest rates. In a roughly $70-million market, the Treasury is the principal borrower. We have just seen the pressure of Treasury borrowing pushing rates up, and when you accelerate tax payments, then you have additional pressures on that market, and I think on the whole it has been amazing that interest rates have not gone higher.

Senator JAVITS. Would you say, too, as Secretary Fowler said, that $16 billion, which is what you would get out of the tax increase as he asks for in the space of 18 months, roughly, something like that, either in expenditure cuts or in tax increase, is what you need? Do you join in that, at least?

Mr. MARTIN. That would put the budget into more manageable proportions?

Senator JAVITS. Do you recommend the tax increase?

Mr. MARTIN. I do.

Senator JAVITS. Do you recommend it as he asks for it, that is, 2 to 1 on individuals versus corporations?

Mr. MARTIN. I do not want to get into the specific of it, and I do not think I should try to be a tax expert. I have my own personal ideas from time to time on this, and it is not that I want to in any way hold back on this sort of thing, but I do not really think the Federal Reserve ought to be talking about what the nature of taxes ought to be and how they should be set up.

I do think we have a responsibility to concur with the administration, as we have, that this budget deficit is reaching larger proportions, and to point out its impact on the money market.

Senator JAVITS. Does it make any difference, Chairman Martin, as long as $16 billion is produced in a given time, whether the tax falls more or less heavily on corporations or more or less heavily on individuals?

Mr. MARTIN. Well, we must think not only of where the burden of it falls but also what it does to the economy. In the area of taxation, we have a larger problem today. Fiscal policy in the last dozen years or so for the first time has been directed at either stimulating or restraining the economy, with less attention paid to just deriving revenue, and I think that——

Senator JAVITS. If I may, then, because I do think that that is a legitimate issue of policy to which you as the Chairman of the Federal Reserve Board could address yourself, to wit, to advise us whether it does or does not make any difference if we tax more heavily corporations than individuals in proportion, and I would hope, Mr. Martin, that if you cannot answer that now, because I do think we are entitled to your advice not only on a matter of policy, you might think it over and if you think you could answer it, I would greatly appreciate that it would be incorporated in the record. It could be a very helpful guide to us.

Mr. MARTIN. We'll submit something on that.

(Mr. Martin later supplied the following for the record:)

The administration's surtax proposal seeks to divide the resulting addition to taxpayer burdens evenly between individuals and corporations. To accomplish this end, the proposal accepts the distribution of tax burdens under present law as the appropriate base from which to start, and then proceeds to change each taxpayer's burden by the same percentage. Both individuals and corporations pay an added 10 per cent of their tax liability under existing legislation. Two exceptions are made to this principle of equal treatment for all taxpayers.

(1) The proposed surtax would not apply to individuals in the two lowest tax brackets. For example, a family with two children and using the standard deduction would not be subject to the surtax if its total income was $5,000 or less, and a single individual would not be subject to the surtax if his total income was $1,900 or less.

(2) The proposed surtax would be retroactive to January 1, 1968 for corporations, but would not apply to individuals until April 1, 1968. Corporations can meet this retroactive feature more easily than individuals, since there is usually a greater lag between corporate earnings and their distribution than between personal income and consumer spending. At the same time, the retroactive feature insures a maximum immediate mopping up of private spending power.

Acceptance of a flat across-the-board surcharge has several obvious merits:

(1) By taking this straight-forward approach attention can be focused on the primary need for a prompt change in the level of fiscal restraint through taxation, without debating the equity of the existing tax structure. Questions regarding the appropriate relative tax burden, and even questions as to who really bears the burden of any given tax, are exceedingly difficult to answer, given our present knowledge of economic behavior. Thorough deliberation and review is, therefore, desirable when it is planned to shift the relative tax burden from one type of taxpayer to another. Shifts in tax structure are, therefore, best undertaken only when there is the time to explore the intricacies of the problem through extensive study and debate. The proposed surcharge would not disturb the equity or inequities in the present tax structure.

(2) By imposing the surtax on both individuals and corporations the proposed tax legislation insures that the additional tax burden will have the desired anti-inflationary effect, and that the desired dampening of price pressures will be spread over the entire economy. If the surtax were imposed on corporations alone, it would tend to focus mainly on demands in the investment sector; if it were imposed on individuals alone, it would tend chiefly to dampen consumption demands. In our present circumstances, while some general reduction in private demands for resources is needed to offset war-induced public demands, there is no single private sector that is contributing disproportionately to private demands.

(3) The growth of corporate profits and personal income has been roughly similar since the present income tax laws were last reviewed by Congress. Since 1963, just prior to the last broad Congressional review, corporate profits have increased 34.8 per cent and personal income (excluding transfer receipts) 33.5 per cent. These roughly commensurate growth rates add further support to the administration decision to try to distribute the added burdens of the proposed surtax evenly at this juncture.

Senator JAVITS. Now, the administration has advertised this tax increase as a way of reducing demand because it will bring spending power otherwise to be spent for goods into the Government in taxes. Some of us here have insisted that that is what is going to cause the tax business to have difficulties, because it is not being recognized frankly as a Vietnam war tax. Do you have any opinions on that?

Mr. MARTIN. I definitely think it is a war tax.

Senator JAVITS. That is what it is to me, and if they do say so and admit it and face it that way, I think you would see so much of this opposition dispelled, not because people like taxes but because they hate war more, and because they want to back up our people in the field.

I say also, Mr. Chairman, that I have been through, at the chairman's request, France—London, Paris, Bonn—and whether we agree with them or not, the universal opinion, of both the private and public sectors, is that a tax increase in the United States is the only thing that will convince the leading industrial nations of the world that we are determined to defend the dollar. This is one of the facts of life that I just must report to my chairman, because that is what I found. I do not have to agree, but that is what I found.

I would like to ask you just one other question. That bears upon our trade surplus. One thing that is being pointed out now—and I know you said it and Secretary Fowler said it today—is the impact of what is happening domestically upon imports, and that the trade surplus which is now contracting and further complicated, very seriously complicated our balance of payments. You affirm that?

Mr. MARTIN. I do, indeed.

Senator JAVITS. Now, will you tell us precisely how—I know, but I think it should be stated for the record—precisely how does the inflationary domestic situation increase imports and maintain exports levels, and, therefore, worsen our international balance of payments rather than improve it, and perhaps even nullify, if we continue along this line of everything that is trying to be saved in the President's $3 billion program? I do not necessarily agree with all of that either, but we are dealing with facts, not my views or theories.

Mr. MARTIN. Well, as costs and prices of goods here rise, it diminishes their attractiveness in the export market, and gives an opportunity for people to find other sources of goods and services by imports. The supply and demand and cost-price relationships have caused a diminution in our trade surplus.

Senator JAVITS. And so also with imports. If incomes here increase the demand for imports is greater; is that right?

Mr. MARTIN. That is correct.

Senator JAVITS. So that trade surplus, roughly $4 billion, will inevitably decline?

Mr. MARTIN. That is correct.

Senator JAVITS. Very materially and worsen our balance of payments?

Mr. MARTIN. That is right.

Senator JAVITS. Can you see it easily eating up $3 billion of the present surplus? It would not take long to do that, would it?

Mr. MARTIN. I would hope that it would not, but that is the trend.

Senator JAVITS. That is the trend. In other words, we have the reverse of what the British hope to gain by devaluation?

Mr. MARTIN. That is right.

Senator JAVITS. They hope monetarily to have cheaper export sales and, therefore, to compete better, while we are hit the other way. Monetarily at least we have more expensive export sales.

Mr. MARTIN. That is right.

Senator JAVITS. Because of the inflation situation. Mr. Secretary, I think that is critically important, and I am obliged for it. Now one other thing which I think you should put in focus, is what is meant by Federal Reserve restraint. You speak here of that with respect to the increase in the discount rate or the increase in the level of bank reserves.

You are engaged in a policy of restraint now; are you not?

Mr. MARTIN. Yes, we are; modest restraint, very modest.

Senator JAVITS. Modest?

Mr. MARTIN. Very modest restraint.

Senator JAVITS. Would you advise stepping that up?

Mr. MARTIN. I think as things develop we may have to. I do not forecast monetary policy here. We want to assist the Treasury to the best of our ability in meeting the requirements they have, and this sizable deficit they have makes our job very difficult. But we also do not want this money supply to be dissipated in rising prices.

Senator JAVIGS. May I just ask one more question, Mr. Chairman? My time is up. I have just one more.

Chairman PROXMIRE. Go right ahead.

Senator JAVITS. In respect to this monetary restraint to which you refer: That tends to lessen the amount of the credit which is available for ventures and other purposes of building up economic capability?

Mr. MARTIN. That is correct.

Senator JAVITS. That is the way it works?

Mr. MARTIN. That is the way it works.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Symington?

Senator SYMINGTON. Chairman Martin, your statement is clear and concise. I may not agree with all of it, but all of it is certainly worth careful attention.

As I understand it, in summary you say that if we do not take more interest in fiscal and monetary responsibility, we could seriously affect the integrity of the dollar; is that correct?

Mr. MARTIN. That is correct.

Senator SYMINGTON. Last year Miss Sylvia Porter wrote a column to the effect that by the end of 1967 there would be $1 trillion of life insurance held in this country, a thousand billion dollars. All the large corporations, and small, and all large unions, and small, emphasize the value of their pension plans and retirement plans; and we all know how vitally important to millions of our citizens is the income from social security. Can you imagine any greater disservice that a public servant could participate in than to back policies which resulted in serious devaluation of the dollar, this from the standpoint of its effect on a large majority of our citizens.

Mr. MARTIN. I cannot think of any greater disservice.

Senator SYMINGTON. The veterans were mentioned earlier this morning. I was thinking about that. Can you imagine any greater disservice to a veteran than, if he was killed or seriously crippled, what the Government gave him as a result of his patriotism turned out to be so small in the way of value that his family could not have even a minimum decent standard of living?

Mr. MARTIN. I can imagine no greater disservice.

Senator SYMINGTON. I have used a phrase recently that in this country today we are now fighting a major war, but the only people giving up anything are those who are giving up everything, and their families. We have no controls, no increased taxes. Is that the way it would appear to you, as a citizen?

Mr. MARTIN. It would. I have repeatedly stated I just do not think we can have guns and butter under these conditions, and I think that the burdens of this war cannot be borne alone by the people who are actually in the field.

Senator SYMINGTON. A famous economist has developed the theory that easy money creates higher interest rates. If you have not examined that concept, would you have someone on your staff do so? It is an interesting theory. I discussed it with the economist in question only last week. Would you have somebody look into it?

Mr. MARTIN. I will be very glad to.

Senator SYMINGTON. I think you know to whom I refer.

Mr. MARTIN. I think so.

Senator SYMINGTON. Now, another aspect. As I understand it, Lord Keynes created the concept of managed currency so as to promote and maintain prosperity and prevent recession. Reading his philosophy, it seems that he emphasized the importance of reducing Government spending and increasing taxation in times of prosperity along with the reverse in recession. At least until recently, the so-called new economists who like to call themselves Keynesians have taken an opposite position; namely, they recommend an increase in Government spending and lowered taxes even in times of prosperity. Do you think Lord Keynes would be happy about this interpretation of his philosophy?

Mr. MARTIN. I think he would be most unhappy with that interpretation. To be fair, I think a lot of the new economists have advocated an increase in taxes, and a reduction in expenditures during the last couple of years.

Senator SYMINGTON. The practicalities of developing events have now forced them to conform to the thinking of the person they have always said they followed.

Mr. MARTIN. That is right, and as both you and I knew him, I think we could confirm from conversations with him that this was the position he would take.

Senator SYMINGTON. I agree, and I have one more thought about this situation. Here is a little statement I plan to put in the record today, and would ask if you agree with it.

On February 8, the Federal Reserve Bank of New York announced the monetary gold stock of the United States had dropped $100 million. In the past week the lowest point in nearly 31 years has put gold at $11,884 million, below $12 billion now. This is the lowest since April 28, 1937.

I notice that the more gold we lose, the more some people say, what is gold worth anyway, as they concentrate on some new setup, either the CRU's of the IMF or the SDR's of the Brazil meeting or some other plan. Maybe gold is worth as little as some of these people say, but don't you believe it would be advisable we have some agreement on what is to be the substitute for gold before, if for no other reason, we are forced off the gold standard because there is no more gold to sell?

Mr. MARTIN. I am a vigorous supporter of the special drawing rights which I think Secretary Fowler negotiated most effectively at the International Monetary Fund meeting in Rio. I believe this is the wisest avenue and it does represent a landmark in monetary history because it will provide for conscious creation of supplements to gold. But the real way to handle the gold situation is for us to get our own house in order. Once we do, we won't have to worry about it.

Senator SYMINGTON. I remember your recent comment about this metal. In other words, you believe that as of today the Special Drawing Right concept is the best solution to this problem?

Mr. MARTIN. I do.

Senator SYMINGTON. Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Senator.

Congressman Patman?

Representative PATMAN. Mr. Martin, you mentioned that we cannot afford both guns and butter. That is the phrase you used. Now, this year we are paying $8 billion more than we would have to pay interest on the public debt alone, just $8 billion if not used as interest on the public debt would provide what is generally termed as the necessary butter, would it not, for other programs?

Mr. MARTIN. The $8 billion would be very nice if we could get it, if we did not have to pay it.

Representative PATMAN. These tables that I put in the record, Mr. Martin, will show that since you have been in office as Chairman of the Federal Reserve Board, after Mr. Truman's time, that you have been charging, the people at least following your policies have, over $14 billion a year excessive interest. That would provide a lot of butter, too. That is based upon the entire debts of the country, not just the national debt; the debts of all States, counties, cities, political subdivisions, and all public and private debts aggregating, I believe, now about $1,035 billion. That figure represents the approximate amount?

Mr. MARTIN. I would think that is about correct.

Representative PATMAN. Yes, sir; and that has been ascertained each year. You will see in those tables, and since you have been in office the people have had to pay over $14 billion a year extra interest compared to the preceding 14 years. So, I think that would produce a lot of butter.

Now, what I meant by not being elected a while ago, I meant for the purpose of running the Government, of running the President's business, and I had specific reference at the time, although I did not want to pursue it, but I would like to pursue it briefly now, that when, within a year of the time that President Johnson was elected overwhelmingly by the people in 1964, and getting up his budget in December 1965, to deal with our fiscal affairs, and you did not know what his budget was. You did not have any idea of what he was doing. I am sure you did not, because they were doing it, of course, internally, as they should.

But you threw the biggest monkey wrench in delicate machinery I guess of any man on earth when you went to Johnson City and told the President of the United States that you were not going to wait, and that you were going to raise the interest rates 37½ percent right then. In fact you had already done it. I think everybody felt that you were going down there to discuss it with the President, but you went down there to tell the President.

Now, don't you think that is interfering with fiscal affairs and interfering with the running of the Government by the person who is elected by all the people to run the Government? You were not elected to run that part of the Government, and yet you threw this big monkey wrench in the machinery.

Mr. MARTIN. Mr. Patman, we have been over this before, as you know. There was full coordination within the Government. The only difference was the difference of judgment, the difference with respect to what ought to be done, and so far as the budget was concerned, I was given information about it, and a judgment had to be made.

Now the Federal Reserve, as you know, as presently constituted—the Congress can change it at any time that it wants, of course—is independent within the Government, not of the Government. We have broken our neck to coordinate our activities with whoever has been in office, whether it has been the Republicans or the Democrats. We are there to serve the best interests of the Government in accord with the Constitution and the Federal Reserve Act that the Congress has enacted. There was an honest difference of judgment at this time as to what ought to be done. Let me finish with this because I think it is important. After discussing this with the President, repeatedly, and with the Secretary of the Treasury, repeatedly, and the Chairman of the Council of Economic Advisers and the Budget Director, the Board, by a divided vote, decided that we could not wait for next year's budget. The majority position, as I testified before your committee, when you held hearings promptly after our action, was, that markets will not wait for kings or Presidents or Prime Ministers or Chairmen of the Federal Reserve Board or Secretaries of the Treasury, and we had a market situation that required our moving on the interest rate or we were going to be locked into a policy that I think would have been more unfortunate that the policies that we pursued.

Representative PATMAN. The way I construed your testimony and that of Vice Chairman Balderston, and the other members who testified a few days after that before this committee on December 13, 14, and 15, I think, was the emergency that a half a dozen banks were experiencing because they could not pay enough interest to roll over their outstanding certificates of deposit. Mr. Balderston admitted that, right in the open meeting, as you will remember. That was the pressure that was on you. It was not the budget of the United States so much.

Mr. MARTIN. That is not——

Representative PATMAN. It was a half a dozen banks that had overextended themselves on certificates of deposit. Therefore, it was for the purpose of raising those rates 37½ percent at that time, which had the effect of relieving the emergency with those half-dozen banks. Now, that is in the hearings and printed testimony. I do not think anyone can dispute that.

But I want to go back to this independence of the Federal Reserve.

Mr. MARTIN. May I just, because I want the record to show here——

Representative PATMAN. Certainly.

Mr. MARTIN (continuing). There is just an honest misinterpretation of the record. Governor Balderston, who is, unfortunately, not available to testify, would certainly confirm this. That was not the——

Representative PATMAN. Well, he testified.

Mr. MARTIN. He testified, but you are misinterpreting his testimony.

I talked to him within the last 2 months on this thing. There was never any intention in his testimony to suggest that we were doing this to relieve any large banks of their problems. What we are doing was what we had to do. Banks probably would have put their prime rate up considerably before they did, except they were being restrained by political reasons. You had around that a situation develop—where you had, as I put it repeatedly, rocks in the stream—that had to be corrected.

Governor Balderston did point out in that testimony the later Regulation Q problem and the problem of the pressures in the money market, but I am afraid you are not interpreting—I would say you are interpreting his testimony incorrectly, with my knowledge having dealt with him. Certainly what we were trying to do was to be constructive, not destructive, and this again——

Representative PATMAN. Of course, you consider that constructive.

Mr. MARTIN. I did and you considered it destructive, but I just want the record to show that there is that honest difference of judgment.

Representative PATMAN. Well, I will rely upon the printed record then and his answer.

(Representative Patman subsequently supplied the following:)

HEARINGS BEFORE THE JOINT ECONOMIC COMMITTEE, PART I, PAGES 230–231, DECEMBER 14, 1965

Mr. BALDERSTON. Mr. Chairman, I would like to remind you that passbook savings may be withdrawn almost immediately. In a practical sense they are withdrawn immediately. That is not true of CD's. Now you have referred to the matter of the negotiable CD's that were coming due in December. They amounted to $3.5 billion. Of those, $1,854 million were outside of New York and Chicago.

Chairman PATMAN. How much?

Mr. BALDERSTON. $1,854 million.

Chairman PATMAN. Out of the $16 billion?

Mr. BALDERSTON. Out of the $3.5 billion coming due in the month of December. Our concern, of course, was that if those $3.5 billion were withdrawn from the banks, and the banks were placed in a severe enough bind, the impact upon the economy of this country right at a time of seasonal need, might have been very bad indeed.

After all, we don't want to have loans called just because the needs of the economy and of the banking system are not accommodated.

Chairman PATMAN. You felt like more interest should be allowed for that reason?

Mr. BALDERSTON. Unless they were allowed to bid a sufficiently high rate of interest to hold the CD's in the face of the declining flow of funds in our corporations you might have had the bind that I referred to. After all, December 15 is not only a tax date but the approach of dividend dates.

Chairman PATMAN. Thank you very much. You have proved my point.

Mr. BALDERSTON. I am glad you understand, sir.

Mr. MARTIN. I rely on the printed record also, and I just wanted the record to show that we have an honest difference of opinion.

Representative PATMAN. Now this independence, Mr. Martin, you said independence within the Government. That is a phrase that you have used within recent years. Do you mean you are independent from the President? Who are you independent from within the Government?

Mr. MARTIN. We are a creature of the Congress.

Representative PATMAN. Could anybody overrule you? Could the President overrule your decision as a Board?

Mr. MARTIN. The President alone could not.

Representative PATMAN. Could not. You have said that. Of course, that is contrary to our form of government the way I see it. That means that we do not have a democracy in a republic as President Madison said. We have an autocracy on monetary matters, and we have two forms of government here, one run by the bankers and one run by the people's representatives, and I do not think they can operate together very well, because the President runs for office on a platform. He promises to have certain things done. Now he is faced with the Federal Reserve Board and the Open Market Committee that determines on monetary affairs and interest rates and make it impossible for the President to do what he is obligated to do for the people. That is what I meant by elected. You see, he is obligated to do that.

Now, I do not impugn the motives of the people who are not elected and are appointed. I am sure that they try to do their duty, to perform their duties honorably and well. But at the same time you do not have the authority to run around here and lobby against the President, the Government, and the Congress. There should be somebody to overrule you. We do not have the kind of government we think we have if we just turn over an important governmental function to an institution that is run for bankers, because it is inconsistent.

Now, if you are independent within the Government, you are independent from the President, and you are also independent from all the other agencies; aren't you?

Mr. MARTIN. That is correct.

Representative PATMAN. That is correct?

Mr. MARTIN. Yes, sir.

Representative PATMAN. In other words, you are responsible to most but——

Mr. MARTIN. No; we are independent as stipulated by the Federal Reserve Act, which can be changed at any time by the Congress.

Representative PATMAN. Just one other question, Mr. Chairman. My time is up.

What rate would you step in with if, say, the housing rate went to 10 percent? Would you as the Chairman of the Board take any action to try to buy some of these housing bonds for the benefit of keeping that rate from going up beyond 10 percent?

Mr. MARTIN. That is a hypothetical situation.

Representative PATMAN. I know it is, but it could happen. They are shooting for it.

Mr. MARTIN. No.

Representative PATMAN. They are shooting for it.

Mr. MARTIN. I do not think anybody is shooting for it.

Representative PATMAN. I know some people that are shooting for 10 percent. I do not think you are resisting them too much. That is our problem.

Mr. MARTIN. Well, I respectfully——

Representative PATMAN. Do you want to resist them at any point? Suppose they get to 10 percent. Are you going to try to keep them from going higher?

Mr. MARTIN. The best way for us to prevent getting to 10 percent on anything is to just have fiscal and monetary responsibility.

Representative PATMAN. You are getting in a field though that somebody else was elected to represent and not you. You are complaining about that now. If you would pay more attention—of course, I should not be advising you, but my opinion is——

Mr. MARTIN. Always glad to have your advice.

Representative PATMAN (continuing). That if you spent as much time on interest rates as you are spending on trying to influence the Government's action, I think we would have much lower interest rates. Thank you, Mr. Chairman.

Chairman PROXMIRE. The last chance I had to question you, Governor Martin, I got your views on the kind of fiscal restraint you thought we ought to pursue. What will be the effect on monetary policy, if the Federal Government follows about the kind of fiscal policy the administration has recommended—that is, we pass the surtax, we spend our $186 billion, we have an $8 billion deficit if the President's estimate is about correct—what will this do to your monetary policy do you anticipate?

Mr. MARTIN. It will permit it to be easier than it would be if you did not pass this tax bill. Now, how much he cannot forecast.

Chairman PROXMIRE. Well, that is apparent.

Mr. MARTIN. Right.

Chairman PROXMIRE. But I am just wondering if you feel under these circumstances you will be able to have somewhat easier policy than you have at the present time or will you continue at about along the present lines?

Mr. MARTIN. You are in a hazardous area of prediction, but personally, as I have stated earlier on a couple of occasions, I think there would be a tendency, quite apart from policy, toward lower interest rates because you would eliminate all of this tension and anxiety, and you would resolve something that was mentioned by Senator Javits, earlier, that financial markets both here and abroad are looking to our dealing with this deficit, and particularly to the tax increase. It is a psychological determinant for them as to whether we are going to be able to manage our affairs.

Now, I think they are exaggerating the importance of this. Don't misunderstand me. I think they are placing more importance on this than the tax actually deserves. But I think it is a psychological factor of great importance, and I think that if we get the $16 billion that Senator Javits is talking about——

Chairman PROXMIRE. Is it psychologically important on the spending by individuals and corporations?

Mr. MARTIN. Yes.

Chairman PROXMIRE. You think if we pass the tax increase it may exercise restraint on both the consumer and the businessman?

Mr. MARTIN. I think it will be a stabilizing influence on everybody.

Chairman PROXMIRE. I am wondering about that, because you know the consumer, as you know, last year exercised remarkable restraint. As a matter of fact he increased his savings as a percentage of his income to 7.1 percent which is extraordinarily high compared with what we have had in the past. It would seem to me that one of the reasons according to the Michigan Survey of Consumer Intentions, that he exercised restraint—it may seem contradictory—is because he anticipated inflation and he was deeply concerned about this, and he felt that he might not have enough to meet the cost of living if he spent all he had, so he saved more.

It would, therefore, be conceivable, at least, that a tax increase could assuage this fear and result in saving a lesser percentage of his income?

Mr. MARTIN. But this would return the economy to more normal activity. Over the last 2 years the economy has been whipsawed with expectations of this, that, and the other thing, and people are naturally concerned about wartime conditions in the world, and they are concerned over this issue of guns and butter, and you have had genuine certainty in the money markets that I think will be stabilized by some assurance that we will have a more manageable budget of deficit to deal with.

Chairman PROXMIRE. At any rate if the fiscal restraint is less, in other words if we fail to pass the surtax and do not decrease spending very much, you would foresee the necessity for a substantially less easy monetary policy, a tighter monetary policy?

Mr. MARTIN. Yes; as I perceive things now, yes.

Chairman PROXMIRE. And, on the other hand, if we follow a more restrained policy, pass the surtax, cut spending both, then it might be possible to have an easier monetary policy, and you think that that would mean lower interest rates?

Mr. MARTIN. Without predicting; yes.

Chairman PROXMIRE. I would like to ask you about something that did puzzle me last year. You were right in saying that I criticized the Federal Reserve Board for what I thought was an inflationary policy during part of this period. I would like to quote a statement by Dr. Julius Backman, who is a prominent economist, which he made at a meeting of the National Industrial Conference Board late last November—November 27. He said:

The explosive growth in bank credit during 1967 provides another powerful stimulus to price inflation. Money supply, that is currency in private demand deposits, has increased at an annual rate of 7 percent, and time and savings deposits at an annual rate of 17 percent this year.

Which was just a few months ago.

Combined, the growth has been about 12 percent. In the past year the Fed has bought more than $5 billion of Government securities. Currency in circulation has increased by more than $2 billion. Member banks reserve balance has increased by $0.7 billion.

Now, I realize that is history, that now you are following a more restrained policy. But we get the feeling—many of us on this committee, many Members of Congress—that the Federal Reserve Board is following a policy of stepping on the gas and zooming ahead when we seem to be in somewhat of a slowdown in the economy. You are zooming ahead at a rapid rate, and then jamming on the brakes when it appears that the economy may be moving ahead a little too rapidly, and that this start and stop, this wide sweep in monetary policy, is unsettling. And that there is a sufficient lag in its effect that it may be perverse even in its economic effect.

This committee, last year, as I recall, recommended a somewhat more moderate, within a 2- to 5-percent variation, increase in the monetary supply as a more realistic approach.

Mr. MARTIN. I think we ought to work toward that, and I do not like these wide swings, either. I am not suggesting that we have been perfect in our administration of monetary policy. I do not point out, however, that the money supply and the theories of the impact of the money supply are quite complex, and you have a great many aspects of impact and timing that come in when the Treasury has to finance in great amounts during the year. While I think we are working toward less tension and toward a more orderly swing between stimulus and restraint to monetary policy, I think we have a long way to go yet before we have really achieved it. We have seven men on our Board, and we do not always agree as you know, but we have to try to weigh the pros and the cons and come out with a policy that seems the most appropriate at the time.

Chairman PROXMIRE. You see what we are asking for is something your philosophy would seem to support and that is more reliance on market forces. If there is a relatively steady, with some variation of course, adjustment in buying and selling securities and in other actions that you take to affect the money supply, then in an expansionary period you have an automatic restraint, and in a depressed period if the money supply continued to increase, you would have an automatic stimulus. But it would be modest and moderate rather than sharp.

Mr. MARTIN. Well, I think we are working in that direction. Now, I do not think we are going to get to the point where we just automatically increase the money supply at a fixed rate.

Chairman PROXMIRE. No; that is why you think there should be leeway, of course?

Mr. MARTIN. Right.

Chairman PROXMIRE. Of course, you have other problems in addition to the monetary policy of the country which is very important. But, also important is a certain regularity in the money markets and in meeting the Treasury's demands for their securities and so forth?

Mr. MARTIN. Absolutely. This has been complicated in the last couple of years by our problems over defense expenditures.

Chairman PROXMIRE. I would like to ask you whether you can give us any idea of the supply and demand of credit which you expect in 1968. You see, we are trying to get some picture of the possible effects of the credit crunch and some notion of what should be the increase in the money supply in view of the demand and supply of credit that you anticipate in the coming year.

Mr. MARTIN. I do not believe I can give you an estimate that would be worth anything on that. All I can say is what I have said several times. That so far as another money crunch is concerned, we want to do everything in our power to avoid that sort of thing. We want to be responsible in our management of the money supply, to avoid unduly sharp swings in that, but at the same time we want to see to it that we do not have just a supply of funds that is pushing up prices without producing any additional goods and services.

Chairman PROXMIRE. My question relates to what your estimates are for the entire economic situation. You apparently anticipate the kind of growth in GNP that is predicted by the Council of Economic Advisers, maybe larger. Under these circumstances I wondered if you could give us an idea of what you anticipate would be the probability of demand and supply for credit.

Mr. MARTIN. We have a projection, Senator. Mr. Brill, who is the head of our research division, has a model and he estimates that if the tax increase passes, the demand for funds will decline in the second half of the year. But you know that this is just a model. I was not going to try to put anything off on Mr. Brill, but if your committee would like to take the time some time, he might give you a chart show, as we have occasionally presented for committees of Congress.

Chairman PROXMIRE. It would be most helpful. That is exactly the kind of thing we would like to have done.

Mr. MARTIN. We have done it on several occasions for committees. I do not suppose he is looking for more work, but I am sure he would be glad to do it.

Chairman PROXMIRE. Yes, indeed.

Senator Javits?

Senator JAVITS. I just have two questions, Mr. Chairman. One is this: Do you think that the request for a surcharge on taxes has come too late, being made only this January, whereas these inflationary forces which you describe have been moving so strongly all the year since December?

Mr. MARTIN. No; I do not think it has come too late, but I think it is late.

Senator JAVITS. In other words, it should have been made earlier, but it is better late than never?

Mr. MARTIN. That is right.

Senator JAVITS. It is not too late?

Mr. MARTIN. That is right.

Senator JAVITS. You believe it can still bite in and do what needs to be done?

Mr. MARTIN. I think we have to make a start at it; yes.

Senator JAVITS. The other question relates to page 2 of your statement, where you point out the matter of wage demand being twice as large as the long-run gains in productivity. Do you believe that it is time to try to use some mechanism in that regard to endeavor to bring some of the influence of patriotism or restraint on the wage and price levels?

Mr. MARTIN. Well, I think it is essential that we get a better relationship between productivity and wages, and without talking about the means or the methods of doing it, I think Gardner Ackley deserves a lot of credit for having persistently brought this to the attention of business and labor and to the public over the last couple of years. He took a figure of 3.2. I am not holding to any particular figure, but basically he fought vigorously that something ought to be done here.

Senator JAVITS. Exhortation has not worked, has it, Mr. Chairman?

Mr. MARTIN. No exhortation has not been too successful, but it is no reason for giving up the struggle.

Senator JAVITS. I understand. Do you think we need, in the interests of the economy, something more than exhortation? I am not going to ask you what because that is outside of your field of policy but do you think we need some governmental machinery or technique for wage and price restraint at this time as well as these other things we have been talking of?

Mr. MARTIN. Yes, I think so.

Senator JAVITS. You would not be prepared to recommend any particular means to us, would you?

Mr. MARTIN. No.

Senator JAVITS. But, certainly, something must be done more than has been done?

Mr. MARTIN. More than has been done.

Senator JAVITS. Now, suppose we have the tax increase. Suppose this Congress votes the surcharge. Do we still need some governmental machinery or technique for wage and price restraint?

Mr. MARTIN. I think it will be less necessary than if we do not, but I think we are going to need it anyhow.

Senator JAVITS. We are going to need it anyhow. So that you would not rely upon the automaticity of wage and price relationships at this time?

Mr. MARTIN. I think we are in a—I do not like to be so—we are in a wartime economy to a certain extent.

Senator JAVITS. Mr. Chairman, that is what I have been trying to do as one Senator, to make it clear that we are, and I cannot tell you how gratified I am that a person of your reputation and knowledge should feel the same way, and I cannot, for the life of me, understand why the administration runs away from this. It is not going to make any difference politically. The people know it as well as I do. And yet the idea that we are ostriches and talk about reducing demand and all kinds of things that do not go with a war economy, and refuse to accept what does go with it, is just beyond me. Thank you, Mr. Chairman.

Chairman PROXMIRE. Chairman Martin, the President is counting on $500 million of savings in our adverse balance of payments by actions by you and by your Federal Reserve Board. He says in his message that he has requested you to tighten the program restraining foreign lending by banks and other financial institutions. Is this $500 million that the President estimates can be saved a realistic figure?

Mr. MARTIN. Governor Robertson, who has been designated by the Board to run this program, our Vice Chairman, who is extremely competent, thinks that it is realistic and it can be attained.

Chairman PROXMIRE. I have great respect for both you and Governor Robertson. Why didn't we do this kind of thing before? This is a voluntary program, as I understand it; is that correct?

Mr. MARTIN. Yes; it is voluntary. It has its involuntary nature, I make no bones about that, because we have authority to make it mandatory for the banks. Now we have wonderful cooperation from the banks.

Chairman PROXMIRE. Why is there this much advantage in it? After all, this situation has been bad for a long, long time. It got much worse last year. Why didn't we tighten it before? What is there in the program that can be changed that is going to make this much different?

Mr. MARTIN. I think it would have been wiser if we had put more emphasis on it, but the reason for the balance-of-payments deficit—I come back to my earlier points—is the fiscal and budgetary situation.

Chairman PROXMIRE. I understand that, but my point is—you see as long as this is a program that works and does help our balance-of-payments situation, and as I understand it, the President says that we can go ahead without harming—you can tighten up lending abroad, reduce it without harming in the financing of our exports, we can do so without jeopardizing development funds in the rest of the world and this objective can permit continued cooperation by the financial community.

You see, it seems to me that we were not doing a good enough job last year if we can pick up $500 million without any change in our technique this year.

Mr. MARTIN. Well, we did not have the same urgency on the problem that we perhaps should have but we did not. Of course, when the devaluation of the pound came in, we had the United Kingdom selling a lot of their securities over here, and we had a little different sense of urgency about it.

Chairman PROXMIRE. Is $500 million as much as we can save or can we save more?

Mr. MARTIN. I think it is just an arbitrary figure picked out in connection with this program. I think that Governor Robertson will do a first-class job on it, and he will save more if he can.

Chairman PROXMIRE. Why can't we apply what we have learned here to the nonbanking community that is investing abroad? Why can't we use this same kind of program which I understand has worked well and you have confidence and Governor Robertson has confidence that you can do even better? Why can't this be applied on a voluntary basis to the rest of the American business without resorting to licensing and so on?

Mr. MARTIN. Well, I think a lot of it is being applied. I am not talking about the Commerce Department program, but the nonbanking investment houses and the nonbanking investment institutions.

Chairman PROXMIRE. Why not the Commerce Department program?

Mr. MARTIN. The Commerce Department program I am not close enough to to know, but Secretary Trowbridge felt that he had gone about as far as he could on the voluntary program, and I am just not competent to judge.

Chairman PROXMIRE. It seems to me that if the Federal Reserve Board and the Commerce Department got together, that we could greatly improve the Commerce Department program.

Mr. MARTIN. We are working very closely together.

Chairman PROXMIRE. Do you foresee the situation in which the problem of control can be eased by a natural decline in foreign lending? I understand that the figures now show that American industry has a better return, something like a 15-percent return compared to an 11-percent return for European industry. This kind of yield, it would seem to me, would naturally tend to correct the adverse flow of funds in the investment centers, if it is sustained and if this is accurate.

Mr. MARTIN. It would be very helpful if this is correct. I do not know that——

Chairman PROXMIRE. Do you have any studies to indicate what seems to be the situation or what seems to be developing? I understand that business has slowed somewhat in a number of other countries.

Mr. MARTIN. Yes; and I also think that it has become a fad in the last year or so to invest abroad, and I think maybe the fad will be running out.

Chairman PROXMIRE. I hope the Fed can end the fad.

Mr. MARTIN. That is right.

Chairman PROXMIRE. Well, thank you very very much, Chairman Martin. You have done a fine job and we very much appreciate it.

The committee will reconvene at 2 o'clock this afternoon, to hear the Secretary of Agriculture.

(Whereupon, at 12:05 p.m. the subcommittee was recessed, to reconvene at 2 p.m. on the same day.)

AFTERNOON SESSION

Chairman PROXMIRE. The committee will come to order.

We are very honored and pleased to have as our witness this afternoon the distinguished Secretary of Agriculture.

This committee is deeply interested in the farm economy, and we are very much aware of the marvelous contribution that agriculture has made to American productivity. We are most concerned, as I am sure you are, Mr. Secretary, about the great difficulties that our farm population has endured over the past 20 years and we are looking forward enthusiastically to your testimony.

STATEMENT OF HON. ORVILLE L. FREEMAN, SECRETARY OF AGRICULTURE, ACCOMPANIED BY FRANCIS KUTISH, STAFF ECONOMIST

Secretary FREEMAN. Thank you. Mr. Chairman, Senator Miller, and ladies and gentlemen, I deeply appreciate the opportunity to appear before this committee.

In my presentation I want to do three things:

1. Point out the importance of a productive and healthy agriculture to the Nation.
2. Report on the progress of our agriculture in the decade of the 1960's.
3. Appraise the adequacy of current programs for American agriculture and rural America to assure continued progress in the years ahead.

AGRICULTURE IS THE KEYSTONE OF AMERICAN ABUNDANCE

Up to a relatively few years ago there would have been very little disagreement, if any, about the accuracy of the statement that agriculture is our most basic industry.

Almost instinctively, it seemed, people agreed with the old Chinese proverb: "The well-being of a people is like a tree and agriculture is its root."

Even as late as 30 years ago something of this attitude still prevailed. One out of four of our people lived on a farm. Throughout rural America agriculture was the great employer. Most of our national leaders had a farm or a farm-rural background.

Today many Americans hold a quite different concept.

Long years of blaming agriculture for producing surpluses and accepting subsidies have led many to regard the farmer as a failure. The prevailing attitude is rather like that once expressed by Charles Dudley Warner: "Blessed be agriculture! If one does not have too much of it."

Less than 6 percent of our people now live on farms. There are only two persons on farms today for every five that were there 30 years ago.

Consequently, some people say: "Agriculture is a declining industry—a dwindling influence in national and world affairs." And their unspoken corollary is that the Nation no longer needs to pay much attention to the economic well-being of U.S. farmers.

They could not be more wrong—on all counts.

U.S. agriculture is *growing* in importance, not declining. It is the keystone of American abundance. Its role in the world has never been so vital as now. There has never been more reason for painstaking attention to the needs and problems of our farmers and rural people in general.

Our agriculture has made, and continues to make, at least six specific contributions of major importance to our economy of abundance.

Historically, it has been and still is a multiplier of the Nation's manpower.

The average U.S. farmer can now produce as much before breakfast as he did in a full day 30 years ago.

The average person in U.S. agriculture today supplies abundantly the food and fiber needs of more than 40 persons—compared with 26 persons in 1960 and 10 persons 30 years ago.

Never before has there been a production success story to match this. It is a production miracle without parallel in the history of mankind. This continuing rise in productivity not only makes it unnecessary for more people to enter agriculture to supply our growing food and fiber needs—it enables the actual number of farmers to be steadily reduced. Actually, the scientific and technological progress of our agriculture has been so rapid that the economy has found some difficulty in adjusting to it. Nevertheless, agriculture's labor-saving contribution has been, and continues to be, a cornerstone of our economy of abundance.

Agriculture's progress has resulted in sharply lowered food costs relative to income. This both reduces inflationary tendencies and provides a larger market for industry. U.S. consumers last year paid out only 17.7 percent of their disposable income for food—and most of this went for marketing and other services. The farmer received only about 5 percent of consumers' disposable income.

In 1960 consumers spent 20 percent of their disposable income for food; in 1950, 22.2 percent; in 1929, 23.4 percent.

If U.S. consumers in 1967 had paid for food the same proportion of income as in 1960, they would have had $11 billion less to spend on other things.

Agriculture sustains abundance by its steadily growing purchases of goods and services—despite the rapid drop in farm population.

Farm gross income in 1967 was almost $49 billion. Of this, farmers spent more than $34 billion for goods and services to produce crops and livestock. Most of the remainder went for the same things that city people buy—food, clothing, drugs, furniture, appliances, and other consumer products and services.

In the mid-1960's, farmers spent annually about $3.4 billion for new farm tractors and other motor vehicles, machinery and equipment, providing jobs for 120,000 employees.

They annually purchase products containing about 5 million tons of steel and 320 million pounds of rubber—enough to put tires on nearly 6 million automobiles.

They use more petroleum than any other single industry—and more electricity than all the people and industries in Chicago, Detroit, Boston, Baltimore, Houston, and Washington, D.C., combined.

Rapidly growing exports of U.S. farm products bulwark our economy of abundance. These exports are now equivalent to the production of one out of four U.S. harvested acres. They provide about 1 million jobs in such fields as the manufacture of machinery and fertilizer, the transportation industry, and storage, packaging, and processing. They also bring back to the United States many of the dollars that move out because of defense and aid, tourism, and U.S. investment abroad.

The net favorable balance of agricultural trade currently makes up over 50 percent of our country's total favorable balance of trade in all products—even though agricultural shipments make up only 22 percent of total exports.

U.S. agriculture is the world's No. 1 weapon in the fight against hunger: Not only is it the world's biggest exporter of food and fiber, it is also the world's biggest storehouse and factory for agricultural knowledge. And research and knowledge will be the ultimate answer to the world food problem. Unless we help the less developed countries to learn to feed their own growing population the world will one day run out of food.

Finally, agriculture is still the keystone of revival in rural America. Even though only about one in five of our rural people live on a farm, agriculture is still the biggest single industry, the biggest single source of employment, the biggest single producer of income in Countryside U.S.A.

The age of abundance is obviously the end product of many converging forces. At the base and providing a foundation for all, however, is our productive and efficient agriculture.

Where Agriculture Stands

Agriculture today is far better equipped to play its full role in the national economy than it was 7 years ago.

Looking back after 7 years of growth and progress, it is a bit difficult to recall fully the gravity of the problems agriculture faced early in 1961.

Farm programs simply were not dealing realistically with the situation. They had resulted in an enormous accumulation of surplus farm stocks. The wheat carryover which had been only 256 million bushels in mid-1952 climbed to 1.4 billion bushels in mid-1961. Feed grain stocks shot up from 20 million tons in 1952 to 85 million in 1961.

Over $8 billion in CCC loans and inventories had been accumulated. It was costing the Government over a million dollars every day just to store and handle CCC stocks.

As surplus stocks went up, farm income came down—from $14.1 billion in 1952 to $11.7 billion in 1960, a drop of 17 percent.

Now, contrast those conditions with the present situation.

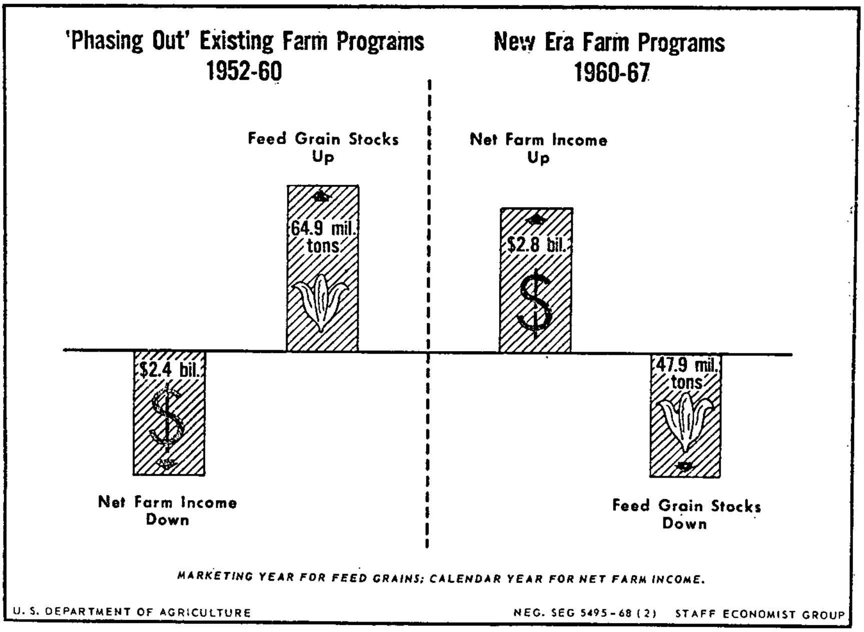
Last year's net farm income, even though it was sharply lower than in 1966, was $14.5 billion, 24 percent higher than in 1960. During the past 7 years, net farm income has average $13.6 billion. This is $2 billion a year more than the average of the preceding 7 years.

Net income per farm last year is estimated at $4,573—55 percent higher than in 1960.

Today, the surpluses are gone. The wheat carryover last year was only 426 million bushels. The feed grain carryover was only 37 million tons. The cotton carryover at the end of the current marketing year is estimated at $6.7 million—500,000 bales less than in 1961.

The Commodity Credit Corporation investment is down to $3.4 billion. The inventory of commodities owned by CCC has dropped from $6.1 billion in 1960 to below $1 billion, the lowest since 1952.

Mr. Chairman, this chart gives just a quick summary perhaps of that. The left side of the chart, these are the changes between the years 1952 to 1960. That is the period during which feed grain stock is kind of a barometer. It increased 64.9 million tons. During that same period net farm income dropped $2.4 billion. That is what happened between 1952 and 1960.



Between 1960 and 1967, under the voluntary farm programs, net farm income climbed $2.8 billion and feed grain stocks dropped $47.9 billion. So, there was a complete reversal of the forces which existed before.

Many factors contributed to these dramatic improvements in the agricultural situation. Among them we can cite some 84 months, or 7 years, of continuous economic prosperity, a 55-percent rise in consumers' disposable income, and crop failures in India which required record U.S. wheat shipments to prevent famine.

But a central factor contributing tremendously to rising farm income and the elimination of the surpluses was the remarkable legislation of the past 7 years.

The sum total of this legislation to my mind is unique in the Nation's history. It set up voluntary farm programs which enabled farmers to act together and thus effectively gear their production to demand. It expanded domestic food programs and foreign trade and aid programs. It set in motion vigorous new efforts to conserve and improve natural resources and to review rural America.

The voluntary commodity programs began with the emergency feed grain program of 1961—a turning point in the battle to stop the surplus buildup and end stagnation in agriculture.

This was followed by the Agricultural Acts of 1961 through 1964 which established programs for wheat, feed grains, and cotton, and extended the wool program and the special milk programs.

Then came this historic Food and Agriculture Act of 1965, providing realistic programs for the major crops through 1969.

Outstanding resource programs were provided by the various food and agriculture acts, the Land and Water Conservation Fund Act, the Wilderness Act of 1964, the Federal Water Project Recreation Act of 1965, the Appalachian Regional Development Act of 1965, and the amended Watershed Protection and Flood Protection Act.

To help revitalize rural America, Congress set up new and expanded programs for housing, community water and sewerage systems, and other local facilities.

In striving to expand foreign trade and aid Congress extended and greatly improved Public Law 480.

To help us carry out our mission of raising the quality of American life, Congress passed the Food Stamp Act of 1964, the Child Nutrition Act of 1966, expanded the school lunch program, extended the special milk program with the Armed Forces and veterans' hospitals and passed the Wholesome Meat Act of 1967.

The programs provided by these various laws interlock to form a remarkable combination of services to farmers, consumers, agribusiness, and the whole Nation. Very briefly, let me summarize some of the results they have already produced.

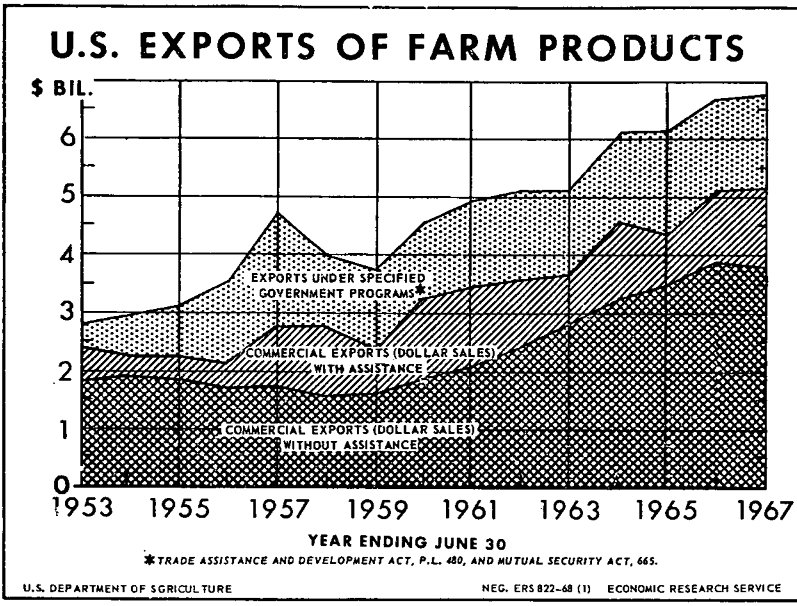
I have already mentioned the two great overall results: The upswing in income and the end of the surpluses. Now let us look at more specific advances.

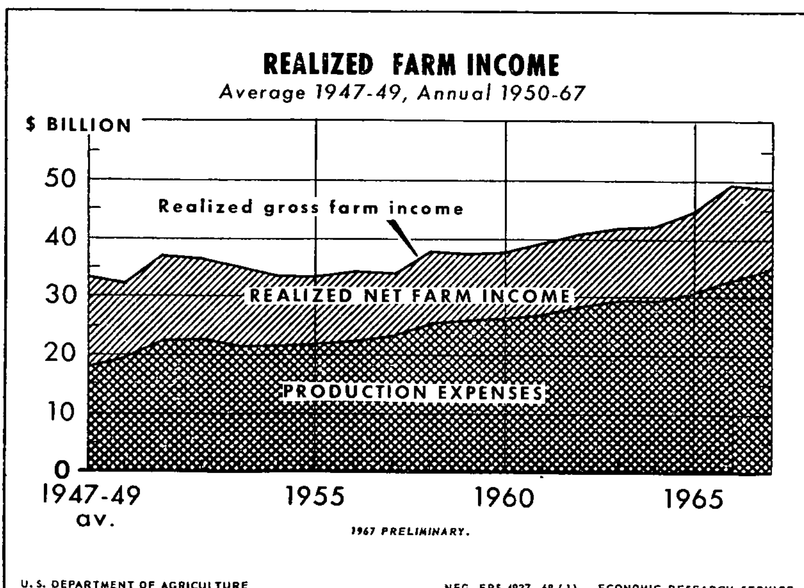
In fiscal 1960, U.S. agricultural exports totaled $4.5 billion. In fiscal 1967, they climbed to a record $6.8 billion, a gain of nearly 50 percent.

In fiscal 1960, commercial exports of farm prodcts were $3.2 billion. Last fiscal year they were $5.2 billion, a gain of more than 60 percent.

A forecast made by the previous administration in 1960 projected total agricultural exports in 1970 at $5.2 billion. We shot far beyond that figure in 1964, 6 years ahead of the timetable.

You get a better idea by looking at this export chart, which shows, you will note, three categories of exports. The bottom heavily cross-hatched section represents commercial exports—that is dollar sales without any governmental assistance whatsoever. The next category, the more lightly colored section on the chart, represents commercial exports that have some kind of assistance, such as export subsidy which now is very nominal and virtually only on wheat. We also have a 3-year export credit program to assist in expanding exports. Such exports also would be included in this category. The top area on the chart, of course, represents exports made under Public Law 480.





Now, I want to take a quick look at the farm income chart.

This chart shows the realized net farm income beginning in 1947–49 on the left-hand side of the chart. It also shows the production expenses. You will note how the realized net farm income area dipped in the 1950's, but that realized net farm income in 1966 had returned almost to the level of 1947, which was an alltime high.

Senator MILLER. Could I ask a question on that chart, please?

Chairman PROXMIRE. Yes, indeed.

Senator MILLER. Mr. Secretary, on the chart on exports, what is the figure for 1960 and the figure for 1967 for commercial exports?

Secretary FREEMAN. The commercial export figure was $3.2 billion in 1960, and it was $5.2 billion in 1966.

Senator MILLER. The balance which, as I understand it, the overall was $4.5 billion to $6.8 billion; the balance would be noncommercial?

Secretary FREEMAN. Noncommercial.

Senator MILLER. Thank you.

Secretary FREEMAN. That is right; primarily Public Law 480.

At least 6.2 million Americans—almost 50 percent more than in early 1961—will be helped this year to better diets, better nutrition, better health, through USDA food stamp, and direct distribution programs.

In 1961 the food stamp program was launched on a pilot basis in eight areas. In January 1968, it was operating in 848 communities and serving 2.2 million persons.

In January of this year, school lunches were served to 19.5 million children compared with about 13.5 million in January 1961. Two and a half million got their lunches free in January 1968. And, under the Child Nutrition Act, we also served breakfasts to about 80,000 undernourished children.

Milk consumption by children in the school milk program is about 25 percent greater than in 1961.

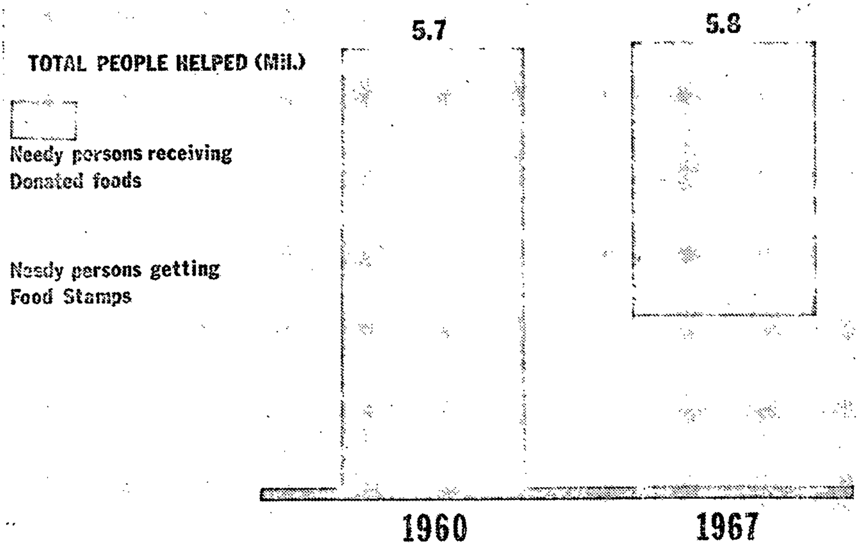
Last July 1, the Department's food distribution programs were reaching 669 of the 1,000 lowest income counties of the United States. Our goal this year is to bring these programs to all 1,000 of these counties.

Again I have charted this. We will just go over it very quickly and the committee may go over it in more detail. The chart shows the family food assistance program and the school feeding programs, the value of the food-help programs in total figures, and the cash assistance for school feeding allocated to States. In all of these areas the availability of food has moved up very sharply.

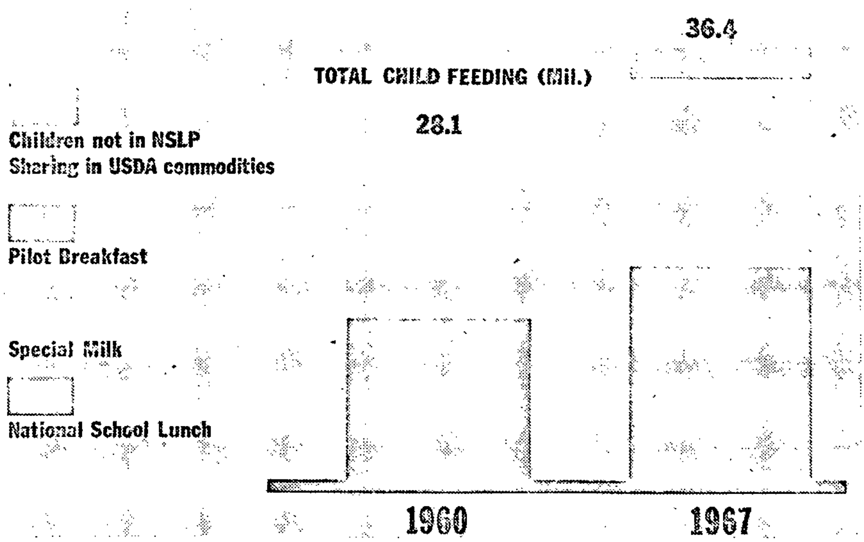
Department conservation programs are giving extra emphasis to the multiple use development of all natural resources. They are offering far more services to low-income and small farmers and to rural communities. Outdoor recreation, natural beauty, and wildlife are receiving greater attention in agricultural, forestry, and watershed programs.

We're integrating conservation with economic development through multicounty resource conservation and development projects. Seven years ago we didn't have one in the United States. Now 41 have been approved for planning and operations embracing an area of 100 million acres.

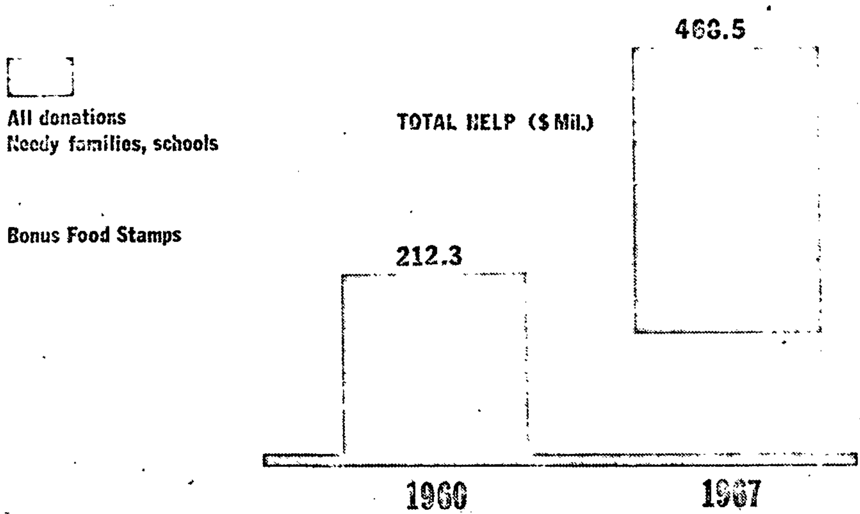
FAMILY FOOD ASSISTANCE



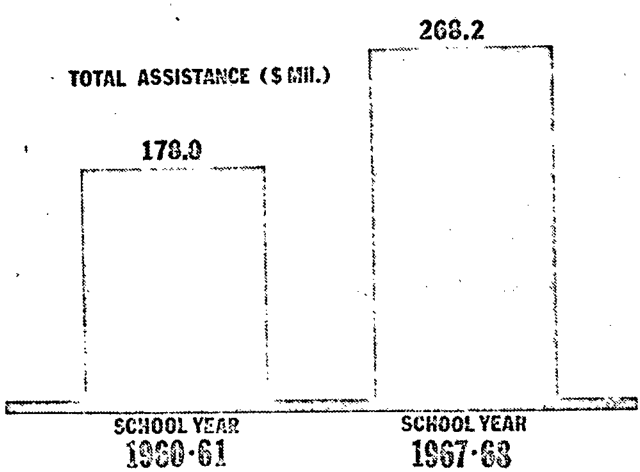
SCHOOL FEEDING PROGRAMS



VALUE OF FOOD HELP PROGRAMS



CASH ASSISTANCE FOR SCHOOL FEEDING ALLOCATED TO STATES



Expenditures to develop and protect our national forests are more than double the 1960 level.

National forest recreation use has grown from 90 million visitor-days in 1960 to more than 150 million last year. With the development of 3,800 new recreation sites, capacity to accommodate people at one time has been increased to 1.2 million, nearly double the 1960 capacity.

Loans to improve rural electrification and rural telephones are nearly 60 percent greater than in 1960. From 1960 to 1967, rural electric power sales increased 94 percent, and the number of consumers rose about 1 million.

About 830,000 additional telephone subscribers were served by REA-financed systems during this period and the proportion of farms with telephones increased from 67 to 80 percent.

I have labeled under this community action, the town and country programs in this chart, which I would hope, Mr. Chairman, the record might show, to note what has taken place.

TOWN AND COUNTRY

COMMUNITY ACTION	1960	1967
SMALL WATERSHED PROJECTS	7	167
RC & D PROJECTS	0	27
RECREATIONAL FACILITIES	0	$28.0 Mil.
GREENSPAN	0	1.5 Mil.
WATER & SEWER SYSTEMS	$1.9 Mil.	197.7 Mil.
HOUSING	69.0 Mil.	442.0 Mil.
FARM LOANS	319.0 Mil.	659.0 Mil.
EO LOANS (Low Income Families)	0	32.0 Mil.
TELEPHONE LOANS	0.7 Bil.	1.4 Bil.
ELECTRIC POWER LOANS	4.3 Bil.	6.4 Bil.
NATIONAL FORESTS		
Recreational Use (Visitor Days)	92.6 Mil.	150.0 Mil.
Timber Receipts	140.0 Mil.	173.0 Mil.
Total Receipts	148.0 Mil.	183.0 Mil.
(Returned to States for Schools & Roads)	30.0 Mil.	43.5 Mil.

Small watershed projects have increased from seven to 167 in 1967; research conservation and development projects, to 27; recreational facilities to $28 million, those are loan funds primarily; green spans rose to $1.5 million; water and sewerage systems from $1.9 million, loans again, to $197.7 million; housing loans made available through FHA from $69 million to $442 million, that again is credit; farm loans, $319 million to $659 million.

There were, of course, no economic opportunity low-income loans in 1960; there were $32 million in 1967.

The data on telephone, electric power, and national forests are in the statement.

THE YEARS AHEAD

The progress of the past 7 years has led agriculture into a new era. Farmers and rural people have reached a new plateau from which they can begin to share more fully in the continued economic growth of the Nation.

But most of the conditions which made our voluntary farm programs necessary in the first place are still with us. American farmers still have the capacity to produce more than the market can absorb at a fair price to them. Our experience last year, with production up substantially for most of the major commodities, is a dramatic illustration. Farm prices dropped off substantially last year as the result of overproduction, which was triggered in part by conditions around the world. The net result has been a rather sharp drop in 1967 farm income, about $2 billion from the high of 1966, and a drop in farm prices depending upon the item to which you direct attention, of from 5 to 10 percent.

Other things haven't changed either. No one has yet discovered how to control the weather and its impact on production. World trade is still exist today, and will stil exist tomorrow, and for a long time to world trade and world prices cannot be established by fiat.

Finally, of course, the march of agricultural technology continues unabated, with its advances immediately and widely diffused throughout the developed agricultural world.

These fundamental conditions existed when I became Secretary, still exist today, and will still exist tomorrow and for a long time to come.

The current voluntary farm programs were designed to allow farmers to cope with these bedrock problems; to allow them to participate in the shaping of their own destiny through the mechanism of Government, just as food for freedom was designed to meet the bedrock problems of a hungry world which needs desperately to develop its agriculture and its economy.

The Food and Agriculture Act of 1965, the food for freedom program, and the domestic food distribution programs—school lunch, school milk, direct distribution to needy persons, food stamp programs—complement each other.

None of them can be fully effective in isolation. But they are extremely effective when closely coordinated. They permit us to set up a viable national food budget to produce what we need in the right amounts at the right time—subject always, of course, to the vagaries of uncontrollable environmental and biological forces that agriculture must live with always.

About 3 to 4 percent of our Nation's farm production now is going under the food for freedom program. This makes a major contribution to world security and peace. It provides food to many million of persons around the world. It buys time until they can improve their own agricultures.

About 1 percent of our farm output now is going under our domestic food distribution programs. This improves the diets of millions of needy families and protects the health of our schoolchildren.

Both food for freedom and our domestic food distribution programs supplement the commercial demand for food which is registered through established market channels. Skillfully used, this supplemental purchasing power can help stabilize prices preventing wild and disruptive price swings.

The Food and Agriculture Act of 1965 makes possible a working balance between supply and all demands for several major farm products. It is designed to keep farm prices at as high a level as is consistent with remaining competitive in world markets. If world prices are too low, the difference is made up to farmers by direct payments. These payments can also be used when necessary to withdraw acreage from production to avoid surpluses.

The Nation must decide this year whether to extend existing Public Law 480—food for freedom—legislation. This extension is vital not only to agriculture but to our hopes for world security and economic progress.

As you know, the existing act, as amended in 1966, makes our food aid to other countries conditional upon self-help measures to improve agriculture and a progressive transition from sales for foreign currencies to sales for dollars.

In 1969—or perhaps this year—the Nation will also determine the fate of the Food and Agriculture Act of 1965.

Further progress in the years immediately ahead depends on the extension of this legislation.

Agriculture's reserve capacity for the past several years has approximated 10 to 12 percent. This is about the same as our national reserve capacity in manufacturing. It is not likely that the Nation will need to call on agriculture's reserve capacity during the next decade at the least.

The National Advisory Commission on Food and Fiber concluded from its studies that American agriculture has excess production capacity and is likely to continue to have it for many years ahead—unless action is taken by Government to hold land out of production, overabundant market supplies would seriously depress farm prices. This has been the conclusion, also, of almost every study by professional agricultural economists in recent years.

All serious studies of the agricultural economy indicate clearly that farm prices and income would drop sharply were it not for our farm programs. The study made by Iowa State University economists for the National Advisory Commission on Food and Fiber indicated that in the absence of programs the prices of corn would fall to 75 cents a bushel, wheat to $1.27, soybeans to $1.23, and cotton to 17 cents a pound and continue at those levels for 10 to 15 years.

Although livestock prices are not supported, lack of an effective program for grains would cut livestock prices as well. In general, a 10-percent drop in feed prices leads to a 1½-percent increase in total livestock production—which in turn results in a 5- to 6-percent drop in livestock prices.

But some people ask, Won't foreign demand, because of the population explosion, soon take up the slack? No. Unlimited overseas demand is a mirage. Our latest long-range study of the world food situation through 1980 indicates a continuing world capacity to produce more grain than effective world demand can absorb at stable prices. Strong competition in commercial markets will continue and so will the potential for overproduction, for a long time to come.

As for food aid, the quantity of food that can be moved under these programs is limited by several practical factors. It depends on the ability of the receiving nations to handle food at the docks, and to store and distribute it without disrupting their own agricultural economy. It also depends on the extent to which political leaders in receiving nations will permit their governments to become dependent on U.S. food aid. Food assistance becomes counterproductive if it is permitted to depress farm prices in the receiving countries. To win the war on hunger the LDC must learn to feed themselves—not depend on the United States. Our food aid must be an assist, not a crutch.

To allow the Food and Agriculture Act of 1965 to expire would be an unmitigated disaster for agriculture. With the extension of the act, however, further agricultural progress would be assured and farm income would be able to resume and continue the upward trend that, except for last year, has prevailed since 1960.

In addition to extension and improvement of Public Law 480 and the Food and Agriculture Act of 1965, some new tools are needed to enable agriculture to play its full economic role in the 1970's. With the major surpluses gone, the national security demands that reserves of certain crops should be maintained, some under public control and some in the possession of producers. These security reserves must be insulated from normal market channels. Protected by such reserves, the Secretary of Agriculture will be able to administer the commodity programs more aggressively to help keep supply and demand in fair balance. For this purpose, we favor the Monroney-Purcell bills.

Farmers also urgently need more bargaining power. About 60 cents out of every dollar of farm cash marketings comes from the sale of crops and livestock not covered by farm programs. In this "no program" area the farmer essentially must go it alone in the market. The basic truth is that farmers, by the large, are presently unable to bargain effectively in the marketplace.

Competition in the food industry is competition among the strong—and farmers presently are not strong enough.

Most of the food industry is concentrated in the hands of a relatively few firms. In the manufacture of breakfast cereals, for example, the top four firms have 85 percent of the business.

On the other hand, farmers are so numerous and their individual output so small that no one of them can exert much effort on total output or price.

Legislation is needed to help farmers increase their bargaining power for many commodities. Our present programs now provide producers of basic products an opportunity to limit their production and market their products for a better price. I am hopeful that it will be possible to improve the legal climate for farmers not now covered by this basic commodity legislation, to participate more fully in marketing their products through collective action.

It would help farmers to move toward becoming price makers instead of merely price takers. I want to stress, however, that this is strictly an area for self-help by farmers. Such legislation would be enabling for those farmers who wanted to use it—it should not be forced on anyone.

There is one other dimension of our farm and rural situation which we have not yet considered.

Increased farmer bargaining power, higher prices, rising exports, security reserves—vital as these are to a strong and prosperous commercial agriculture—cannot, by themselves, solve some of rural America's most serious and urgent problems.

They cannot meet the needs of the "in-between" people—which explains why rural America with less than 30 percent of the Nation's population has close to half of the Nation's poverty.

Some of them are to be found among our more than 2 million small farmers—those with sales in 1966 of under $10,000—whose average farm income between 1959 and 1966 rose only 7 percent, only $110.

Some of them are the millions of displaced rural laborers, the aged, the unskilled, the uneducated—whom progress has pushed aside.

Some are the small shopkeepers, the service-repair people, the miners, and the railroad personnel who lost out when the mines petered out, and the highways bypassed the country towns, and the railroads stopped serving rural communities.

The in-between people have been migrating en masse from country to city especially since World War II. Their leaving has drained far too many human and economic resources from the countryside. At the same time it has added to the housing, unemployment, congestion, and relief problems of metropolitan America.

Though the exodus is slowing, it is still going on. This is a problem we must solve—for the sake of city and country alike. We must build a more viable rural economy. We must create a rural renaissance. We must restore rural-urban balance to America.

Rural-urban balance will be restored only when new economic, social, and cultural opportunities are opened up throughout rural America—only when private enterprise is attracted to the countryside by the obvious advantages of open space, ample labor, and low-cost buildings—only when rural communities can offer modern water supplies, good housing, and other facilities—only when underemployed small farmers and displaced workers can find alternate economic opportunities—only when we establish vigorous, healthy town and country communities.

We have made a start in all these areas—and a good start in some of them.

Operating loans and grants by Farmers Home Administration to aid low income farm families have increased by 60 percent since 1960. Loans to promote farm ownership by small farmers have increased nearly fivefold. Economic opportunity loans are enabling a growing number of farm and nonfarm people to set up small businesses. But in the light of the total problem, we have hardly begun.

We have made a start toward improving the indecently bad housing scattered throughout rural America. Aids for rural housing this year will be nearly 13 times as great as in 1960. From January 1, 1961, through June 30, 1967, USDA loans provided new or improved housing for 630,000 rural people, including 20,000 senior citizens and 15,000 farm laborers. But, about one-third of all rural homes need major repairs or complete replacement. About one-third also have no hot or cold running water. In the light of the total problem, we have hardly begun.

We have made a start toward providing modern water and sewerage systems in rural America. Funds to build such systems have risen from less than $2 million in fiscal 1961 to almost $200 million in fiscal 1967. Last fiscal year alone these funds helped build or improve 1,100 rural community water or sewerage systems. But, some 35,000 communities still lack modern water and 45,000 lack modern sewers. In the light of the total problem, we have hardly begun.

We have made a start toward training displaced farm and rural people for new economic roles—a start toward attracting new industry to rural America—a start toward improving and developing all the resources of the countryside through Federal, State, and local action.

Technical action panels, composed of USDA field officials, and other Federal, State, and local government leaders, serve all 3,000 rural counties through a network of State, area, and county panels. Today any rural village, any rural person, can receive help in locating the Government agency that can best assist him simply by contacting the nearest technical action panel.

This is the "outreach" function of the Department.

There are a substantial array of Federal programs to help rural America. But better coordination is needed among Federal, State, and local agencies. Many services available are not being used by rural people to any appreciable extent because of inadequate communication.

At the Washington level we have a small staff in the Rural Community Development Service to coordinate and expedite rural programs. In the field the TAP's provide outreach at the grassroots.

This is good progress—but in the light of the total problem we have hardly begun.

As a Nation we have still not adequately recognized that space-starved cities and job-starved rural areas are not too isolated phenomena. They are twins.

We have not yet fully recognized that the rural poor of yesterday have become many of the city's poor today—and that if we do not succeed in revitalizing rural America, the rural poor of today, the "in-between" people will become many of the urban poor of tomorrow.

It is time that the Nation faced up to these facts—and acted on them.

The need for a national plan is obvious. Action on a truly national scale is imperative.

In this age of rapidly expanding science and technology we need no longer be the prisoners of nature. We do not have to live crowded together. We do not have to let rivers and railroads determine where we shall build our town and country communities. We have the know-how to shape our destiny.

If we are determined that we will no longer be the pawns of fate, but instead resolve to shape our future, this is the kind of America I see in the years to come.

I see a countryside dotted with clusters of renewed small cities—new towns—growing rural communities (where the birds don't cough).

I see each cluster with its own jobs, its own industries, and with its own college or university.

I see each with its own medical center, and its own cultural, entertainment, and recreational centers.

I see farms in these clusters—and an agriculture fully sharing in the national prosperity.

And, standing tall, I see our great cities, intact, but changed—free of smog—free of blight—free of despair.

I see 300 million Americans, living where they choose—at ease with each other and with their environment.

That is my vision of America. It is one that I believe we can achieve only by a total national commitment to urban-rural balance, to the purposeful, proper use of space—space that now is measured through a green meadow to the gray granite of a distant mountain by some—and through a broken window to a dirty air shaft by all too many others.

It is easy—the path of least resistance—to think of commodity programs, food assistance programs, trade and aid programs, resources improvement programs, and rural renaissance programs as though they were unrelated and each in a separate compartment. I say it is easy to do this but it would also be disastrous.

If I have learned anything in my 7 years as Secretary of Agriculture it is that we must see rural America whole and in relation to the rest of our country. We must see agriculture and rural America as integral parts of the whole fabric of our national life and, indeed, of our civilization. Rural-urban balance and balanced economic development must be our goal.

All these programs of which I have been speaking are interlocking parts of a vitally important whole. The absence of any one of them leaves a dangerous gap. If agriculture and rural America are to ply their full roles in our continuing economy of abundance, we must leave no important legislative gap unfilled.

Utopia for agriculture—and for rural America—needless to say, is not just around the corner. Perhaps utopia will always be just over the horizon. But, we must keep marching ahead.

Many years ago Dr. Seaman A. Knapp, one of the great names in agriculture, said:

> There are two ways to look at a farm: One view—the common one—is that it is a place to make a living, but rather a hard place, and should be sold as soon as anything easier is found; the other is that the ownership of the land is a mark of honor—that a patent to land is a title of nobility, a right to sovereignty.

I am sure the second view is the one we want to keep alive in America.

(Tables supplied with statement follow:)

FINANCIAL DATA FOR AGRICULTURE, 1960, 1966, AND 1967

	1960	1966	1967 [1]
Cash receipts from marketings	$34,000,000,000	$43,200,000,000	$42,500,000,000
Realized net farm income	11,700,000,000	16,400,000,000	14,500,000,000
Gross income per farm	9,601	15,289	15,415
Net income per farm	2,956	5,049	4,573
Per capita disposable income	1,108	1,717	1,692
Financial assets (bank deposits, savings bonds, investments in co-ops)	[2] 18,000,000,000	[2] 21,200,000,000	[2] 22,000,000,000
Non-real-estate assets (livestock, equipment, crop inventories, household furnishings)	[2] 55,300,000,000	[2] 66,300,000,000	[2] 67,700,000,000
Total assets	[2] 203,900,000,000	[2] 269,500,000,000	[2] 281,200,000,000
Total liabilities	[2] 26,200,000,000	[2] 45,700,000,000	[2] 49,900,000,000
Proprietors' equities	[2] 177,700,000,000	[2] 223,800,000,000	[2] 231,300,000,000
Deposits in country banks, index 1947-49=100: [3]			
Demand	121	146	[4] 147
Time	269	636	[4] 678
Value of farm production assets:			
Per farm	[5] $42,465	[5] $67,259	[5] $73,120
Per farmworker	[5] $21,304	[5] $36,216	[5] $41,307
Delinquent farm mortgage loans of two major lender groups (number)	[5] 20,778	[5] 16,833	[5] 14,866
Foreclosures of farms (number)	[6] 5,500	[6] 2,700	[6] 2,400

[1] All data for 1967 are preliminary.
[2] At close of year.
[3] Financial assets owned by farmers (shown elsewhere) include their time and savings deposits; deposits in country banks are owned by farmers and other rural people.
[4] Average of first half of year.
[5] At beginning of year.
[6] Year ending March 1.

FINANCIAL DATA FOR AGRICULTURE, 1960, 1966, AND 1967

[In percent of capacity utilized]

	1960	1966	1967
Agriculture [1]	91	88	88
Manufacturing industries [2]	81	91	85

[1] Production for commercial markets as a percentage of potential capacity, estimated by ERS.
[2] Economic Report of the President, 1967 estimate is for first 9 months, from Federal Reserve series.

Liabilities as a percentage of assets for selected industries, December 31, 1966

Agriculture	16.9
All manufacturing [1]	41.2
Transportation equipment	46.9
Motor vehicles and equipment	48.5
Primary iron and steel	38.6
Stone, clay, and glass products	35.2
Lumber and wood, except furniture	46.3
Food and kindred products	44.2
Textile mill products	24.6
Paper and allied products	40.4
Chemical and allied products	40.0
Petroleum refining	31.3

[1] Financial data for industries taken from Quarterly Financial Report for Manufacturing Corporations, Federal Trade Commission, and Securities and Exchange Commission.

Mr. Chairman, thank you very much.

Chairman Proxmire. Thank you, Mr. Secretary, for an inspiring and eloquent statement. I must say it is a moving statement, too. It is a statement that is sound in its economic approach and at the same time extraordinarily helpful.

I would like to ask you about the table which you have appended, which shows as you indicated in the substance of your remarks, a rather sharp drop in realized net farm income in 1967 as compared with 1966, and a sharp drop not only in realized net farm income overall but nearly a $500 drop, a 10-percent drop in net income per farm in 1967. If we allow for two factors, No. 1, the continued disappearance of the smallest farms, the lowest income—and the disappearance of these farms, as I understand it, would tend to bring up automatically the average income of the farmers that are left—and No. 2, the inflation that we suffered which would diminish the value of the net farm income, it seems to me that 1967 was a very bad year for farmers, and I wonder—you mentioned briefly, I think, the reasons—if you could expand on those a little more.

Secretary Freeman. Yes, Mr. Chairman, it was a bad year. It was a very disappointing price turndown. It was caused primarily by overproduction, which was the product of two things, first, action taken by the Secretary of Agriculture, for which I am exclusively responsible. In the fall of 1966, with stocks very low in wheat and feed grains, so low that we were really threatened with running out of minimal security reserves, with projections based upon a normal pattern, the best we could make, I was moved finally, after careful thought and wide consultation, to move to sharply increase acreage in wheat and feed grains.

After that decision was made, why, the situation, worldwide, changed literally almost overnight. In retrospect we can see it now. We couldn't see it so clearly then. And we had 2 years of extraordinary production worldwide. In Europe that was considered the harvest of the century. And in both wheat and feed grains, where there was just a complete reversal, the net result was that we just suffered simple overproduction of grains.

That served to trigger drops in other commodities as well as the grains.

Also, 1966, having been a good year, the temptation was there in turkeys, in poultry, in eggs, in all of your consumables for farmers to go out and produce, and produce more, and they did. The net result was that virtually every commodity you can name, why, production went up from 5 to 10 percent, and prices sharply and promptly went down. If there ever was a demonstration of the overproduction capacity of the American agriculture, why, this was it.

Chairman PROXMIRE. Did something like this happen in 1963 or 1964?

Secretary FREEMAN. No.

Chairman PROXMIRE. Didn't it drop and then come back?

Secretary FREEMAN. There was a leveling during that period, but nothing like this. In that period, of course, we were cutting down our surpluses. We were selling and moving them into the market. But we had a complete turnaround in 1966, and a real threat of a sharp and——

Chairman PROXMIRE. What I ask is, I wonder whether you foresee a similar turnaround coming up?

Secretary FREEMAN. We have taken action that we hope will bring turnaround effects this year. We have cut back the acreage in wheat, cut back the acreage in feed grains, and I have used every resource in my command to try and reach, and this is purely voluntary now, the producers of the perishables, and urged them in beef, in hogs, and in turkeys, and all the other commodities, to hold back that production. If the level of production is as large this year as last year we will have the same pattern of low prices. We won't have it in the grains because, having taken action, I am quite confident that grain prices will firm up. But, whether the others will firm up is going to depend upon what farmers do.

We have just been beating the drums and beating them hard trying to get producers to market in a more sophisticated manner. I don't know what that response will be.

Chairman PROXMIRE. One of the arguments that has been made is that the parity ratio has dropped very sharply. You made a very useful contribution—I remember, as a member of the Appropriations Committee last year, I was sitting there hearing you—and you pointed out that the economic indicators which we carry were inaccurate because they failed to reflect Government payments.

We have made an adjustment for that this year, and I find even with the adjustment that the parity ratio is down to 79 percent adjusted, and this seems to be lower as I look at it, you have to go back to 1939 to find a year in which you have this inequitable situation with regard to the farmers. Is that wrong or right?

Secretary FREEMAN. Well, it is partially right and partially wrong. The adjustment made takes into consideration Government payments. The adjustment does not take into consideration all the factors that result in determining what is the farmer's net income.

Chairman PROXMIRE. What are the other factors that are omitted? Is there any way we can have a really accurate parity ratio? We want to be as fair as we can.

Secretary FREEMAN. Mr. Chairman, the Department has tried a number of times, and it has ended up in total frustration, to revive the basic parity relationship. It goes back, as you know, to 1913, and the relationship between productive inputs and end production has changed so enormously that for many, many commodities the parity prices now are virtually meaningless.

Chairman PROXMIRE. There are many unsatisfactory things about this parity ratio, I know, but at least it does seem to me, in one figure dramatize the inequities that the farmers suffer. I just wonder if this is unsatisfactory, and after all, you are the outstanding authority of the Nation on this as the Secretary of Agriculture. Is there any kind of ratio, any kind of proportion that we can use that will indicate whether the farmers are getting a just break or not?

Secretary FREEMAN. Yes, of course, it was. Now, the combination, let me put this in absolute figures first, the net farm income in 1966 was would be, and we submitted a report on that after a year and a half study at the instance of the House Committee on Agriculture. Frankly it wasn't very satisfactory because you are dealing with such a variety of varying factors that to get a really hard, usable criteria was extremely difficult.

We now use on a nationwide basis realized net income. That is a cash figure. We can pretty well tell what net income is. We have been keeping these figures for the last 30 years, and they are kept by professional statisticians. And so, we know what net farm income is.

Net farm income in 1966 per farm was by all odds the highest in the history of the United States.

Chairman PROXMIRE. Income for everyone off the farm was the highest in the history of the United States.

Secretary FREEMAN. Yes, of course, it was. Now, the combination, let me put this in absolute figures first, the net farm income in 1966 was the highest per farm in history by all odds. The total net farm income was the second highest in history. Total gross farm income was the overall highest.

Now, when this comparison is made with the rest of the economy on a per capita basis, net farm income was only about two-thirds of the rest of the economy. That, however, was about 15 percentage points better than it had been 6 years back, when per capita farm income was only 50 percent of per capita nonfarm income.

Chairman PROXMIRE. Right.

Secretary FREEMAN. In other words, we had been creeping up compared with the rest of the economy. But then, we did suffer that 1967 turndown that I have tried to explain, and hopefully we will get this turned around and righted again and moving in the same direction. But the cold hard fact is—and I would stress this before this learned committee, that is studying, reviewing and providing leadership in the economy of our Nation—there is, in my estimation, no doubt but what we will face in this country for the foreseeable future enormous overproduction potential, and in the absence of some way to balance that overproduction potential, we face a grave threat to American family farm agriculture.

Chairman PROXMIRE. We have as members of this committee a number of people who I think reflect views that are quite common in Congress and in the country. That is, as you said in your statement, that since the surplus has been cut sharply in some cases—I guess in some commodities, eliminated—they contend that we should reduce our appropriations for agriculture.

What would happen if the Congress cut appropriations for agriculture by a really substantial amount—one and a half or two billion dollars? What would happen if you did your very best to maintain farm income but had to do it within that very restricted budget. What would be the consequences in terms (*a*) of the farmer and (*b*) of the consumer, who is obviously benefited by many of these programs?

Secretary FREEMAN. It would mean that the farm programs, the basic commodity programs, wheat, feed grains, upon which the rest of the economy rests in large part, would not be administerable, that they would be unworkable, you might as well not have them. What you do under these voluntary programs in effect is to buy land out of production, and if you don't have a good enough price, you don't get it. It is just that cold, hard and simple. I call these programs the "beg and buy" programs as compared to the old mandatory programs.

If we didn't have them as I indicated here in my testimony, in any number of studies—and these aren't my figures—that net farm income would drop one-third, that you would have 75-cent corn and you would have $1.20 to $1.25 wheat and maybe less. You would have $1.20 or $1.30 soybeans in very short order, and you would put enormous pressures throughout American agriculture. You wouldn't solve your problem, because your problem in agriculture is not too many farmers. I hear so many people say this who ought to know better, including agricultural economists. It isn't the individual farmer, it is the land that is being used which produces the overproduction. If you remove the little farmers, so to speak, as some seem to advocate and say is the answer, the likelihood is that the land that they leave is going to be used even more efficiently, produce even more. So that is no solution to your problem.

You are going to have to have some kind of a device to prevent overproduction. The argument is made on the one side that the way to do that would be to drive the prices down low enough so that you would force all but the most productive land out of use. This could be done. Just let prices drive them down. The people that survive in agriculture would not be necessarily the efficient. They would be the ones who have power—economic power. Some of these big diversified corporations that are going into agriculture today, writing off their tax losses, incurring very heavy losses, buying up enormous amounts of land as a hedge against inflation and insurance for the future. They would last because they are not in there to produce and they don't have to be efficient, and most of them aren't. But the farmer who has been efficient, who has made our agriculture the envy of the world—the family farmer—would not last because he doesn't have the financial resources to weather the storm.

When this process was finished, in my judgment, American agriculture would be a public utility, and it would be a lot more heavily regulated than it is today, and we would have gone through some economic trauma that would be heartless in its consequences and would be very adverse in its economic impact on the Nation.

Chairman PROXMIRE. My time is up. I will be back.

Congressman Curtis?

Representative CURTIS. Frankly, Mr. Secretary, I would prefer to state the program different from the way you have stated it, because, of course, the way you present it no one would be in disagreement. But, let me say this:

In light of this history and where we are today, it is hard for me to see how you can speak in glowing terms of the present situation in agriculture. You talk about this being just the beginning, which would be a fine statement if you were just coming into office. You are before us today, having served for over 7 years, and frankly, we are looking for an accounting.

I was interested in Mr. Proxmire's observations and your response on parity. There is one thing that can be said, at least parity is an economic statistical series that we have been using over a period of decades, and in its relative aspects it has significance, even though I myself would agree that it ought to be improved.

Today we are at the lowest parity, measured either way, actual or adjusted, since 1933. Isn't that true? I have got the figure here.

Secretary FREEMAN. No argument about the price parity figures. The price parity.

Representative CURTIS. I understand.

Secretary FREEMAN. Yes.

Representative CURTIS. We are talking about the way it was measured in 1933, 1940, 1950, and so on. So, parity is a fair thing to refer to, because the same important criticism existed as to parity as a technique of trying to measure what the farmer has to buy in order to produce in relation to what he gets for his production. I would argue until we can figure a better way, it is still a pretty good way of measuring how well he is doing. The net farm income which you mentioned I think is an important indicator, too, but to be meaningful that must relate to the amount of investment involved to produce it. It would turn on investment, and we all know and your figures show that investment per farm has increased considerably in the recent years. So, what is his return on investment?

Then, also, when we refer to net farm income, how do you compute the farmer's own labor?

Is your net farm income figure allowing the farmer a certain amount for his labor per hour?

Secretary FREEMAN. No; this is his net cash income the same as you would report in your net income tax.

Representative CURTIS. Yes. You see my criticism. Am I fair in making the observation that although net farm income is an important figure, it must be adjusted to be meaningful to relate to how much investment was made, what the investment is, and also how much labor the farmer and his family put in?

Secretary FREEMAN. The consideration of net farm income in connection with investment involved is a fair point. I would add to that then, in order to have a balanced view, that you would then need to take into consideration the increased value of his resources and particularly of the land.

Representative CURTIS. Oh, yes; I am going to get to that.

Secretary FREEMAN. When you do that you find that there is a very significant increment here.

Representative CURTIS. That part is a little easier. But, let us return to this point of the amount of what the farmer's own labor is, because if we adjusted this net income to allot as an industry so much for labor, this wouldn't be much of a net income, would it?

Secretary FREEMAN. No. This is the equivalent of the wages that, for example, a worker would get.

Representative CURTIS. Exactly. The farmer being an entrepreneur has got both his investment and his own input of labor. Therefore, the net income, to the extent that it relates to both, is what he gets in return for his labor as well as what he gets in return for the amount of capital he has risked and has invested in it; right?

Secretary FREEMAN. But, you have to add to this also now to have a balanced view of these figures that written into those net income figures, as a cost of doing operations, is the depreciation of his equipment.

Representative CURTIS. Oh, yes.

Secretary FREEMAN. And the cost of interest, as a cost of doing business.

Representative CURTIS. Well, I would think your net income would reflect depreciation.

Secretary FREEMAN. That is right.

Representative CURTIS. I mean, the figures that you have given us should reflect depreciation?

Secretary FREEMAN. That is correct.

Representative CURTIS. I am pointing out these other things to show why I would disagree with you that parity is still probably the best way of measuring how well the farmer is doing.

Secretary FREEMAN. I would not agree.

Representative CURTIS. It relates to what he has to pay for fertilizer and all that he has, his purchase of tractors, and so forth, in relation to what his income is.

Secretary FREEMAN. No; I would have to take exception with you on that.

Representative CURTIS. All right.

Secretary FREEMAN. I think it is an indication, in some things it is a reasonable one, in others not. The only really meaningful figure that has any significance is the net income. You cannot eat parity. It is what you have got left at the end of the year that counts.

Representative CURTIS. Let me ask you this then. You have been in office almost 7 years, Mr. Secretary. Have you made recommendations to change the economic indicators to remove prices received and paid by farmers and the parity ratio which we follow?

Secretary FREEMAN. No.

Representative CURTIS. Well, if it is not a good indicator, let us quit kidding the people. I think it is, and obviously the administration thinks it is.

Secretary FREEMAN. I do not think it is. I think it is an indicator sometimes useful, and I think it should be continued, but I do not think it ought to be used to mislead in connection with what the real facts are which there is a tendency to do.

Representative CURTIS. I would put that the other way around, Mr. Secretary.

Secretary FREEMAN. We apparently disagree about that.

Representative CURTIS. Yes, we do, let us set forth our disagreement on the record.

Secretary FREEMAN. Very good.

Representative CURTIS. Inasmuch as you say parity is being used to mislead, I suggest to you that the figure that you have given in your statement is largely misleading as far as the actual economic welfare of the farmer is concerned. It is shown by the fact that you say there are some who advocate the removal of the little farmers. Well, as a matter of fact under your administration they have continued to leave; haven't they? Whether you planned it or did not plan it, under your

7 years of administration the small farmers continue to be squeezed out; aren't they?

Secretary FREEMAN. There are fewer small farmers.

Representative CURTIS. Exactly.

Secretary FREEMAN. Let me add to that question again, so there will not be only a half question, that there also is a significantly higher percentage of food and fiber produced in this country by family farmers as opposed to corporate farms in the last 7 years.

Representative CURTIS. I know it. This is what former Secretary Benson tried to point out to people like yourself who were accusing him of driving the small farmer off the farm. He wasn't driving them off any more than you were. You are dealing with some very serious economic forces.

Secretary FREEMAN. No question about it.

Representative CURTIS. Then it is about time we got rid of the rhetoric and started dealing, as best we can, in figures. If parity is not a good way of measuring, I would have thought within the past 7 years you would have come in with more accurate ways. I think some of the criticism you direct against parity is sound. I think we ought to improve it and we have to some degree done this.

But I think when we get into the guts of it, parity is a fair way to try to figure out how well the farmer is doing.

Let me get into another area which you mentioned, which I think is very crucial and very important, and is not developed in the body of your remarks. You were referring to these corporate farms. I wouldn't just say corporate. I would add that there are some individuals who own farms and do not care whether they make money or do not, because they will write it off on their tax returns. I could not agree with you more on this.

We did try to do something to some degree through the "hobby farm" tax law to stop this.

I have argued for years that we needed to move into this area in a forceful way to stop this kind of business, which really forces up the land values.

Secretary FREEMAN. That is right.

Representative CURTIS. It is most important. Now, what recommendations have you made to the administration to do something in the tax laws to stop what I regard as very unfair competition to the commercial farmer, who has to make a living, and a very damaging thing to the health of agriculture?

Secretary FREEMAN. Well, we have working right now, Congressman Curtis, a task force with the specialists and technicians in the Internal Revenue Department, seeking to develop some kind of effective legislation to check the abuse which you just described. The precise status of those discussions in that task force at this moment I do not know. It has not reported back to me, but we are hard at work at it.

Representative CURTIS. I appreciate that. I see my time is up and I will come back, but I want to emphasize I do not think this is just a trivial thing.

I think this is a very deep and basic thing. When I studied the economics of our meat producers or cattle people, I found an area where the prices for cattle, lands, and so forth, have just been skyrocketing. As near as I can see, it was largely emanating from the tax laws, which encouraged those who made money in other areas to come in and invest, because they just write the thing off in their taxes.

Secretary FREEMAN. Yes.

Representative CURTIS. I again emphasize what we call the hobby law. We tried to eliminate this, but we have not yet succeeded. There has been very little interest in this emanating from the Department of Agriculture, or elsewhere for that matter.

Secretary FREEMAN. May I, Mr. Chairman, just for the record; I would like to make it quite clear that in this useful discussion with Congressman Curtis as to what is the best criteria measuring well-being, I would not want to have the record indicate in any way that the Secretary of Agriculture feels that we have accomplished the millennium or that we are satisfied with farm income or the rest. The point I seek to make is that I think we are on the way to meeting our problems, that we have momentum in that direction, that we have a foundation on which to build, but so long as farm income per capita is only two-thirds of per capita nonfarm income, we have a long way to go. I do not want the record to indicate even obliquely that the Secretary of Agriculture is suggesting that we have it made. That is not the case.

Representative CURTIS. I think you have overstated the case. If not, the facts, of course, would prevent you from ever making claims of that nature, Mr. Secretary.

Secretary FREEMAN. It seems we have a healthy level of disagreement, Mr. Curtis.

Representative CURTIS. We sure do.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Mr. Secretary, you said that if farm programs were done away with, according to the figures of Iowa State, farm income would be down greatly. Then you indicated that you thought this might end up leaving sort of a "survival of the fittest" situation, which would force out a great many farmers?

Secretary FREEMAN. I said not the fittest. I said the most powerful.

Senator MILLER. All right, either way. Let me say first of all that I personally have been opposed to doing away with farm programs, although I must say I have been in disagreement with some of the farm programs that have been proposed. But I remember a couple of years ago in the President's budget there was a statement that looking down the road it appeared that only about 1 million farmers could look forward to a reasonable income, even with the farm programs. I am sure you remember that statement in the budget. I am wondering if this is what we are headed for anyhow.

Secretary FREEMAN. I do not particularly care to get into that numbers game as to how many farms there are going to be in the future. No one can possibly know, and I think that the Chairman of the Council of Economic Advisers was ill-advised to hazard a prediction that had no time limit on it. What the future will hold no one can say. It is perfectly true, as Congressman Curtis said a moment ago, that for the last 20 years, the number of farms has been declining. At the same time our family farms, as you are well aware, are twice as large now as they were 20 years ago.

The likelihood is that that trend will continue. I believe we will continue to have a family farm agriculture. It is important that we should.

I think it is the most efficient. Precisely how large those farms will be and what one man can operate efficiently lies in the future of science and technology, and no one can estimate it with any accuracy.

Senator MILLER. On that family farm situation, I was just out in the San Fernando Valley in California. I was talking with a farmer out there, and I must say I was not able to convince him. He said to me that because of the cost of production, because of the costs of machinery, farming out there for a family-sized farm, that is to sustain a family and to be an economically producing unit, had become such a large operation, requiring so much capital, that he said:

> Unless my boy could inherit a farm or unless somebody with independent wealth came along there was really not much of a future for the family farm.

It looked to him as though this was going to get into large corporate farms. Aren't you a little concerned about that corporate trend?

Secretary FREEMAN. I am concerned about it, and I am concerned about credit availabilities, and certainly deeply concerned about young farmers and the problem that there is such a high-investment level. On the other hand, I think agriculture is coming to be an operation resting in considerable part on borrowed capital as we have in industry.

At this point the percentage of debt in agriculture is substantially less than the percentage of debt in industry. Agriculture runs less on credit than does industry. Agriculture more and more is going to operate on credit. A farmer today tends to think that if you are in debt and you have borrowed, why there is something really wrong about that—while industry tends to think if you are not in debt when you can make money by borrowing money there is something wrong about that. It is a different psychology.

I think that there are a considerable number of young people going into agriculture today. I am not sure just how many. As a matter of fact, the number of farmers 25 years of age that own and run an operation of $10,000 a year gross or more has been going up rather sharply. I do not know how. There is a real problem here, one that I would like to see alleviated, and the credit end of it is a very real challenge.

Senator MILLER. I would like to suggest to you that when you talk about the debt ratio in industry, you are taking into account corporations, and this is the fear that many farmers have today; they are not going to be able to get the credit and they are not going to be able, really to risk the capital, unless they get into a corporate farm, which means that we are headed for corporate farming as distinguished from the family farm situation.

Secretary FREEMAN. Obviously a family farm can be incorporated and still be a family farm.

Senator MILLER. That is right, but they are not talking about a small family farm corporation which is incorporated, maybe just for some tax purposes or for some purposes of taking care of the operation because of the death of the owner. They are talking about the fact that the days of the typical family farm owning and operating its own stakehold seem to be fading away.

Secretary FREEMAN. I do not believe that at all, because the figures will show that in the last 10 years there has been an increase of 200,000 in the number of family farms that will gross $10,000 a year or more. Also that the percentage of food and fiber produced by other than larger than family farms is going up, not down. So far the figures do not show a takeover of agriculture by big corporate farms. Quite the contrary.

Senator MILLER. I think probably those figures can be offset by the realization that there has been consolidations of farms, too. There have been a lot of small farms that have gone out of business. I think over the last 7 years that it shows for 1960 through 1967 a decrease of three-quarters of a million farms, 773,000 farms. I am happy that there may have been increases in the number of family farms that are viable. That would seem to be indicated by the consolidations.

Senator MILLER. But I will venture to say, Mr. Secretary, that if you go around to the average small town in my State or in your State, and talk to the farmers, you will find deep concern about the future of a young man, unless he can inherit a farm, getting into the capital structure that is needed now to sustain a viable family farm, which is much, much greater than the capital structure needed for the average small business or shop.

In your statement, I think you brought out something very significant. You stated that—

> In 1960 consumers spent 20 percent of their disposable income for food whereas in 1967 it was only about 17.7 percent of the consumer dollar.

I would venture this is one reason why you have quite properly said on many occasions that people are getting food for a bargain price?

Secretary FREEMAN. That is right.

Senator MILLER. Relatively speaking. And you indicated that if in 1967 they had spent as much of their consumer dollar for food as they had in 1960, that this could have meant a difference of $11 billion. That if the farmer had received that $11 billion, we would not be worried too much about the agricultural economy; would we?

Secretary FREEMAN. No; we wouldn't.

Senator MILLER. Now, Mr. Secretary, how do we get that consumer dollar portion going for agriculture back to where it was 7 years ago.

Secretary FREEMAN. I have tried to point out in this statement how we have moved in the direction of strengthening farm income, and getting to parity of income, and I think the most important thing right now is to extend with some improvements the basic farm programs we have, and to get some legislation that will give farmers some bargaining power so that they, dealing with processors and handlers, can extract from the market a fair price for their product, so they will have power in the marketplace at least somewhat commensurate with the power they have to deal with, and this is the only way that we are going to get this done, and I hope that something might happen in that direction during this session of Congress.

Senator MILLER. Would you not agree that the Federal Government ought to be exerting its power to move this consumer dollar portion going for food in the direction back to where it was in 1960?

Secretary FREEMAN. I certainly would, and I would certainly agree and have so said any number of times that farm prices are too low, and that farm prices ought to be strengthened. Food is the best bargain of anything people get. When the American people feel they are paying too much for their food, why, they are simply being misled and ought to face the facts that the cheapest thing people get is food.

Food is the best bargain they have, and they ought to be willing to pay more for it, and they had better pay more for it. If they do not, they won't have the efficient agriculture they have today and they will end up paying a lot more for it.

Senator MILLER. I will say amen to that. Now, Mr. Secretary, you also talked about the net favorable balance of agricultural trade today. Is this not in jeopardy if we do not put a stop to the inflation that is driving up the costs of agricultural production?

What I am getting at is this. When I met with your agricultural attachés a couple of years ago, I heard many, many times a warning we must be price competitive in world markets. If inflation continues to push up the costs of production for the farmer, aren't we in danger of jeopardizing our competitive position in world markets?

Secretary FREEMAN. Yes.

Senator MILLER. In other words, if we want not only to maintain this favorable balance but if we want to enhance it, then we had better put a stop to inflation, hadn't we?

Secretary FREEMAN. If we want to do a lot of things in this country, we had better put a stop to inflation. I think we are all agreed to that.

Senator MILLER. Yes; but would you not agree?

Secretary FREEMAN. Sure, it applies to agriculture and exports just like it applies to everything else.

Senator MILLER. But is it not true especially for agriculture?

Secretary FREEMAN. No. I think it is true of the total economy. I think it is true of all our exports, agriculture and nonagriculture, and as we tend to have inflation, we get into a position where we become less and less competitive. That is very dangerous to the total economy, no question about it.

Senator MILLER. My time is up. I will come back. Thank you, Mr. Chairman.

Chairman PROXMIRE. I asked you as I was concluding my questioning about the impact of a very substantial cut in agricultural appropriations on farm income, and you gave a very emphatic answer. What would be the cost of providing the kind of improved rural and urban situation that you describe in your closing pages? Have you costed that at all? What would be the annual cost over a period of, say, 10 years or whatever period you think would be a reasonable period to accomplish this?

Secretary FREEMAN. For commercial agriculture for the moment, I think cost need not increase very markedly in connection with their programs. The farmer should, and with these programs will, get his return out of the marketplace. That is where he ought to get it. We use payments in order to supplement that income in instances where we are not competitive for a number of reasons, worldwide, but mostly where we need to adjust supply to demand.

Chairman PROXMIRE. But to provide these additional opportunities in the rural areas, to get jobs and all that kind of thing, you say it would not require much additional net increase to——

Secretary FREEMAN. No; I did not say that. I was speaking of the commercial side. I said I do not think it will cost very much more. On the other side of the nonfarm rural American, I really do not have a 10-year figure.

Chairman PROXMIRE. A lot of this is taking place, of course. That these things take place even with great rapidity is easy for us to overlook. In my State, and I do not think it is atypical—we may be a little ahead of some others—we have nobody who lives more than 50 miles away from a State university. We have them all over. You talk very eloquently about the availability of the university center. We have them scattered throughout the State; and in many many States, as you know, that have done this, partly with Federal assistance, that is a great contribution.

Secretary FREEMAN. Might I make a suggestion, Mr. Chairman?

Chairman PROXMIRE. Yes.

Secretary FREEMAN. And this committee might look into this. What we really need in large part of rural America, outside of money and such which takes considerable amounts for training, is credit. I frankly think that the makeup of the Federal budget is highly questionable when it puts in as debt, loans for such things as REA, which are repayable loans, for such things as housing, for the things you see on this chart now. We are tying our hands behind our back by failing to make Government credit available when it can be a two-sided instrument, because it shows in the budget as if it was an expenditure. It would never show in the budget of any industry——

Chairman PROXMIRE. The budget does make some provision in that area.

Secretary FREEMAN. Not really.

Chairman PROXMIRE. At least it shows the loans separately.

Secretary FREEMAN. Yes; but, so what?

Chairman PROXMIRE. And tries to make it clear what they are, that they are not an expenditure, that they are repayable, they are repayable with interest.

Secretary FREEMAN. But it still has the same effect and inhibits the adequate use of credit. If we could turn loose credit—and there might be a little subsidy in terms of the interest rates on water and sewer, or recreation, on housing—why we could make the greatest single contribution to building up rural America, and making it possible for people to live where they want to live, that we could make.

Chairman PROXMIRE. Of course, there has to be the real prospect, the assured prospect of earning a good income. You have to be able to support and service the debt.

Secretary FREEMAN. Oh, yes; we do not make loans, except those that do. Every single one of those programs will pay out. The water and sewerage systems for which the loans have gone up to $197 million, ought to be up to $597 million. We could make it right now. We have 2,500 applications pending, most of which would be payable good business propositions. We cannot make them because we do not have credit and the credit is a problem because of the way that we budget.

Chairman PROXMIRE. There are several ways we can meet this problem. One was ingeniously suggested by Senator Javits and I am cosponsoring it, as far as college housing is concerned. Instead of providing $600 million in college housing loans, and I think the administration is adopting this pretty much, the bill provides $10 million to subsidize the interest rate a little.

Secretary FREEMAN. That is one way.

Chairman PROXMIRE. Doing that, it greatly reduces the impact on the budget. In fact it cuts it down to 1 or 2 percent of what it was. You could do the same kind of thing here, a guarantee and a very very modest subsidy. We are doing the same thing here.

Secretary FREEMAN. We are doing exactly that. We have legislation pending to do that; but why do we have to go through those shenanigins? Why not just recognize that these debts are being repaid. There has never been a better repayment record than that of REA. Why do we deceive the people of the country by calling that an expenditure? I do not think it makes any sense at all. I think it limits what we can do as a nation in using our credit to build our own country. We tie our own hands behind our back.

Chairman PROXMIRE. Let me ask you about a very interesting part of your presentation which I agree with wholeheartedly and which is very important; that is, getting bargaining power for the farmer. I think this is the heart of it.

If we do not do that, we are going to continue to have a very unsatisfactory situation. I am delighted to see that you are so forcefully in favor of it.

Has the administration had a chance to take a position for or against the Mondale bill?

Secretary FREEMAN. As I understand it, the Mondale bill was introduced today.

Chairman PROXMIRE. I see. I did not realize that. I thought it had been introduced before.

Secretary FREEMAN. No.

Chairman PROXMIRE. I know I am cosponsoring it.

Secretary FREEMAN. He was going to introduce it today, and we are obviously going to review it. It has two titles to it. As I understand it, he is going about it in two different ways. I am not prepared yet, Mr. Chairman, to say specifically the exact machinery and how this will work in detail. It is enormously complicated. It goes right to the heart of our economic system and how it will function. But I do expect, when I am called on to testify here, to be prepared to go into it with considerable specificity. At least that is what I project.

Chairman PROXMIRE. I agree wth you wholeheartedly, too, on the desirability, and with Senator Miller wholeheartedly too, on the desirability of increasing farm income and farm prices, but can you give us any estimate of what effect this would have on the Consumer Price Index and inflation? If, for example, farm prices were increased to a relationship that was about the same as it was in 1966.

Secretary FREEMAN. I have never considered food prices very inflationary. They have been counterinflationary, when they go up a little they are a little less counterinflationary.

Chairman PROXMIRE. What do you mean; when the price of food goes up the housewife has to pay more, that is inflation.

Secretary FREEMAN. The farmer has been holding back inflation in the Consumer Price Index.

Chairman PROXMIRE. You lose that counterinflationary effect.

Secretary FREEMAN. It is inequitable as the dickens and it should not be continued.

Chairman PROXMIRE. It is. You have no estimate as to what this might do on the Consumer Price Index. The farmers played a great role last year in holding down the cost of living.

Secretary FREEMAN. That is right. A relatively small amount, I think I said here the farmer gets only 5 percent of total disposable income, only about 37 to 40 cents of the food dollar. Most of the increase that we have seen in food costs, and at this point it might be interesting to point out for the record that farm prices are literally lower than they were 20 years ago. Farm costs are up a third over what they were 20 years ago. If it had not been for an extraordinary increase in productivity, we would have destroyed our farm structure long ago. But every increase in farm price does not automatically reflect itself in an increase in consumer price. One of the hopeful things in the bargaining front is the economic fact that if we can schedule the commodities that move from the producer to the consumer on a systematic basis, there are very important savings to be effectuated. In hogs, cattle, and a number of other things one of the problems has been the inability to schedule and use capital resources efficiently.

Now, under a bargaining power system, presumably some of that could be overcome. Important savings could be effected to the benefit of both the farmer and consumer. But, in answer to your question, I do not have any index number in my mind as to what the final impact might be and I do not think anybody does.

Chairman PROXMIRE. Two quick questions that are somewhat idle because I am not sure of their complete significance but I am very, very curious about them. On page 10 of your statement you refer to the huge capacity to produce of the American farmers. Do you or does anybody else who is, in your judgment authoritative, make a valid estimate as to what the percentage of potential output is now being produced?

Secretary FREEMAN. About 80 percent. We have about 12 percent idle. We are using about 88 percent.

Chairman PROXMIRE. In other words, if you took all restrictions off and the farmer produced as much as he could, he would produce 10 to 12 percent more.

Secretary FREEMAN. Another 10 to 12 percent.

Chairman PROXMIRE. You talk about the exodus from the country to the cities slowing down. That is very encouraging, but I wonder, in view of the marvelous increase in technology, productivity on the farm, and the indication that true research and so forth is likely to continue to increase, isn't there likely to be an exodus from the farm, not from the rural area, from the farm, with a great improvement in productivity, which is a great contribution to our economy?

Secretary FREEMAN. What you are really saying and I think you are right, Mr. Chairman, that family farms are going to grow larger. What one man can operate in one family is going to grow larger with the advance of science and technology. I do not think there is any question but what you are right.

Chairman PROXMIRE. My time is up. I am going to have to leave shortly because I have to catch a plane, but I am going to ask the distinguished Congressman from Missouri, who is the ranking minority member of the committee, to preside in my absence.

Secretary FREEMAN. You mean you are going to leave me here without any Democrats up there at all?

Chairman PROXMIRE. Well, if anybody can take care of himself, you can, Mr. Secretary. You have shown that.

Representative CURTIS. Then I will begin by getting off my chest some of the questions that might not be considered so fair. Very seriously, though, Mr. Secretary, you appear here, of course, with two hats, one as Secretary of Agriculture, but also as a part of the President's Cabinet, and the administration, and I think a great deal of what you have been saying has been said possibly as Secretary of Agriculture. For example, the administration has been dubbing itself, in recent months, as the consumers' administration. I am curious to know whether you cleared your statement, that the housewife had better be ready to pay more for food, with Betty Furness, for example.

Secretary FREEMAN. I do not clear each of my statements or my actions with Betty Furness. That does not involve any disrespect to Betty Furness.

Representative CURTIS. Oh, no, I understand. The seriousness of the question though is: Is this an administration position, or is it just your statement as Secretary of Agriculture, when you say that you feel that the farm prices should go up?

Secretary FREEMAN. Yes.

Representative CURTIS. It involves other sectors of the economy. I might say, as one who feels very strongly that we need to do a great deal to bolster and assist in agricultural areas, but I am anxious to get the administration's position.

Let me put it in further context and then I will turn it to you.

In the President's Economic Report, the only sentence dealing with agriculture was a cryptic comment that "During 1967 farm proprietors' net income dipped, but by yearend had returned to the level of a year earlier."

In other words, apparently you did not get your point of view through to the administration, so that they were brought out at least in the President's Economic Report?

Secretary FREEMAN. Let me say that I have my problems with the economists, generally, including those on the Council of Economic Advisers. I think this is no secret, nor do they always agree with the Secretary of Agriculture, which is their privilege. But I would like to say that the President has clearly and sharply, on repeated occasions said that farm prices were too low, that farm prices should be increased. He made very prominent mention of agriculture in the recent state of the Union message. He sponsored and fought through the Congress what I think is probably the most important farm legislation we perhaps have had in this country, the Food and Agricultural Act of 1965, and has indicated that he will do so again. So, there is no doubt of the position of this administration, and I would state it here, that farm prices are too low and should be higher.

Representative CURTIS. Well, I think there is doubt in view, Mr. Secretary, that this is the Economic Report of the President, and this is supposed to be what this committee is looking into.

Now, granted the President may go off and do other things that affect the total economy, such as you are now suggesting, but frankly this is what creates the credibility gap that we are hearing a great deal of. The administration presents this kind of document, in theory cleared with the Cabinet, in theory with your points of view in it, and yet now you come in with this kind of statement, which I respect because there are these differences. But, I think in fairness, those of us who look to what the Johnson administration is saying, must look to this document rather than to your testimony here.

Secretary FREEMAN. Well, I realize that this committee and the Congressman would think that the Council of Economic Advisers is more important than the Secretary of Agriculture.

Representative CURTIS. No, no; this is 28 pages, signed "Lyndon Baines"—no, just "Lyndon Johnson," but it is 28 pages of what he has got to say as the President. Then the annual report of the Council of Economic Advisers comes along——

Secretary FREEMAN. Well, it is my recollection——

Representative CURTIS. There is not much in there for you and the farmers, I will say that.

Secretary FREEMAN. I don't recall exactly but that there is more than two lines in there to the best of my recollection, but, regardless, I won't argue with you about the Council of Economic Advisers. I spend more time arguing with them than I do arguing about them. So, that presents me with no problem.

But let me just answer your important question and that is where the President stands, where the administration stands, where the Secretary of Agriculture stands, and that is for better farm prices.

Representative CURTIS. Now, let me get to this. When you were referring to that chart that is the activities of only Government. Do you have something that could be fitted right alongside of what the total picture in the economy is as far as credit is concerned? How about the private sector, because, hopefully, we are not going to have the Federal Government doing all that lending? I mean what is this Federal Government figure in context with the total of farm loans? You have got $659 million. What is the total of farm loans?

Secretary FREEMAN. Well, the farm loans referred to here are operating loans.

Representative CURTIS. I understand.

Secretary FREEMAN. And ownership loans.

Representative CURTIS. Yes, but now the private sector makes these kind of loans; doesn't it? In the same way you have got housing $442 million, but what is the amount of the private sector involvement?

Secretary FREEMAN. I do not know. I will have to get those numbers.

Representative CURTIS. I wish you would, and I think it is very important because, hopefully, you are not trying to build up bureaucracy or a Federal Government empire. You are trying to meet a problem; aren't you?

(The following information was later supplied by the Department:)

On December 31, 1960, farmers had loan liabilities totaling $26.2 billion—made up as follows: $12.8 billion, real estate; $12.0 billion, non-real estate; $1.4 billion, CCC loans. On December 31, 1967, total farm loan liabilities were $49.9 billion—made up as follows: $25.0 billion, real estate; $23.6 billion non-real estate; $1.2 billion, CCC loans.

Secretary FREEMAN. These loans are only made when they cannot get credit anywhere else.

Representative CURTIS. I understand all that, and no one can get 2 percent credit, of course.

Secretary FREEMAN. These are not 2 percent, either.

Representative CURTIS. No, but some of them are.

Secretary FREEMAN. Only REA would be 2 percent.

Representative CURTIS. Well, I say some of them. I think that we need to know what is being done, totally, for the farmer. I agree with you there are some areas where the conventional lending won't do it. But then you approach it in a way, hopefully, that you can encourage them to do it. So when we start listing what the Federal Government does, I think it ought always to be in context with what the private sector is doing. And I might add a further thing here.

One of the criticisms I had in following your statement, the word "we" was continually used, I kept wondering who "we" is. Is that the Federal Government? Is that the society? Is that the total? Then later you did go on to refer to "local and State."

I think also we need to know, in order to understand the farmer's picture, what is being done. I am talking about figures now, in these areas, by local and State governments as well as what is being done in the private sector. That is the statistical series that we need in order to understand these problems of water and sewerage systems, housing, telephone lines, and so forth. Do you suppose you could supply this to the committee?

Secretary FREEMAN. Yes.

(The information requested concerning the return on capital assets used in agriculture was later supplied and appears below:)

Data on production assets used in agriculture provide a basis for imputing a rate of return on assets used in farming. These imputed rates are typically lower than those of nonfarm businesses because farm assets are revalued each year in terms of current prices whereas the assets of nonfarm businesses are usually valued at cost of depreciated value. However, the method used in valuing farm production assets is quite similar to the procedure used to value common stocks.

In making estimates of returns to farm capital, allowances have been made for returns to operators' and family labor, for operators' management and for the cost of borrowed capital. The allowance for return to operators' and family labor is based on the average cash wage rate per hour paid hired farm labor. The allowance for management is estimated at 5 percent of cash receipts from marketings and government payments.

Following these procedures the rate of return on assets owned by operators is estimated at 4.9 percent for 1966. This compares with 4.6 percent in 1965 and 3.0 percent in 1960.

It should be clear that the rate of return on productive assets is highly dependent on the assumptions regarding the allowance for operator and family labor and the allowance for management. Assuming a higher allowance for labor would reduce the imputed return on capital. Similarly a different assumption regarding return on management would change the imputed return on assets.

Representative CURTIS. With that context?

Secretary FREEMAN. Surely.

Representative CURTIS. Now one further question. You gave us the liabilities as a percentage of assets in agriculture, and you were saying that it is much less than that in industry in all manufacturing. This relates back to that figure that you gave us of net farm income, and the reason I was anxious to break it down to find out that which might be attributed to the farmer's labor and that which might be attributed to his return on his capital investment, is because I am afraid what we will find is that though the percentage of debt to assets is as low as you have it here, the return on the assets measured in dollars will be exceedingly low. Do you have any idea what the return on farm investment is for last year or the year before?

Secretary FREEMAN. Are you asking a question about land?

Representative CURTIS. Yes. I am talking about that. You gave us the figures on the total assets. You had it broken down into real estate and non-real-estate assets. In other words, we are talking about capital assets. The first question would be: What is the return on his capital assets? He has now got $281 billion. What was the net income last year? You gave us the net income last year, $14.5 billion; am I right?

Secretary FREEMAN. Yes; I think that is right.

Representative CURTIS. That would be roughly about a 5-percent return. But then if you put in a big item of the farm labor, that I suspect it would be probably 50 percent, and I think I am being cautious; we would have a return on the farmer's capital assets of something around 1 or 2 percent.

Secretary FREEMAN. I think it is substantially lower, certainly, than the industrial sector of our economy, no question about it.

Representative CURTIS. Yes, considerably. I think it would be worth getting that arithmetic out. Again it will help make the case.

Secretary FREEMAN. Yes.

Representative CURTIS. It would help make the case in my judgment for the economic plight of the farmer?

Secretary FREEMAN. Yes.

Representative CURTIS. Here is one place I do agree with you, Mr. Secretary. I think he is in real rough shape. It looks like I am now temporarily chairman.

Senator Miller?

Senator MILLER. Mr. Secretary, I think that the cost to the Federal Government will be nearly $2 billion for food for peace and items of that nature this current fiscal year. I personally do not see much possibility of increasing that outlay for the taxpayers in present circumstances of our country. But looking down the road, when this costly war is ended, and we have some of the expenditures that are going for national defense which could be translated into other areas, do you see any probability of increasing the amount of the appropriations for the food for peace program?

Secretary FREEMAN. Yes; I think they will increase steadily but modestly in the years ahead. I do not foresee any dramatic increase, because the ability to absorb much greater amounts consistent with the self-help standards in the law which I support is not very much greater than we have now.

Senator MILLER. Well, that gets to the point I want to bring out, because you have stated many times that we must be very careful that we do not turn our food for peace program into a permanent fixture in these countries, and that the only ultimate answer is for them to produce their own food. I know we are bending every effort to get them to produce their own food, and yet it seems as though the increases in the populations of these countries sometimes cause us to feel we are on a treadmill.

It has been suggested in some quarters that we might double or treble or quadruple our food for peace costs to the taxpayers, that this might serve as a great force for world peace, and that this might mean that we can eventually look forward to exports for food for peace to take over from the farm program.

The Iowa State Survey that you referred to indicated that we could do away with farm programs if we would double our exports, for example. Do you have any thoughts on that point?

Secretary FREEMAN. Only that I do not foresee that as a realistic possibility. It is difficult to predict too far in the future, but let me just say, during the next 5 years I cannot conceivably foresee our exports, including Public Law 480 and commercial, being at such a level as to absorb the productivity of American agriculture and prevent the price depreciating effects of overproduction. I do not think that is in the cards for at least 5 years and frankly, I would make it longer. I do not see it in the foreseeable future.

Senator MILLER. The Iowa State Survey indicated that if exports were doubled, then the farm programs could be done away with. Suppose the war was over tomorrow, would it not be possible that within 5 years we might have $4 billion going to food for peace rather than just $2 billion?

Secretary FREEMAN. No; I do not think so.

Senator MILLER. Why do you say that?

Secretary FREEMAN. Because if we tried to increase the volumes of production to that level, we would disrupt the agricultural development of the countries in question. You are well aware, having been there yourself a number of times, that one of the biggest problems in trying to get Indian agriculture moving was a price structure that provided no incentive for the producers. One thing we ought to have learned as a capitalist nation—and it took us too long a time to learn regarding India—was that farmers, like anybody else, won't produce if they cannot get a fair price. If we willy-nilly send food into these countries, they will take their resources and put them somewhere else, and their farm prices will come tumbing down, and their agriculture will stagnate and their economic development will be nonexistent, because no country in the world has ever advanced economically other than with a strong agricultural base. So, we have to keep this very much in mind, and use our resources and this potential with circumspection and good judgment, and not just dump our farm production around the world because we would like to get rid of it.

Senator MILLER. May I say I agree very much with you? I just think possibly there might be more that your Department could do to spread the word around among the agricultural community, that the hope of such a tremendous increase in exports for food for peace as a result of which they can go ahead and produce as much as they wish with no fear of the market development for them is not well founded.

Now you pointed to net income per farm last year as being up 55 percent over 1960, and that is true, but I do think, Mr. Secretary, that the record ought to be balanced to show that net debt per farm was up 140 percent in 1967 over 1960. Another thing we might show is that the cumulative net income increase from 1960 going through 1967 was about $8 billion. In other words, if you will take the increased net income per farm in each year since 1960 and add it altogether, you will find an $8 billion cumulative increase, but at the same time net debt went up $20 billion.

I must tell you that while I understand that there are some increases in land values that have been going on, that many farmers are worried sick about how they are going to pay this increased debt. In 1966 net debt per farm had gone up over $1,200 and in 1967, while net income overall was going down, net debt per farm went up $1,500, and they do not know how they are going to meet this increased indebtedness.

It looks as though many of them are going to have to liquidate their farms in order to do it.

I think that the record ought to show these figures, because while there may be some good figures to show, I think that the farmers ought to be shown the bad ones as well.

Secretary FREEMAN. Certainly the net debt figures you have given are accurate. I think they ought to be considered in terms of the asset figures as well, and during the period to which you refer, of course, total assets have climbed from $230 to $281 billion, and farmers' equities have climbed from $177 to $231 billion.

Senator MILLER. May I ask whether that includes the farm real estate?

Secretary FREEMAN. That would include the farm real estate, that is right.

Senator MILLER. And probably most of that increase represents that increase in the farm real estate value, does it not?

Secretary FREEMAN. Yes. Now, non-real estate, let me add in that connection, non-real-estate assets had climbed about 12 percent, from $55 billion up to $67 billion.

Senator MILLER. Yes.

Secretary FREEMAN. I stand corrected, that is $12 billion. It is more than 12 percent.

Senator MILLER. That is right, like tractors, equipment, and things like that.

Secretary FREEMAN. Sure.

Senator MILLER. The point is that for the farmer to realize additional net income, he has been going into debt even worse, and it is not going to satisfy him to say, "Well, look, old boy, your assets have climbed up in value." His answer to that is, "Well, how am I supposed to pay my debt? Do I have to liquidate?" That is the problem that they are faced with, and I think that that is one big reason why there is a great amount of restlessness in the rural areas in this country.

Now, you pointed out that the surpluses are gone, and the wheat and feed grain carryovers are down, and they are. But, cannot that very happy condition be traceable to the fact that our exports have increased dramatically during this period of time?

Secretary FREEMAN. I think that I said in my testimony that many factors were responsible for this, and one of them was increased exports. The answer is "Yes."

Senator MILLER. Well, I think if you will look at the increase in the exports, and it has been a very dramatic one, that that would just about account for that change.

Secretary FREEMAN. If you took the figures on that basis, but just add 50 million tons a year more production on the average to feed grains, and see where you end up, and that is what you would have without a feed grain program.

Senator MILLER. But that is not the point. I must say this. I understand how strongly you feel about doing away with farm programs. I share your view. But I do not think that we can conclude from that that any particular farm program has been the panacea for reducing these surpluses. I know you can say, "Well, we had a farm program that was in existence during these years, but we could have had another farm program or maybe another one, two, or three different farm programs, and if exports had gone up as dramatically as they have, and if these other farm programs would have deterred farmers from overproduction, we would end up with about the same results."

Secretary FREEMAN. If you assume that we would take out of production in feed grains, for example, which is of primary importance in your country and mine, during that period 30 million acres a year, or about 50 million tons less production than we would otherwise have, I would say of course. The objective is to get the acres out and cut back production. If you come up with a program that will do it more efficiently and as well, I will be happy to buy it.

Senator MILLER. I do want to say this and I have said it on several occasions. That you and your Foreign Agricultural Service are to be commended for what you have done on agricultural exports under legislation which I am pleased to say has been wholeheartedly supported by the members of both parties.

Secretary FREEMAN. I think that is right, generally.

Senator MILLER. I hope that we can continue to be competitive, but I must confess that I am deeply disturbed about the inflationary trends that we are undergoing, and the increased costs of farm production which can kill off our export future.

I just wanted to pick up one thing that you said. You said credit is a problem because of the way we budget, and you suggested your unhappiness with the fact that an REA loan, for example, is treated for budget purposes as an outgo.

Now, I grant you that does not sound fair when you are taking into account a comparison with a typical P. & L. statement of a business. That would be reflected as an acquisition of an asset in the form of a loan. But I must tell you that the important thing is: How much does the Federal Government have to borrow?

They can set up this loan as an asset on their books, but they still are going to have to go out and borrow money if they go into a deficit condition, and with an $18 billion budget deficit staring our Federal Government in the face today, to have to go out and cover that by borrowing in the private money market, this is one reason why interest rates are at an alltime high. My farmers are paying 7½ to 8 percent for 90-day cattle loans, so it may be that the budget does not show a proper relationship between an outgo and the acquisition of an asset, but the important thing that counts is how much does the Federal Government have to borrow in competition with others for this money in the money market.

In addition to that is the fact that, when the Federal Government runs these deficits, that gives the Federal Reserve Board power to monetize the national debt, which in turn generates the very inflation that you and I want to put a stop to.

I think this should be very carefully thought through before we advocate increased borrowing by the Federal Government in our present budget deficit situation.

I have one more question. Last year, Mr. Secretary, I believe it was in November, the Common Market for the first time in its history set a uniform export subsidy for canned ham. I believe that one of your people in FAS made a speech in which he pointed out the anomaly that the Common Market was charging duties on our feed grain imports coming in there, and then were turning around and taking that money to pay subsidies for canned hams coming to the United States.

There were, I think, 45 Members of the Senate who sent a telegram over to the Treasury Department on this, and at one time we thought that there was going to be some action taken by the administration to retaliate for this subsidy by the Common Market on its canned hams. Do you know of any progress that has been made on that point?

Secretary FREEMAN. I do not know to the moment precisely where it is, but there has been long and careful consideration concerning some actions taken to withdraw or to minimize this export subsidy in a number of EEC countries. Now, whether the result that has been attained is to remove the export subsidy at the point of origin, or whether we will end up applying countervailing duties, I do not know precisely at this moment, except I know this has been a matter of great concern and much activity, negotiation, and discussion, and one with which we are concerned.

Senator MILLER. May I say I understand there has been a lot of discussion, and I know there has been some contacts with the Common Market on negotiations. But, in the meantime, the subsidy has gone on, and farmers like mine have been hurt. They cannot meet the competition from these foreign hams coming in with that subsidy that the Common Market has furnished. I hope that you will do your utmost to get some action on this without any further delay. I realize that this is not in your Department for final action, but I would hope that with the power of your Department, looking after the best interests of the farmers, that you would be able to get some action taken without any further delay, because this has gone on and on and on, and I am continuing to get letters, as are all of us who signed that telegram, wondering why no action has been taken. I have no further questions right now, Mr. Chairman.

Representative CURTIS. Mr. Secretary, in one sense you are in good shape now because there is a difference between Senator Miller and myself on the point of food grains and the present program. But, let me ask this: Whether or not exports might not have been even more if the unit price had gone down, thus getting more dollars for the farmer through the increased production?

Secretary FREEMAN. The answer is "No."

Representative CURTIS. That is your opinion.

Secretary FREEMAN. You mean through the increased production?

Representative CURTIS. Oh, yes, sir.

Secretary FREEMAN. Well, if you would assume that you would have a 10-cent lower price and, let us say, have $1 corn instead of $1.20 corn, of course, you would sell more in the foreign markets; yes.

Representative CURTIS. And that is a theory on which American business proceeds and, as a matter of fact, isn't that really what happened with soybeans? And I might say it happens with animal foods, where some of our companies have been able to export considerable amounts of processed grains.

Secretary FREEMAN. Well, I do not think that you can equate or make legitimate comparison between industry and agriculture in this respect. Industry is not going to export at a loss. They are not going to continue doing that. Farmers will and have sold at a loss, as you pointed out yourself just a moment ago. You are dealing with two different industries entirely, and we have to use the instrumentality of Government cooperating with farmers in order to have any kind of balance between supply and demand.

Representative CURTIS. But the economic theory is the same. I do not care whether it is agriculture. Namely, if you get your unit cost down through productivity, and then reflect that in getting your unit price down, you can make—I am not saying you always do—but you can make more money if in the process you increase your sales.

Secretary FREEMAN. That is a good theory. What you state is absolutely right. It works that way in industry. But there are very important factors that limit the application of that to agriculture.

Representative CURTIS. Well, that is interesting. That is what needs to be developed. Let me ask, Didn't that actually work out in soybeans?

Secretary FREEMAN. Yes.

Representative CURTIS. And I think it might be well——

Secretary FREEMAN. But the price of soybeans has not gone down. The price of soybeans has held up at a very high level.

Representative CURTIS. But, I am talking over a period of time.

Secretary FREEMAN. I do not think it was pricing, frankly. It was a development of new demand rather than it was a pricing policy.

Representative CURTIS. Yes; but part of the demand results from lower unit costs which then open up new areas for use. Now, this is in raw materials, and that is why it is comparable. You can take cotton, you can take copper, you take iron. These things have a displacement factor. One displaces the other or competes with the other in various areas, and your pricing has a great deal to do with whether or not you can build up new markets.

Secretary FREEMAN. Well, it does, of course, but let me say at this point that if you followed that philosophy, why, you would really have a low parity-price index.

Representative CURTIS. No; because if your parity price works—now follow this through because this is not the point of our disagreement yet, but if you follow it through—if parity is talking about the income of the farmer, and we are talking about it in relation to his costs, and that is where you get your productivity in, so it does relate to parity. If this economic theory is right, then the soybean farmer, who used to maybe put in 20 acres and now can put in 200, his unit cost of his fertilizer, the fact his tractor is utilized for 200 acres instead of 20, everything else continues to lower his unit cost. Therefore, the unit price can go down, and yet if—and this is the key, of course, and this is where the argument would come—if he can increase his total production, he can, through quantity, make up his return.

Secretary FREEMAN. That is right.

Representative CURTIS. The theory is correct. I think this is what did happen in soybeans, and it has happened in many areas.

Secretary FREEMAN. May the record show, I think, Mr. Chairman, that soybeans can be used honestly as an illustration of the theory you set forth, but I think it is a somewhat misleading one as compared to, let us say, wheat or feed grains, because soybeans has had an enormous expanding market and a strong demand and very limited competition.

Therefore, you have been able to produce heavily here and maintain a pretty good price because of a galloping demand, and because of not very much ability to meet that demand. It has been a peculiar and unusual set of circumstances.

Representative CURTIS. Let me give you a purely hypothetical case, although some people go beyond the hypothesis to say it is a real possibility.

If wheat and our grains from which we can make distilled alcohol were of a lower price, that industrial alcohol could be made at a cheaper price where it would become part of the mixture used in automobiles along with gasoline to operate automobiles. As a matter of fact, this I do know: from a fuel standpoint, a high mixture of industrial alcohol and gasoline is what they use at the Indianapolis Speedway for efficiency as well as safety. But your unit costs of grains have not gone down, so that you have never been able to tap this area. Now, I regard this purely as hypothetical. I do not think it is proved out. It does illustrate the possibilities and has happened in a dynamic economy in many, many areas. The reason I pose all this is that, let's assume, if we may, that both you and I are concerned about the farmer, and we are both concerned about getting him on a better economic base than he is, so when I argue a different theory from the theory that your administration has followed, and which Senator Miller seems to espouse in this particular point, it is not because I am not concerned about the farmer. It is because I am so concerned and our disagreement, Mr. Secretary, should be over the details. I will take wheat or any other and argue as to whether or not the marketplace does not produce, does not result in a self-discipline on the amount of production on the part of farmers. Then we do have to watch any new program you would put in with guidelines to be sure that you do not cut things off. Very few things move in dramatically. During any period of shift we would have to watch very closely the inhibiting effects of Government programs.

Secretary FREEMAN. Let me just say that what you are talking about has been tried a number of times, and the theory that you would have adjustments made through the so-called discipline of the marketplace, and it simply has not worked that way as a practice. Instead of getting a decrease in production, you have gotten an enormous increase in production, with farmers desperately trying to stay alive by producing more and more, because there is no kind of organized force that can in any way pattern production to demand. This is done in industry, generally quite well.

Representative CURTIS. We had developing at one time futures markets in grains. It has practically been destroyed by what I regard as really economically self-defeating programs. There still are remnants of it, but the development of proper futures markets would have helped to stabilize price as well as encourage this kind of discipline in production. I happen to share your views, by the way, on the need for agriculture to speak with more of a common voice, so that they are not proliferated when they are dealing in the marketplace.

Secretary FREEMAN. May I comment on that for the purpose of accuracy?

Representative CURTIS. Sure.

Secretary FREEMAN. I think that on this, if I may, without being presumptuous, make a point that you have gotten two things mixed up here—a little bit of overproduction on the one hand, but a free market on the other.

We are doing a good bit to try and hold back production, but today the market is functioning and the futures market is functioning with absolute freedom. The Department of Agriculture is not making prices on a day-by-day basis at all. The volume of trading is higher than it has ever been in the history of the country.

Representative CURTIS. Mr. Secretary, I am not confusing it at all. I think I could take you through the history of what has happened in the futures market to make the point I am making, that they are not performing the kind of function that I would like to see them perform, which would be to exercise this kind of discipline. Indeed they cannot so long as you have the Government moving in through its actions.

Secretary FREEMAN. No; I think you are just plain wrong on that.

Representative CURTIS. That is all right.

Secretary FREEMAN. I think you are just plain wrong on that. The futures market is functioning and the Government is having no effect on the operation of the futures market today whatsoever.

Representative CURTIS. Well, we will have, and have had, testimony from people who are still trying to work in the futures market, which I think contradicts your point.

Secretary FREEMAN. On what commodity?

Representative CURTIS. You name it.

Secretary FREEMAN. On grain?

Representative CURTIS. Yes; on grain.

Secretary FREEMAN. Well, I would like to see that testimony.

Representative CURTIS. Sure.

Secretary FREEMAN. Because it is just simply not true. Now this was true——

Representative CURTIS. Wait a second. You have got your opinion. You can say that from your point of view it is not. This is not a question of truth or falsity. These are differences of opinion.

Secretary FREEMAN. No, no. In this case——

Representative CURTIS. There are people who are just as experienced, and, in fact, I am sure more experienced, than you and I. Both of us are a couple of lawyers, they are more experienced than either one of us in this area, and I think it behooves us to listen to them a bit.

Senator MILLER. Would my colleague yield?

Representative CURTIS. Sure; I will yield.

Senator MILLER. I think one example which I was very unhappy about, Mr. Secretary, occurred about a year ago, when Commodity Credit Corporation called in, I think it was, 1963 and 1964 corn. My recollection is that this amounted to around 200 million bushels anyhow, and caused a lot of concern on the part of many of the farmers I represent, and when I asked the Department of Agriculture what its reason for calling in both 1963 and 1964 corn was, the answer I was given was that this was to take care of manufacturing conditions.

Then when I went back over and asked how much the manufacturing livestock feed program was estimated to be, they said something like 20 million bushels, just a fraction of what was called in.

I am sure you are familiar with this. I know there were many telegrams sent to your office, and I think at the time it was too late to change it, because some of them had already delivered. But that is the kind of an example that I think Congressman Curtis is referring to, which had an adverse impact on the corn market out in my State.

Secretary FREEMAN. I think maybe I owe the chairman, Congressman Curtis, an apology in this. I do not want to be at all smug about this, but you have got to be very careful that you are not talking about apples and oranges at the same time.

Representative CURTIS. That is right.

Secretary FREEMAN. The volume of trading and making of price and the amount of futures trading is, I think, at the highest level it has ever been in the history of the grain market. On the other hand, if what you meant is that the factors to be considered in trading in the futures market must take into consideration the fact that the Government may, at a given time, be in the market——

Representative CURTIS. That is right.

Secretary FREEMAN. Why, this would be right.

Representative CURTIS. You are very fair in pointing it out, as I was, and perhaps by the use of the term "futures markets" it does convey to you——

Secretary FREEMAN. The same thing——

Representative CURTIS (continuing). The breadth in which I am trying to use it as an economic mechanism.

Secretary FREEMAN. That is right.

Representative CURTIS. To produce the results. I appreciate the clarification. I see my time is up.

Senator MILLER. I just have a couple of questions.

Is it not true that roughly half of the poor in this country live in rural areas?

Secretary FREEMAN. Yes; 40 to 50 percent of the poverty is in the rural areas.

Senator MILLER. That being so, doesn't it seem incongruous that only about 15 percent of the war-on-poverty funds are going to the rural areas?

Secretary FREEMAN. I cannot really allege as to the accuracy of the percentage, but I do not believe that a comparable and appropriate percentage is going to the rural areas, and we are trying in every way we can to move more resources into the rural areas from the poverty program.

Senator MILLER. I realize that this is something you cannot do by yourself, Mr. Secretary, but I am concerned about the fact that most of the publicity that comes out on the poverty sector talks about the poverty in the cities and the ghettos.

Secretary FREEMAN. That is right.

Senator MILLER. Rarely do I hear anything said about the other 50 percent of the poor who live in the rural areas. I think maybe more press releases by your Department might help counterbalance that.

Secretary FREEMAN. And in addition, if I may say, a more effective mobilization of local leadership in the localities. One of the problems, in all fairness to those who administer the poverty program, is: often some of our rural communities just do not have the expertise, do not have the trained people that can bring together and develop a program, and prepare an application and follow it through. This is one of the things we are trying to do with the Technical Act on Panels to which I refer: to use the people in the Department of Agriculture who are in the rural areas, working on programs, in this related need, which in its largest sense is overall rural community development. We are trying very earnestly to correct that.

Senator MILLER. I think your rural-area-development people have done a good job. I don't want to have any implied criticism of that, Mr. Secretary. My only difficulty is that all the attention of the general public of this country seems to be focused on the ghettos in the cities now.

Secretary FREEMAN. I agree.

Senator MILLER. I think it is out of balance, out of proportion, and that maybe a little more publicizing on the part of your Department might help acquaint the American people with the fact that it is not in just the cities that we have problems.

Secretary FREEMAN. I will try and holler louder.

Senator MILLER. All right.

Now, in your statement, when you say, "Only when private enterprise is attracted to the countryside can we hope to achieve some of these objectives," let me say, "amen," to that. I have used those words, in fact probably the same phrases, many times myself over the years.

However, here again it appears that your views, and I know they are conscientiously held views, do not necessarily represent the views of the administration as a whole.

For example, 4 years ago I offered an amendment over here on the Senate floor during consideration of one of the bills relating to depressed areas to provide Federal funds for low-interest loans, to encourage private industry to move into not the orderly, defined depressed areas, but I define a depressed area to mean a rural area where there has been a substantial decline in farm population. The very kind of an area you are talking about here to which we want to attract private enterprise, to provide job opportunities for those people moving off the farms instead of forcing them into cities to crowd our cities, and that amendment was defeated as a result of administration leadership.

I just hope that you will do all you can to get this viewpoint adopted by the administration and its congressional leaders, because I feel very strongly that this is the only way we are going to avoid making the problems of our cities worse than they are, and get the rural areas of this country back to where they should be. I shouldn't say back, I should say forward to where they should be and where they can be.

I have no further questions, Mr. Chairman.

Thank you very much. It is always good to see you, Mr. Secretary.

Secretary FREEMAN. Thank you, sir.

Senator MILLER. Even though you and I may have a little argument once in a while.

Representative CURTIS. I have just three other areas to examine briefly.

Getting back to what I think is one of our serious problems, the value of farmland which is now at $191.5 billion. I am reading from table B-82 in the Economic Report, page 305, which conforms to your figures, I must say, Mr. Secretary. You don't happen to have it broken out, but it jibes with your figures.

Secretary FREEMAN. Fine.

Representative CURTIS. We have discussed one reason that value is up. This is good for the farmer, in a sense, because his assets, if he sells out, he has got a capital gain. But, it is a very damaging thing, as you have been pointing out, and I agree, when it comes to commercial farming. When that land is jacked up because of the impact or hobby farming, these people will take their losses from other sources of income. They can, and do, come out and buy, and pay prices that make it very difficult for anyone to get a return on that kind of investment, of that value.

There is another feature in this increased valuation, which, by the way, has gone up from 1960, from roughly $130 to $191 billion, so it has gone up $61 billion just in that period of time. This factor is suburbanization. I see it in my own county, St. Louis County, Mo., which I represent.

St. Louis County still has agriculture. It had a great deal when I first began representing it. There is no question that the main value of the agricultural land that is in wheat, corn, feeder lots, and other things, is potential lots and subdivisions. This I see occurring all over, even around smaller towns. This is a big city, but it occurs even in towns of 20,000 population. This, too, has pushed land values up, and this puts a real burden on the farmer, although, as I say, this increases his wealth so he can get more cash if he goes out of farming. But servicing the debt, which Senator Miller has pointed out, is a tough thing, even though the value in relation to the actual farm debt is as low as 16.9 percent. Servicing of it in relation to his income is real rough.

And then taxes take effect in the same way. To some degree, of course, farmland is kept on the assessment books as farmland, so maybe the impact of these increased values to serve suburbanization will help ease that impact. But not the hobby farmer, of course. So, the farmer is pinched twice in two different directions because of this unrealistic value coming in.

I think it is so important, and I am on the Ways and Means Committee and I have been trying to get something done here to cut this back.

In reference to that same thing, I wanted to point out, as Senator Miller has pointed up, the impact of inflation on our exports. You were saying, Well, the housewife had better look forward to increased food prices. If we go in that direction, this is going to have a deleterious impact on our exports just as inflation is having a deleterious impact; right?

Secretary FREEMAN. It could; in certain commodities it might. We are going to have to be competitive.

Representative CURTIS. That is right.

Secretary FREEMAN. If you get to $4 soybeans, you are going to lose markets. Maybe you can go to $3 soybeans or maybe it will have to be $2.75 soybeans in order to compete, and you can't disregard this. The whole philosophy of the current farm program is that we move commodities into the marketplace completely subject to market forces. The price is made in the market. Now, we affect that price by holding land out of production, and sometimes by doing minimal marginal buying when there is temporary overproduction, and when we were getting rid of the surplus we did some selling. But we do very little selling any more, because we don't have anything to sell. But, fundamentally, this whole philosophy is geared to precisely what you are saying. That we will price at the going world market price and be competitive. This is the whole philosophy of the program. It is much different than the old programs that would have a high price support, a high loan rate that would make its price in the market. The Government used to make the price. The Government doesn't make the price now.

Representative CURTIS. But the trouble with that, Mr. Secretary, is what you ran into with your two-priced cotton. Then you have the people who utilize it——

Secretary FREEMAN. I know. I am not for it. We got rid of it.

Representative CURTIS. I understand, but you run into that problem when you go into subsidizing the price that you export, because if our own people who utilize this raw material have to buy it at the higher price in the domestic market, then what do we do? Instead of rectifying it, we put another subsidy on. That was the way it was corrected, which I thought was just buying more trouble, and I would argue that it is.

Nonetheless I want to make a point here in the record of the very damaging effect that inflation has on the agriculture sector. I think, second to old people on retirement, there is no segment of our society that inflation hurts worse or hurts more than the farmer.

Secretary FREEMAN. I think that is true; yes.

Representative CURTIS. And, here we are not really moving in on what I regard as the fundamental cause of inflation, which is deficit financing and the accumulated deficits we have.

Secretary FREEMAN. I am sure you would consider that I was sound asleep if I didn't say your being on the Ways and Means Committee would help a lot if you would pass out a tax bill.

Representative CURTIS. And we would, and I have said as a member of this committee, along with 19 other members, all 12 of you Democrats, if you will cut expenditures. You gave us an expenditure figure of $135 billion for the present fiscal year, and we said cut it back to $130 billion, and I said, I think even then we probably would have to increase taxes, but instead of cutting to $130 billion you are spending at a rate of $144 billion. Mr. Secretary, that is the crux of the problem and I am not about to ask the people of this country to come in and just give more taxes, because even your own administration witnesses before the Ways and Means Committee and this committee said that, even if we gave them the tax increase, inflation was going to be above 3 percent. So, their medicine is inadequate to meet the serious problem. Their only answer is, well, it will be more, and it will be, if we don't give them the tax increase. I don't think agriculture can live with the 3 percent, probably 3 to 4 percent, inflation that the Council of Economic Advisers said will occur even with the tax increase. I don't see how agriculture can really grow strong under those conditions.

Then I want to relate farm problems to another thing: high interest rates, the highest since the Civil War. This again hits the agriculture sector and across the board. It has hit hard at the homebuilding industry, for example, but it sure knocks the pins out in the agriculture area. So, here you are, you see, in your basic statement, talking about how well agriculture is doing and what you hope to do in the future. You have the lowest parity since 1933, and the highest interest rate since the Civil War, and we have——

Secretary FREEMAN. And the highest income.

Representative CURTIS. Now, wait a second. You already have stressed that.

Secretary FREEMAN. You stressed the other.

Representative CURTIS. No; I am now stressing it, because I haven't. I am now stressing it. And this inflation. I am simply saying, Mr. Secretary, this is the proper context and in this context I think that the administration for the farmer has done a very mediocre job. I think I would flunk them if I were the professor giving them a grade on the program.

Secretary FREEMAN. There can be no doubt about that. That is a good political speech and I will take the flunk with the source in mind.

Representative CURTIS. Yes, I know; and you also have gone around making these kinds of speeches, Mr. Secretary.

Secretary FREEMAN. And you the other kind.

Representative CURTIS. Now, wait a second. Yours attack the motives of people and mine do not. I have been talking about differences of opinion, and I will not and do not now attack your motives. However, your speeches have been the ad hominem, if you want to get personal, and this I don't appreciate. I hope we can keep it on the level of difference of opinion. What I am pointing out is in balance to the economic factors you presented in a lengthy statement which is well received and I appreciate it. I am trying to point out, for the sake of this record that other people will read, and scholars around this country, what the other side of it is. You can restate yours.

I have one other area to inquire about.

Senator MILLER. Would you yield at this point?

Representative CURTIS. I yield.

Senator MILLER. Mr. Secretary, you said net income was up high. I don't know whether you said it was the highest it had been.

Secretary FREEMAN. The total net income in 1966 was the second highest in the history of the Nation.

Senator MILLER. What was the highest?

Secretary FREEMAN. Net income per farm was the highest in the history of the Nation.

Senator MILLER. Yes; but let's just take farm income.

Secretary FREEMAN. Total net income; all right.

Senator MILLER. What was the highest?

Secretary FREEMAN. The highest was in 1949.

Senator MILLER. All right. Now, maybe Dr. Kutish can help on this. If we should wring the inflation out of the 1967 net farm income and get it down to the value of the dollar in 1949, how much would we have to tear off that?

Secretary FREEMAN. I think those figures were adjusted for the change in value of money as I have made them and given them. I would have to check again to be positive, but I think the difference of money was taken into consideration.

Senator MILLER. Were they in 1949 dollars?

Secretary FREEMAN. Yes.

Senator MILLER. Or what?

Secretary FREEMAN. I would have to check to be sure, but that is my best recollection.

Senator MILLER. May I suggest that you do so for the record, because I think that it is very important that the 1967 net farm income, for example, be reflected in terms, let us say, of 1960 dollars, which was just before this administration took over, and in terms of 1949 dollars, which is when you said was the top net income nationally.

Secretary FREEMAN. I will certainly do that, but in any event, why, I would again want to say that I am not suggesting before this committee that the Secretary of Agriculture or the administration has earned an A or that I am by any means satisfied with the level of current farm income, and particularly with the turndown in 1967. The point I do make is I think there has been very significant progress, and I think we are learning what it is going to take to reach our targets in connection with farm income and the effective mobilization and use of agricultural production.

(Information concerning 1967 net farm income measured in 1947 and 1960 dollars was subsequently furnished as follows:)

To have maintained the same buying power, as in 1947, total net farm income would have been $19.6 billion in 1967. To have maintained the same buying power as in 1960, it would have been $15.9 billion.

Senator MILLER. Let me make clear I am all for recognizing some areas of progress, and as I said before, Mr. Secretary, I think you and your Foreign Agricultural Service have done a great job on our agricultural exports. That is a real plus. And you have done so under bipartisan legislation. I don't think either Republicans or Democrats can take credit for it. I think it has been a completely bipartisan matter. But at the same time while you are giving these pluses, I think it is only fair to show the minuses, and there are some very deep and serious minuses, which is the reason why there is so much unrest out in the agricultural community.

You take a farmer who has to pay 7½ or 8 percent for a 90-day cattle loan, and, being squeezed with increasing debt per farm, he is pretty unhappy. I think that we will make more progress if we will face up to these hard facts of life than if we just face up to the bright side of things and kind of gloss over the other side, because the other side isn't going to go away. It is going to be there, and I agree with Congressman Curtis that this inflation is one very big part of it.

Farm prices are down, but that other side of the cost-price squeeze, the price side, is getting up more and more all the time due to this inflation, and that in turn is due to the failure of the Congress to come out with a reasonably balanced budget. They are at an impasse right now because most of them, I think, are ready, willing, and able to vote for that tax increase that you mentioned, provided it is a shared sacrifice, provided that the administration comes over and makes a meaningful cut in expenditures, especially at a time when we have such a serious budget deficit facing our people.

Representative CURTIS. I have this one other little area to discuss.

May I say this, though, Mr. Secretary? When I began to list the minuses, and I was listing what I thought they were, you responded by saying this was a political speech. It could be, just as your listing the pluses could be. Here in this interrogation it was meant to try to get this into context, and the record will be open and is open for your further response, if you care to make it, on these areas which I think are very serious minus points that lead me to the conclusion that I gave you. I thought that the record looks very dim as far as the farmer is concerned.

Now, the final area of interrogation has been mentioned at some length, which I am pleased about; namely, the problem of rural poverty, if you want to give it that term, or the problems in the rural area. Of course, agriculture is the biggest industry. But, I think, in order to get our record clear on rural poverty, we need to have these other industries coupled in.

I would like to have for the record—maybe our staff can do it, maybe you have these data—the amount of agriculture income that goes to our rural areas from other sources. Of mining, because mining is usually in the rural areas. Recreation is one and I have seen figures on its growth. I am talking about the income for recreation that has gone into rural areas. It is particularly true in my State of Missouri, but it is true in all States, where this has become a great source of income. How does it relate to agriculture? Agriculture is still by far the biggest, of course.

Forestry, which, of course, is in your Department is another. When you give us agriculture figures, do you usually include forestry under agricultural income?

Secretary FREEMAN. No.

Representative CURTIS. I didn't think so.

Secretary FREEMAN. On a farm; yes. Farm forestry.

Representative CURTIS. If it is on a farm where you have woodlots.

Secretary FREEMAN. Yes.

Representative CURTIS. I think we need to have the figure that is not included in agriculture. We are relating it to the rural question of the income from forestry.

Secretary FREEMAN. All right.

(The following information concerning the income from forestry not included in farm income was later supplied:)

The value of the timber harvest not included in farm income (cut by corporations from their land or from National Forest land) is estimated to be $3 billion to $3.5 billion. This compares with about $250 million from farm forests which is included in the farm income computation in 1967.

Representative CURTIS. And then there is another area. Industry, to some degree, at any rate, is moving into rural areas.

Incidentally, the administration has approved the proposal to remove the tax exemption that the industrial municipal bonds presently enjoy. I happen to favor this for many other reasons, but this would be a backward step, in one sense, possibly, as far as getting industry into small communities and rural areas.

Is there anything I have left out that is a major income producer in what we might call rural areas?

Fishing, I think, would probably not be, although it could be. I am concerned with the total picture of what we call rural income. It is usually Agriculture's figures that give us the picture of rural income.

Secretary FREEMAN. And industry, I suppose, really; commercial and service.

Representative CURTIS. Yes; I was thinking of that, though they are dependent, really, on your main sources. Take a small farm town, for example, it really derives its income basically from the farming that goes on in the area. I was thinking of the basic industries that bring in the basic income.

Secretary FREEMAN. I think, really, to get a well-rounded figure of this you would probably need to take a look at construction and service and commercial, because we find in many of these communities that once you get started in such things as homebuilding, institution improvement, water, sewer, recreation, they feed on one another.

Representative CURTIS. All right. To the extent that you do have it and could supply it for the record, I would appreciate it.

Secretary FREEMAN. All right.

Representative CURTIS. Then one final point on the same thing.

The farmer, as I understand it here, is defined as one who derives at least 51 percent of income from farming. I note that over a period of years around 30 to 33 percent of the farmer's income comes from other than agricultural sources. Those came out in our economic statistics.

Secretary FREEMAN. Yes.

Representative CURTIS. Is this essentially the income that the smaller farmer tends to get? I have a hunch it probably is.

Secretary FREEMAN. Yes

Representative CURTIS. But I don't know.

Secretary FREEMAN. It generally is of the small farmer who, gradually, in many cases, becomes more an employee than an entrepreneur.

Representative CURTIS. That is right.

Secretary FREEMAN. But there are instances where commercial farm operations, particularly at certain levels and certain times with certain problems, do engage also, and women particularly, in off-farm employment, so this gets very well commingled.

Representative CURTIS. Do you have any breakdown of that statistic that you think might be helpful?

Secretary FREEMAN. Let us look.

Representative CURTIS. Would you, please?

Secretary FREEMAN. I honestly don't really know if it has been gotten in that particular area. The statistics and information on this kind of thing, generally speaking, are much thinner than they should be.

Representative CURTIS. The statistic in the Economic Indicators I think just refers to nonfarm. The agriculture income it describes as "derived from agriculture," and then it describes the rest as "nonfarm source." I was just seeking a further breakdown.

(The following was supplied as requested:)

In 1966, the average income of farm operator families on farms with value of sales less than $10,000 was $4,755. This was made up of $1,658 realized net farm income and $3,177 off-farm income.

Representative CURTIS. Does anyone have any further questions?

Senator MILLER. I do.

Mr. Secretary, on page 299 of the Economic Report, if I could refer you and Dr. Kutish to that—do you have the report?

Secretary FREEMAN. I don't have it with me.

Senator MILLER. On page 299 is income from agriculture, 1929–67. The first column shows the year, the second column personal income received by total farm population, and then the first column under that is from all sources, showing $20.1 billion, and then from farm sources it shows $13.2 billion. I realize there is a little difference in time phasing on some of these tables, but is that $13.2 billion figure, which is a preliminary figure, approximately comparable to your $14.5 billion that you show on the next to the last page of your statement?

Your statement says, "Realized net farm income 1967," which is also a preliminary figure of $14.5 billion, and this one is also a preliminary figure, probably prepared earlier than yours.

Secretary FREEMAN. Dr. Kutish points out to me that, according to the footnote on the page, that the figures here include net inventory position. The figures we submitted are on a cash basis.

Senator MILLER. I see. And the inventory adjustment would make the difference, then.

Secretary FREEMAN. Inventory adjustment would make the difference.

Senator MILLER. Referring to your figure of $14.5 billion, the dollar has depreciated about 15 percent since 1960, so, if you would reduce that $14.5 billion by 15 percent, you would be down to somewhere around $36 billion, which does not show nearly the dramatic increase that your figures show. That is the reason I wanted to bring out earlier the importance of translating these figures into 1960 dollars and into the 1949 dollars, because the farmer is not impressed, for example, if he is getting $26 for cattle today, as against $24 in 1960, he is not a bit impressed, because he knows that the $26 isn't worth as much as $24 was back in 1960. I think that is another point that we should emphasize. It is the real price that counts.

We could do the same thing on the other side of the coin with respect to foreign debts and translate it into real dollars in foreign debts in 1960. I think that, if something like this were done, it would give us a better feel of the situation than what we have here in this report. Perhaps you could help the Council of Economic Advisers to do that for us.

Secretary FREEMAN. To be very frank with you, I haven't been too influential with the Council of Economic Advisers. They tend to agree more with Mr. Curtis than they do with you and me.

Senator MILLER. That is all I have.

Representative CURTIS. Thank you very much, Mr. Secretary. You have been very, very patient.

Secretary FREEMAN. And you, sir.

Representative CURTIS. The committee will stand adjourned until tomorrow at 10 o'clock when we will meet in the Old Supreme Court Chamber in the Capitol to hear Secretary of the Treasury Fowler.

Secretary FREEMAN. May I, Mr. Chairman, submit for the record a little pamphlet here that we have gotten out, "Communities of Tomorrow, Agriculture 2000." It talks about rural development. You may not want to put it in the record but at least make reference to it.

Representative CURTIS. I think it would be very well to put it in the record.

Senator MILLER. May I suggest, Mr. Chairman, that it be put in the permanent record, although not necessarily be printed with the record.

Representative CURTIS. The pictures can't be printed.

Secretary FREEMAN. Yes; I realize that, but if you think that text——

Representative CURTIS. I think, because this is the Secretary's statement, I think it probably belongs in the record, and I would urge that it be done. You can make a comment on it.

Senator MILLER. I would just like to suggest—I am just trying to be helpful here—that we let the chairman of the committee make the final decision as to whether or not this is printed.

Representative CURTIS. Without objection it will go in the record. If you want to object, object, but without objection it will go in the record.

Senator MILLER. You mean to be printed?

Representative CURTIS. Yes; to be printed. This has been our policy, Senator, for some time and I think a good one because people who read the Joint Economic Committee hearings are students and any data that is pertinent I think should be available to them. They might get this from other sources, but, on the other hand, it appropriately belongs in there.

Senator MILLER. Do you think that the printing of this without the pictures and so on will suffice for your purposes?

Secretary FREEMAN. I don't think that the pictures can be printed, as the chairman says.

Senator MILLER. I know they can't be.

Secretary FREEMAN. I think it would be very helpful that this information approach to this basic problem would be available to students.

Senator MILLER. All right.

Secretary FREEMAN. If the committee felt it was worth doing, why, I would.

Representative CURTIS. Without objection.

Secretary FREEMAN. Thank you.

(Whereupon, at 4:45 p.m., the committee adjourned to reconvene at 10 a.m., Thursday, Feb. 15, 1968.)

(The pamphlet referred to above follows:)

A Time for Action

For too many years too many people have crowded themselves into central cities—people attracted by the hope, often the illusion, of greater opportunity.

As a result, our metropolitan areas have more people and problems than they can cope with. All around us they are exploding with violence. At the same time, many villages, small towns, and their surrounding countryside are being drained of people and economic vigor.

This document outlines in broad terms the solution to this imbalance of people and opportunity: A new type of community, neither urban nor rural, but possessed with the highest values of both; a functional, multicounty Community of Tomorrow that blends the economic and cultural opportunities of affluent metropolitan life with the space and beauty of the countryside.

These Communities of Tomorrow will make possible in both city and countryside a quality of civilization that fully reflects man's aspirations and inventiveness. Rural improvement will make the urban improvement job easier.

We intend to help people build those communities. Our objective is to remove the scars of collision between man and his environment and to avert further collisions that will occur if we continue our present course.

I believe the American people will decide that the Communities of Tomorrow are worth the money, effort, and work their building will require.

Secretary of Agriculture

Collision

When the United States took its first census in 1790, only 1 out of 20 Americans lived in an urban area.

Today 14 out of every 20 Americans live in urban centers—core cities and suburbia.

Seventy percent of our people are living on about 1 percent of our land.

If this trend is allowed to continue, 100 million more Americans will, by the year 2000, be stacked on top of the 140 million already in urban areas.

Is this what we want? Both our urban centers and small towns already are in trouble.

Our urban centers—core cities and urban sprawl—are:
- congested, noisy, and full of tension.
- surrounded by polluted air and polluted water.
- burdened with too many people on relief, many of whom moved in from the country, unskilled, uneducated, and unable to cope with city life.

They also are costly.

No one can put a price on human life or human dignity, but we can figure the cost of congestion in our cities.

When a New Yorker moves to the suburbs, he not only takes his paycheck and goes off the city's tax rolls, *he costs the city $21,000 in capital outlay to provide facilities* so he can drive to and from work in the city every day.

In Washington, D.C., the cost for every added commuter auto is even higher—$23,000.

Contrast this with the $487,000 street department budget for an *entire year* in Fargo, N. Dak., a city of 50,000, for *all* its transportation facilities. Washington must spend that much to add only 21 commuter cars.

"A city can get too big simply because the cost of providing services increases all out of proportion to total population growth," reports Mayor Davis of Kansas City. "This becomes perfectly clear when put on a per capita basis, which is about $120 a year in Kansas City. In a city twice this size, per capita costs would rise to more than $200 a person."

But financial cost is only one factor in rural-urban imbalance. There is the effect of megalopolitan life on man himself.

Dr. René Dubos, a Nobel Prize biologist, says research indicates "some of the most profound effects of the environment created by urban and technicalized civilization may not be on the physical health, but on man's behavioral patterns and mental development."

The larger cities become the less people seem to communicate, and Dr. Dubos fears this "impersonal relationship of people in our cities is producing a gross impoverishment of individuals which could lead to the death of this civilization "

The towns and small cities of the countryside are in trouble too:
- rural America with about one-third of the Nation's population has nearly one-half of its poor housing and nearly one-half of its poverty.
- for years many of the brightest minds and most venturesome spirits in rural America have been drawn to the cities.
- for years, hundreds of thousands of small farmers, sharecroppers, and farmworkers—the people who supported town and small city businesses—have been leaving the countryside to seek rewards elsewhere.
- hundreds of small towns have become hollow shells haunted by boarded-up stores and large, half-empty homes occupied only by elderly citizens because the younger generations have fled to the cities.

Man has indeed collided with his environment.

The question is: Can we avoid the deepening catastrophe that faces our Nation if we fail to halt the flow of people from the countryside into huge central cities?

These cities will grow until they join together in seamless sprawls of steel and concrete canyons, shopping centers, and suburbs that stretch for hundreds of miles.

Experts say that by the year 2000, the largest of these sprawl cities will have a population of 60 to 70 million. Even in suburbia, people will have to "double up, like it or not." To cut costs for tomorrow's projected twice-as-big urban populations, the suburbs will have to grow up instead of out.

The Alternative

There is a better way to meet the needs of a growing population for living space.

We can revitalize the villages, towns, and cities of the countryside and build new towns and cities there.

We can reverse the flow of population to metropolitan centers, and in so doing, help big cities conquer the urban improvement job by easing the pressures exerted by a constantly expanding population.

We can use the countryside with all of its assets—space, beauty, outdoor recreation, moderate land and building costs, power, and underemployed people—as a site to expand industry and jobs.

We can use the countryside as a location for new research centers, colleges, and training schools.

We can use the countryside to meet the public demand for outdoor recreation, a demand which is expected to triple by the year 2000.

We can preserve in the countryside the maximum feasible number of family-type farms.

We can develop housing, community facilities, and jobs that will enable our towns, small cities and open countryside—when joined in functional, multicounty Communities of Tomorrow areas—to hold their young people and to provide living space for those Americans who would prefer to live, work, and play in, or close to, the great outdoors.

Much has been done, and more will be done, to make our large central cities more livable—partly by utilizing the opportunities of the surrounding countryside.

But these huge metropolitan centers will be hard pressed to absorb and provide for the growth of their own population.

Orderly and intelligent development of nonmetropolitan parts of this Nation can ease congestion and strife in our cities and give every person an opportunity to choose where he will work and raise his family.

That freedom of choice too often is unavailable today.

Communities of Tomorrow

Imagine, if you will, a time in the future when the American landscape is dotted with communities that include a blend of renewed small cities, new towns, and growing rural villages. Each is a cluster with its own jobs and industries, its own college or university, its own medical center, its own cultural, entertainment, and recreational centers, and with an agriculture fully sharing in the national prosperity.

Imagine hundreds of such communities that would make it possible for 300 million Americans to live in less congestion than 200 million live today—that would enable urban centers to become free of smog and blight, free of overcrowding, with ample parkland within easy reach of all.

A dream world? Not exactly. It is a world we can build, if we are willing to work for it.

These ideal communities *can in fact* be the Communities of Tomorrow.

What Will They Be Like?

The shape and nature of the Communities of Tomorrow will vary with the needs and desires of the people.

However, they will have certain basic characteristics.

First, the Community of Tomorrow will cover a much larger geographic area than today's community. It may extend over several counties. It will include a large or small city or two and a number of towns, villages, shopping centers, with open country in between. Together they will provide the economic, social, and cultural facilities for the area.

Second, the Community of Tomorrow will be natural in its geographic structure. Each of its components—villages, towns, cities, and counties—will be bound together by roads, rivers, and other physical and resource features that enable it to be a dynamic and fully functioning economic, social, and cultural unit.

Third, the Community of Tomorrow will offer a wide range of industrial jobs as well as a full range of employment in business, research, professional, and trade services. Other jobs will be available in government, in the field of public recreation, and in the arts. A wide variety of jobs will be filled by people simply providing services for other people.

How will all this differ from the troubled big cities of today?

Communities of Tomorrow will use space as an asset for a better life.

Rather than build ever larger, more impersonal cities, we will help people build communities where each individual can find a place, where each person can make a more important contribution to his community.

A National Effort

This effort to help the Nation and all its people enjoy the benefits of a vigorous and healthy countryside involves many Federal agencies.

President Johnson has directed the Secretary of Agriculture to work with other Federal departments to help them make their programs and services as readily available to people in town and country as they are to people in cities.

The Secretary of Agriculture is using USDA's Technical Action Panels in every nonmetropolitan county, in every multicounty district, and in every State to help people obtain whatever Federal and State services they need—to help them build Communities of Tomorrow.

Technical Action Panels are composed of USDA personnel stationed in field offices across the Nation, plus local officials of other Federal, State, and local agencies that offer programs useful to nonmetropolitan people. businesses, and governments.

Cooperative Federal-State Extension Service workers provide educational and organizational leadership.

These Panels work with local and State governments, development organizations, and community leaders to help them identify the assistance they need for economic, social, and cultural growth.

In the meantime, the Secretary of Agriculture and the heads of the other Federal departments are directing research and conducting studies:

To determine the economic and social costs of big city congestion and rural decline—including determination of who pays these costs and comparing costs of permitting increased concentration of people and industry with the costs of designing and implementing new programs to build Communities of Tomorrow.

To determine, from the human standpoint, the desirable maximum size, population, and industrial concentration for one city.

To establish a dollar value for an environment that encourages man to develop his talents and thus enrich his civilization.

To determine the cost of providing public services to differing intensities and patterns of population concentration.

To propose steps the States, local governments, and the private sector can take to attract and encourage people to settle in the countryside, to create job opportunities, and to build "new towns" and "new cities" outside metropolitan areas where there is space to live.

The findings will help develop and strengthen rural/urban balance policies and programs.

How Will These Communities Come Into Being?

Many Federal and State programs are available to help plan and finance community development projects. But without dynamic local leadership there can be little progress.

An informed and aroused public is a "must" in building Communities of Tomorrow.

It takes private citizens, organized into development groups and working with the area's municipal and county officials, to mount an effective community development effort.

Technical Action Panels are there to help—to work with the people, to help them organize, to survey their problems, to take stock of their resources, to formulate a plan of action and to carry it out. They also inform local leaders of all Federal and State programs they might use to develop proposed projects, and help them obtain whatever Federal or State aid they need from any agency.

People already are organized and at work in hundreds of towns and counties throughout the Nation. Many new and expanded communities have been formed and are moving ahead.

In some areas comprehensive planning is being carried out on a multicounty basis. New factories are springing up in the midst of cottonfields and cornfields.

Multiuse plans for our water and forest resources are being formulated. Manpower training programs, community colleges, and vocational technical schools are appearing in rural areas.

USDA is financing the construction or improvement of 50,000 rural homes each year. Every year USDA helps more than 1,000 rural communities obtain modern water or waste-disposal systems.

A vast network of superhighways is providing easy access to large sections of rural America.

We are not mounting a new effort to strengthen rural America from a standstill position. In the past 6 years a concerted drive has been underway to create public programs that would restore some rural/urban balance and enable rural people to gain a fair share of the fruits of the Nation's overall remarkable progress.

A partial list of such measures includes the Food and Agriculture Acts of 1962 and 1965, the Rural Water Systems and Sanitation Act, the Housing and Urban Development Act, the Appalachian Regional Development Act, the Manpower Development and Training Act, the Elementary and Secondary Education Act, the Public Works and Economic Development Act, and the Economic Opportunity Act.

There is a new spirit permeating rural America.

But the biggest steps in the revitalization of the countryside remain to be taken.

Bracing Up the Communities of Tomorrow

To support the development of Communities of Tomorrow the Department of Agriculture has established policies and methods to conduct programs in 12 supporting areas:

1. Planning

2. Farming and Ranching

3. Business and Industry

4. Community Facilities

5. Elimination of Poverty

6. Education and Job Training

7. Housing

8. Outdoor Recreation and Natural Beauty

9. Natural Resource Conservation and Development

10. Health and Welfare

11. Food

12. Transportation

1. Planning

Sound multicounty planning is basic to the Communities of Tomorrow.

The development plan must be comprehensive. It must describe the area, its resources, its problems, its opportunities, the development objectives, the proposed projects to improve the area's economy and its social and cultural facilities and services, and the interrelationship between the various projects. It must take into consideration the needs of both skilled and unskilled people.

Lack of a comprehensive plan has frustrated the development of many towns.

When these towns applied for Federal or State aid, their applications often failed to spell out the full potential of the proposed project. This has caused delays and too often lingering death to many proposals.

When these towns tried to attract private industry, they often lost out because they had no comprehensive plan to develop needed public services nor to develop recreation that would make the town more attractive to industry executives and workers.

Many small towns found, however, they could fill the economic, social, and cultural needs of their people by pooling resources with neighboring towns, counties, and cities in a comprehensive development effort.

Multicounty planning will be the rule in Communities of Tomorrow.

Such planning, for maximum effectiveness, should be coordinated with a consistent and purposeful national land use policy.

In support of proper planning in Communities of Tomorrow, it is USDA policy:

To help people organize and plan on a multicounty basis.

To encourage comprehensive multicounty planning among rural areas development groups.

To encourage and enable individual counties and municipalities within multicounty communities to participate fully in development of the broader community.

To give preference to project applications that are part of a locally developed, comprehensive, multicounty plan, and to encourage other Federal and State agencies to do likewise.

To encourage proper use of land and water resources in comprehensive planning and in implementation of zoning and other land use improvement measures.

To encourage economic planning that emphasizes human development as well as natural and economic resource development.

To make available to Community of Tomorrow planners USDA expertise in housing and in development of community facilities.

To provide applicable technical and professional assistance and basic data as they relate to the use of soil, water, woodland, and other natural resources.

To provide a national land use policy that would provide guidelines for multicounty planning.

To encourage planning of communities in which homes are in close proximity to job opportunities, recreation areas, community centers, and schools.

To encourage planning of communities in which there is a place for people who are highly skilled and those who are relatively unskilled.

To help other Federal agencies extend their planning services into rural areas.

2. *Farming and Ranching*

In the Communities of Tomorrow a wide variety of farms will be needed.

With adequate income, commercial family farms and ranches will produce the bulk of the food and fiber.

Techniques and policies must be adopted to enable family farmers to continue to compete effectively in agriculture.

However, in addition to commercial family farms, we must develop opportunities for people who want to farm on a part-time or subsistence basis—for people who because of physical or other handicaps are limited to smaller operations, and for the elderly who wish to remain on their farms in a retired or semiretired state. There must be programs for low-income farmers, as well as new-era farm commodity programs to enhance the bargaining power of commercial family farms.

The farming system should be flexible enough to enable young farmers to get started and to remain in farming.

The programs that are oriented toward helping low-income farmers increase their incomes from farming must recognize this as a social problem more than an agricultural one and must be structured accordingly.

Included in such programs should be measures to provide needed resources and improved management skills, to permit adoption of new production techniques, and to develop marketing facilities.

When commercial farmers and ranchers hire workers, the workers and their families must receive adequate incomes.

Conservation and proper use must be made of all of the soil, water, forest, grassland, and wildlife resources on our farms.

In support of more attractive and varied farming opportunities in the Communities of Tomorrow, it is USDA policy:

To help direct the forces of change so that commercial farms and ranches of the future are owned and managed by the people who work them.

To help commercial family farmers and ranchers obtain the bargaining power they need to get a fair return for their investment and labor.

To maintain balance between supply and demand of farm commodities.

To provide the financial and technical help farmers need to become firmly established on the land and to adjust their farming operations.

To help—to the extent possible—to find farms for people who want to farm and who have farm skills or a farm background.

To work with low-income farmers to increase their farm incomes.

To help farm laborers acquire the rights and status of American labor.

To encourage measures that conserve our land, water, forests, grasslands, and wildlife.

To encourage part-time farming where farmers want to combine farm and off-farm employment.

3. *Business and Industry*

The major reason for the present rural/urban imbalance of people and opportunity is the relative availability of jobs in metropolitan centers—and the lack of jobs in smaller cities, towns, and the countryside.

Between 1945 and 1960, economic growth created more than 13.5 million jobs in the United States. But, in effect, all the net gain took place in large urban centers. New business and industrial jobs in towns and smaller cities were offset by rural job losses in agriculture, mining, and other resource-based industries. As the national demand for labor declines, rural counties experience the first and greatest decline.

However, a recent study indicates improvement in the rural job situation. In 1962, 1963, and 1964, when an average of 1.2 million new jobs a year were added to the national economy, the study shows that 800,000 jobs a year were created in large cities, or standard metropolitan statistical areas, and that 400,000 jobs a year were created in counties with no city as large as 50,000 population. Movement in the right direction has started.

These 400,000 new jobs a year are about two-thirds the number needed to stop the flow of people from countryside to city centers. To maintain this growth in jobs we need a rapidly expanding national economy.

Communities of Tomorrow must expand job opportunities fast enough to absorb the countryside's natural population growth and to provide jobs for those who would prefer to move from impacted city centers to less densely populated areas.

Jobs can be created by expanding industry, business, and agriculture; by developing health, education, and recreation facilities; by building new homes and community facilities; and by providing all the services demanded by a prosperous, progressive society.

Most jobs will be created by investor-owned private business. Other jobs will be generated by private rural cooperatives, which, in 1965, provided 193,000 jobs—a number that expands each year—outside our major cities. Federal and State Governments will also have job-generating responsibilities in rural areas.

The town, small city, and open countryside that will become Communities of Tomorrow already have much to offer businessmen: Plant sites that cost less to buy, less to build on; space for plant expansions; space to park; a stable and willing work force; and an opportunity to live within easy commuting distance of job and outdoor recreation areas.

In support of the economic development of Communities of Tomorrow, it is USDA policy:

To inform businessmen of the economic and personal benefits of locating new plants outside areas of congested traffic, impacted population, and high-cost commuting.

To encourage the development—including financial support where needed—of training programs and electric, telephone, transportation, housing, water, waste disposal, recreation, and cultural facilities. Facilities will encourage industries, businesses, services, and other job-creating enterprises to locate where there is space and need for them.

To develop public and private financial support for enterprises that will create jobs in Communities of Tomorrow.

To encourage incentive plans that will induce new business and industry to locate in Communities of Tomorrow.

To encourage and facilitate growth of new and existing rural cooperatives to provide jobs and increased economic opportunity.

To encourage Federal agencies to locate new installations in Communities of Tomorrow where feasible and, when awarding contracts, to give special consideration to developing rural areas.

To work with rural leaders to help develop in rural communities an understanding of the importance of developing industrial financing, zoning regulations, essential community facilities, and other resources needed to attract industry.

To help other Federal agencies extend their community facility development services into rural areas.

4. Community Facilities

To attract people and industry, a community must develop modern public facilities and offer its citizens a full range of services.

Industry demands fully adequate central water and sewer service, transportation facilities, fire and police protection, and electric and telephone service.

In addition, to be an attractive place to live a community needs recreation centers, modern schools, public hospitals and clinics, libraries, theaters, art galleries, community centers, and other facilities and services.

In support of the development of adequate community facilities for the Communities of Tomorrow, it is USDA policy:

To provide the financial and technical help communities need to develop modern public facilities and services required for a viable economic community.

To help residents of Communities of Tomorrow obtain public services at a cost comparable to similar services in densely settled areas.

To expand research into ways to lower the costs of such rural public services.

To encourage the development of rural libraries that are flexible enough to bring well-developed, modern library services to rural areas, including the expansion of the bookmobile service.

5. Elimination of Poverty

Of the more than 17 million poor people in nonmetropolitan areas, about 12 million are white, more than 4 million are Negro, and 250,000 are American Indians. Many of these people, particularly hired farmworkers, have part-time or seasonal jobs that provide them with such small incomes they are all but unemployed. This underemployment amounts, in effect, to about 15 percent of the people between the ages of 20 and 64 in the nonmetropolitan labor force being unemployed.

To help Communities of Tomorrow recognize and eliminate discrimination and poverty, it is USDA policy:

To seek new ways of making the poor and minority Americans aware that assistance is available to them and to develop ways they can make better use of this assistance.

To encourage an "across-the-board" approach to needy individuals—for example, to couple basic education and cultural advancement with job training and placement.

To encourage low-income people to pool their resources and talents in cooperative endeavors that will enable them to achieve goals they cannot reach alone.

To help establish opportunity centers at appropriate locations to provide minority and low-income families with guidance, advice, legal counseling, public assistance, education, training, job placement, and—if needed—housing.

To cooperate fully with all public and private agencies and organizations that strive to eliminate poverty.

To seek new ways of involving low-income and minority groups in the development of programs that will strengthen their economy, make them an integral part of the leadership of their communities, and make it easier for them to attain their educational and cultural goals.

To make certain that low-income families who benefit from one type of government assistance are aware of all of the services available to them.

6. Education and Job Training

The educational attainments of many youngsters in the country now fall far behind that required for full employment in the Community of Tomorrow. For example, the rural school dropout rate is 33 percent for 18- and 19-year-olds. Nineteen percent of the rural children aged 14 and 15 are behind in their schooling.

The Communities of Tomorrow must have modern and dynamic educational systems that meet the needs of each citizen.

In support of the highest level of educational development in Communities of Tomorrow, it is USDA policy:

To help other Federal and State and local agencies strengthen rural education more effectively.

To make full use in the Communities of Tomorrow of the land-grant system of research, teaching, and extension education.

To give personal counseling and guidance through USDA services for community development to individuals and groups.

To make available to educational leaders in the new communities the knowledge USDA has gained through the years in development and execution of rural educational and action programs.

To support incomes for teachers and school administrators that are high enough to attract the most able and well qualified.

To support the development of vocational education and training which will help old and young to meet the changing demands for skilled labor and technical proficiency required by most industries today.

To encourage the development of vocational technical schools, community colleges, and manpower training programs in rural areas.

To encourage the development of school systems that are keyed to the needs of the communities in which they are located.

7. *Housing*

Much of the housing in rural America is bad. About 1 million of the houses are unfit for human habitation.

One in eight low-income rural people lives in a dilapidated house. One in two lacks piped hot water or flush toilets.

In support of adequate housing for all who will live in the Communities of Tomorrow, it is USDA policy:

To expand existing housing programs, with special emphasis on programs such as self-help housing where owners provide most of the labor to build their homes; rental and other housing projects that include a component of Federal cost sharing; cooperative housing; loans and grants for farm labor housing, and housing adapted to the needs of the elderly.

To encourage development and use of government-backed programs that reduce the cost of housing for low-income families by some form of cost sharing.

To encourage experimentation in construction methods to reduce the cost of housing.

To help people make use of the housing programs of other Federal, State, and local agencies.

To work with private groups in the development of housing in rural areas.

8. *Outdoor Recreation and Natural Beauty*

Americans spend $20 billion a year for outdoor recreation. By 1980, this expenditure is expected to be about $47 billion. By 1980, this recreation boom should create 200,000 new full-time jobs in small cities and open countryside. These jobs will range from directing ski resorts, shooting preserves, and golf courses to providing support services, such as lodging, food, service stations, bait and tackle shops.

Coupled with this effort to expand outdoor recreation is a drive to beautify the countryside, to make its cities, towns, and open spaces more attractive and inviting. Natural beauty is more than a rich source of pleasure. It shapes our values, molds our attitudes, and feeds the spirit.

To help develop outdoor recreation and natural beauty in Communities of Tomorrow, it is USDA policy:

To assure balance in outdoor recreation through comprehensive planning.

To provide technical and financial help that stimulates development of privately owned recreation on a profit-making basis.

To provide technical and financial assistance to rural communities for the development of public recreational facilities.

To make full use of publicly owned resources in meeting recreational demands through multiple-use planning and management, coordination with the private landowners, protection of wilderness values, and responsive facility development.

To encourage public hunting, fishing, and hiking on lands where farmers use Federal funds to make land use adjustments or to install conservation measures.

To help counties and municipalities buy cropland not needed for production of crops and convert it to open space, wildlife habitat, beautification, recreation use, or use for control of air or water pollution.

To provide research, technical advice, and other services that help the public and interested organizations fight costly despoilers of natural beauty—fire, floods, erosion, plant diseases, harmful insects and other pests, and water, air, and soil pollution.

To emphasize natural beauty in conservation and resource development work where the Department provides technical advice or financial support.

9. *Natural Resource Conservation and Development*

By the year 2000, the land and water resources we use today will have to provide:

—Double the food output.

—Double the water for municipal use; quadruple the amount for manufacturing use.

—Double the land for homes, schools, factories, and other urban uses.

—Double the production of wood products.

—Fifty percent more irrigation water.

Creative conservation policies and programs can meet this need while upgrading the quality of the environment and strengthening the economy and standard of living in Communities of Tomorrow.

To help develop resource potential in Communities of Tomorrow, it is USDA policy:

To provide research, technical advice, and financial support to achieve multipurpose, multicounty resource development that will provide greater employment in resource-based industries.

To help landowners use and care for every acre in accordance with our national interest.

To offer technical advice and guidelines to county and municipal governments, State agencies, and others in the selection of proper sites and in land erosion control in the building of homes, highways, and other facilities.

To assist communities in the development of pollution control programs.

To help local leaders organize soil and water conservation districts, resource conservation and development projects, grazing associations, drainage districts, and similar undertakings.

10. *Health and Welfare*

Small towns today are short of health and welfare facilities and professional medical personnel. Rural residents have less than half the adequate number of doctors and less than a third the adequate number of dentists.

One out of 10 rural people has a chronic health condition that limits his activity; more than 2 in 10 farmworkers have such conditions.

The Communities of Tomorrow must have adequate health facilities for all.

In support of development of adequate health and welfare facilities in the Communities of Tomorrow, it is USDA policy:

To encourage development of public assistance programs that support needy families at an adequate level.

To encourage planning, financing, and construction of clinics, hospitals, healthmobiles, nursing homes, diagnostic and treatment centers, and other health facilities adapted to the needs of rural areas.

To encourage programs that will give doctors and nurses adequate incomes for their work in less densely populated areas.

To help other Federal agencies extend their health and welfare services into rural areas.

To encourage development of programs that will enable the recipients of public assistance to become partially, and, if possible, entirely self-supporting.

To encourage the construction of child development centers that will enable children of working mothers to have the advantages of supervision and cultural enrichment during their formative years.

To encourage special programs and facilities for the mentally retarded and physically handicapped in rural areas.

To encourage programs that will increase the number of personnel trained in health and welfare services.

To encourage programs in rural areas that provide needed training in first aid, medical self-help, accident prevention, and physical fitness.

11. Food

Millions of Americans, in both small towns and large cities, do not receive balanced diets. As a result their physical growth and their mental development is stunted and their lifespan shortened.

In the Community of Tomorrow each person must be well nourished.

In support of adequate diets for all in Communities of Tomorrow, it is USDA policy:

To maintain a family farm agriculture capable of meeting the food needs of all our people.

To support food programs that will fill whatever gap is unfilled by rising incomes.

To encourage education that gives homemakers knowledge of a proper diet and how to select and prepare food in appetizing, nourishing ways.

12. Transportation

Improved transportation facilities are needed to spur economic development and to make the movement of people and goods easier among towns and small cities. Three out of 10 rural residents cannot now conveniently commute to a city of 25,000 population. Yet, parity of economic opportunity demands transportation facilities and services equal to those commonly found in cities of 50,000 population and up.

Regular, highly efficient public transportation must provide easy access to education, training, and jobs in the Communities of Tomorrow.

To help develop the transportation needed in Communities of Tomorrow, it is USDA policy:

To include transportation as a part of community development.

To help other Federal and State departments and agencies identify the special transportation problems of low-density population areas and to help them extend services or develop programs to meet these needs.

To encourage development of a public transportation system that will provide easy access to educational and training facilities and employment opportunities.

This document outlines in broad terms the solution to the imbalance of people and opportunity: A new type of community, neither urban nor rural, but possessed with the highest values of both; a functional, multicounty Community of Tomorrow that blends the economic and cultural opportunities of affluent metropolitan life with the space and beauty of the countryside.—

ORVILLE L. FREEMAN, *Secretary of Agriculture.*

(The following article is included at this point in the record at the specific request of Representative Curtis:)

[Reprinted from: *Review*, Federal Reserve Bank of St. Louis, February 1968]

CHANGING SOURCES OF FARM CREDIT*

I have been requested to discuss the changing sources of farm credit and means whereby businessmen can influence the paying habits of farmers. It is to the first item, namely, the changing sources of farm credit, that I would like to direct most of this discussion. Then, based on some conclusions relative to farm credit sources and the changing structural pattern of agriculture, I shall make some concluding comments on farm debt repayment.

At the beginning I might say that outside credit has played a relatively minor role in financing our agricultural plant. Most farms have been largely financed internally. Much of the physical capital as land clearing, drainage, fencing, and building was produced on the farm by the farm family. Only in the past few decades has a large portion of farm capital been acquired through off-farm purchases, and many of these capital inputs were covered by savings of the farm family.

Since 1948 credit used by farmers has not exceeded 17 per cent of total farm assets, and in the 6 years prior to 1954 the volume of farm credit outstanding was less than 10 per cent of total farm assets (Table I). In comparison, credit used by manufacturing establishments has accounted for a much greater portion of total assets. During the period 1948 to 1967, inclusive, total liabilities of all manufacturing corporations, excluding newspapers, on the basis of book value never fell below 28 per cent of total assets. Furthermore, in 1967 debt exceeded 40 per cent of the assets of these firms.

Although the spread in debt-to-asset ratios of farms and manufacturing firms remains quite wide, it has declined steadily since 1948. At that time debts totaling 31.2 per cent of assets in manufacturing were 4.3 times the per cent of debts to assets in agriculture. Since then the per cent of debts to assets in both industries has risen steadily. However, the per cent in agriculture rose at a greater rate than in manufacturing, and in 1967 the per cent of debts to assets in maufacturing was only 2.4 times that in agriculture.

Internal financing of agriculture has thus declined substantially since 1948 relative to total farm capital, and credit has played an increasing role in farm capital accumulation.

As implied in the subject of this discussion, farm credit sources are changing. The change, however, has been gradual rather than revolutionary. It is when we view farm credit over the past half century that major contracts appear. Significant changes have occurred in both number of competitor groups in the business and the relative portion of farm credit supplied by each group.

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*Speech by Darryl R. Francis, president, Federal Reserve Bank of St. Louis, at Chemical Dealers' "Independence Day" meeting, Tan-Tar-A, Lake of the Ozarks, Osage Beach, Missouri, December 13, 1967.

TABLE I.—TOTAL DEBT AS PERCENT OF TOTAL ASSETS, AGRICULTURE AND MANUFACTURING [1]

	Agriculture (1)	All manufacturing corporations (2)	Ratio of (2) to (1)
1948	7.3	31.2	4.27
1949	8.5	30.2	3.55
1950	9.4	28.0	2.98
1951	8.6	33.6	3.91
1952	8.8	36.1	4.10
1953	9.8	36.2	3.69
1954	10.5	34.9	3.32
1955	10.7	33.9	3.17
1956	11.1	35.0	3.15
1957	10.9	35.8	3.28
1958	11.0	33.9	3.08
1959	11.7	33.7	2.88
1960	12.2	34.4	2.82
1961	12.8	34.2	2.67
1962	13.5	35.2	2.61
1963	14.4	35.8	2.49
1964	15.2	36.1	2.38
1965	15.7	37.8	2.41
1966	16.3	39.7	2.44
1967	17.0	41.1	2.42

[1] Data as of the 1st quarter of each year. Farm assets based on current market value and assets of manufacturing corporations based on book value.

Source: Balance Sheet of Agriculture, USDA; Quarterly Financial Report for Manufacturing Corporations, Federal Trade Commission-Securities and Exchange Commission.

FARM MORTGAGE CREDIT

Prior to the 1900's, most farm mortgage credit in the United States was supplied by individuals and other noninstitutional sources. A recent study of farm mortgages recorded in Tippecanoe County, Indiana, shows that individuals supplied more than three-fifths of all such credit extended in this county in each of the years 1865–1880, inclusive. In the four years 1865–1868, inclusive, such loans by individuals accounted for more than 90 per cent of the total.[1] Similar results were obtained in a study of farm mortgage credit in Champaign County, Illinois, for the same period. Individuals supplied more than three-fourths of all such credit in this county during the 16-year period.[2]

Since the turn of the century, a relative decline has occurred in the per cent of farm mortgage credit supplied by noninstitutional lenders. Conversely, the per cent supplied by institutional sources has consistently increased. For example, in 1910 institutional lenders supplied only 25 per cent of the outstanding farm mortgage credit in the nation, while in 1967 the amount supplied had increased to 60 per cent. Despite the recent increase in use of land contracts, which tend to increase seller-financed farm transfers, the per cent of farm mortgage debt held by institutions has remained stable since 1960.

[1] Jay Ladin, "Mortgage Credit in Tippecanoe County, Indiana, 1865–1880," *Agricultural History*, January 1967, pp. 37–43.
[2] Robert F. Severson, Jr., "The Source of Mortgage Credit for Champaign County, 1865–1880," *Agricultural History*, July 1962, p. 154.

TABLE II.—FARM MORTGAGE DEBT HELD BY PRINCIPAL LENDERS

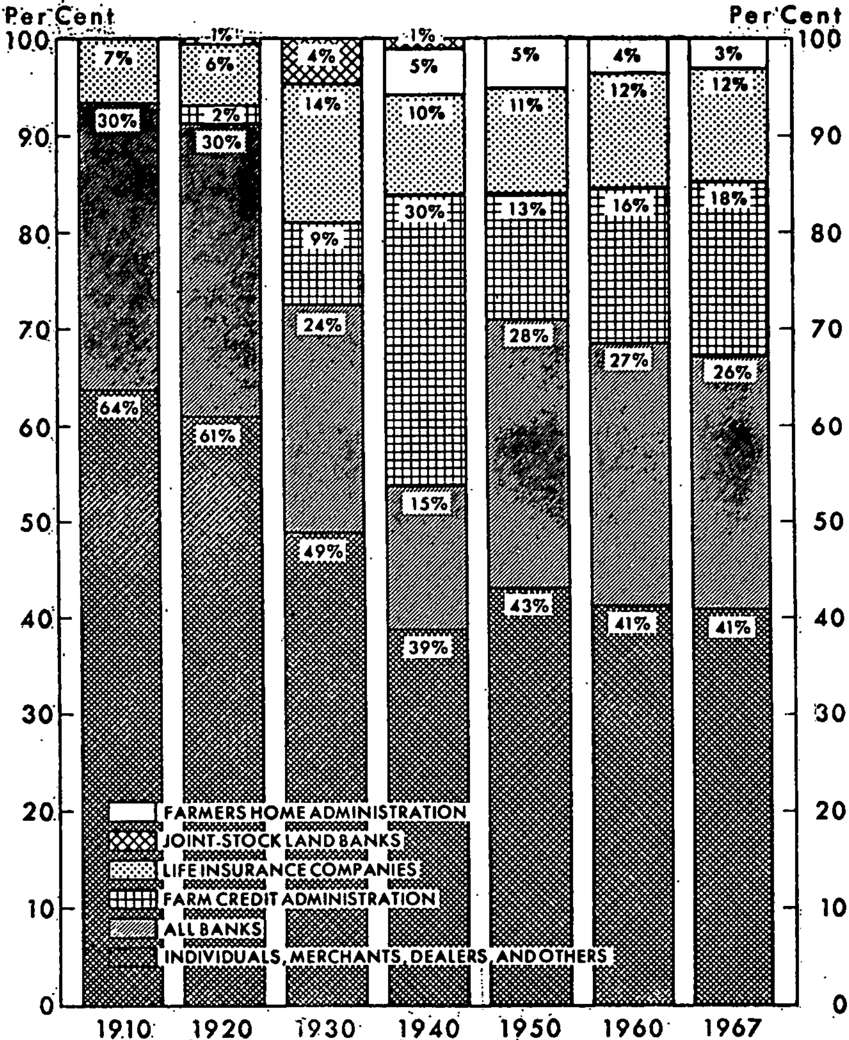
[In millions of dollars]

	Federal land banks and FFMC	FHA	Life insurance companies	Joint-stock land banks	All operating banks	Individuals and others	Total debt
1910			387.0		406.2	2,414.7	3,207.9
1915			670.0		746.1	3,574.7	4,990.8
1920	293.6		974.8	60.0	1,204.4	5,915.9	8,448.7
1925	923.1		1,942.6	446.4	1,200.5	5,400.1	9,912.7
1930	1,201.7		2,118.4	637.8	997.5	4,675.3	9,630.7
1935	2,564.2		1,301.6	277.0	498.8	2,942.9	7,584.5
1940	2,723.1	32.2	984.3	91.7	534.2	2,220.9	6,586.4
1945	1,557.0	195.5	938.3	5.5	449.6	1,795.1	4,941.0
1950	964.7	193.3	1,172.3	.3	937.1	2,311.5	5,579.2
1955	1,279.8	287.2	2,051.8		1,210.7	3,415.8	8,245.3
1960	2,335.1	439.3	2,819.5		1,631.3	4,857.2	12,082.4
1965	3,686.8	619.5	4,287.7		2,668.5	7,631.8	18,894.3
1967	4,914.5	585.4	5,219.7		3,169.5	9,421.9	23,311.0

Source: USDA.

Only two major institutional lender groups, commercial and savings banks and life insurance companies, were in the farm mortgage credit business in 1910 (Table II). With the creation of the Federal Land Banks in 1916 a third major credit supplier entered the field, and in the 1930's the Farmers Home Administration (Farm Security Administration) was created to finance high-risk farm mortgages with Government assistance. The land bank system through sale of bonds provided farmers with another excellent credit pipeline to the nation's financial centers.

Per Cent of All Farm Debt Held by Principal Lenders



Sources: USDA, Credit supplied by merchants and dealers estimated for years prior to 1940.

Each of the three major groups of financial institutions supplying farm mortgage credit has over the years either held their relative positions or supplied an increasing proportion of the total, except during the Great Depression of the thirties. The Federal Land Banks and life insurance companies, which have better pipelines to financial markets, have supplied relatively larger portions than commercial banks which rely primarily on local funds, and are often short of mortgage credit supplies. The share held by the Land Banks rose steadily from the date of their organization through the 1920's. With substantial Government assistance they undertook emergency mortgage financing in the mid-1930's, and their share rose rapidly. After the liquidation of these loans in the 1940's and early 1950's, the Land Bank's share again increased and accounted for 21 per cent of the total in 1967. The share held by life insurance companies rose from 12 per cent of the total in 1910 to 22 per cent in 1967. The share held by commercial and savings banks rose from 13 to 14 per cent of the total during the period.

In addition to the expanded role of the three major institutional suppliers of farm mortgage credit, the group listed under the heading of "individuals and others" may have expanded from its composition of earlier years. In the late Nineteenth Century this group was probably composed almost entirely of individual investors, which included primarily relatives and acquaintances of borrowers, and a small number of other individuals.[3] More recently, however, this group consists of a number of other lenders, including endownment funds of schools, fraternal societies, cemeteries, hospitals, etc.[4]

The evidence thus indicates that the supply side of farm mortgage credit markets has increased in competitiveness. The number and types of agencies in the business have increased and the geographic area covered by some has been enlarged. Insurance companies and the Federal Land Bank have tapped the national financial markets for farmers, greatly supplementing local sources of farm mortgage funds. Furthermore, both operate on a nation-wide basis. In contrast, prior to the turn of the century the Federal Land Banks had not been created, and the relatively small portion of mortgage credit supplied by insurance companies was limited primarily to the Corn Belt states. Indicative of the more expansive area coverage of insurance loans during recent years are the data on such loans in specific areas. In 1930 insurance companies held less than 0.2 per cent of the farm mortgage debt in the Northeast and less than 8 per cent of the total in the Mountain and Pacific states. In 1967 they held 3.4 per cent of the total in the Northeast and 27.4 and 17.0 per cent, respectively, in the Mountain and Pacific states.[3]

NON-REAL-ESTATE FARM CREDIT

Non-real-estate farm credit supply groups have also increased since 1910. Even to a greater extent than mortgage lenders, this groups was dominated by local suppliers well into this century. Local banks, dealers, merchants, and other local sources were almost the only extension by the Federal Intermediate Credit Banks and the Farmers Home Administration (emergency crop and feed loans) in the mid-1920's (Table III). In the mid-1930's the Production Credit Associations entered the short-term farm credit supply market and have become a major source of such loans.

It is generally believed that merchants, dealers, and other non-reporting lenders held at least 50 per cent of all non-real estate farm credit prior to the 1940's. Since early 1940, however, the per cent of the total held by this group of lenders has declined, and by early 1967 it accounted for only 41 per cent of all non-real estate farm credit outstanding.

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[3] Severson, *Ibid.*
[4] William G. Murray and Aaron G. Nelson, *Agricultural Finance* (Ames, Iowa: Iowa State University Press, 1961), p. 266.
[5] USDA, *Agricultural Finance.*

TABLE III.—NON-REAL-ESTATE FARM DEBT HELD BY PRINCIPAL LENDERS

[In millions of dollars]

	All operating banks	PCA	FICB	FHA	Nonreporting creditors	Total
1910	1,350.0				1,350.0	2,700.0
1915	1,606.0				1,606.0	3,212.0
1920	3,453.8				3,453.8	6,907.6
1925	2,674.2		18.8	2.5	2,695.5	5,391.0
1930	2,490.7		47.3	8.0	2,546.0	5,092.0
1935	627.9	60.5	55.1	203.9	947.4	1,894.8
1940	900.1	153.4	32.3	418.0	1,500.0	3,003.8
1945	948.8	188.3	29.8	452.6	1,100.0	2,719.5
1950	2,048.8	387.5	50.8	346.7	2,300.0	5,133.8
1955	2,933.9	577.0	58.3	417.2	3,200.0	7,186.4
1960	4,819.3	1,361.2	89.6	397.6	4,900.0	11,567.7
1965	6,990.0	2,277.5	124.7	643.9	7,100.0	17,136.1
1967	8,533.5	3,015.6	156.9	737.5	8,800.0	21,243.5

Source: USDA, except for loans by nonreporting creditors prior to 1940. Credit by this group before 1940 estimated on the basis that such credit equaled that provided by banks and the federally sponsored agencies. For further discussion see: Alvin S. Tostlebe, "Capital in Agriculture," a study by the National Bureau of Economic Research, Princeton University Press, Princeton, 1957, p. 160.

Commercial banks have been the largest single institutional supplier of non-real estate farm credit throughout the period since 1910. It is generally believed that banks supplied about 50 per cent of such credit until the 1930's when the Production Credit Associations and the Farmers Home Administration began operations. Following this additional competition, the per cent held by both banks and non-reporting creditors declined. The banks' per cent of such credit fell sharply in the 1930's, picked up somewhat in the 1940's, held about steady in the 1950's, and has declined somewhat since 1960.

Similar to movements in farm mortgage credit, suppliers of non-real estate farm credit have probably become more competitive in recent decades. Since the early 1930's one major supplier, the PCA's, which can tap the nation's financial markets through the Intermediate Credit Banks, has been added to the credit source group. The Farmers Home Administration has been created to finance the high-risk credit demand with government assistance. In addition, numerous agribusiness corporations with great financial backing have entered the farm financing field in the merchant-and-dealer category in order to enhance sales of farm supplies. These additions have broadened both the number of opportunities for farmers to obtain short-term credit in any locality and the areas in which such funds can be assembled for farm use.

A combination of farm mortgage credit and non-real estate farm credit further points up the changes in farm credit supplies. On the basis of estimates for merchant and dealer credit, which probably understate the amount of such credit in the earlier years, non-institutional credit to farmers has declined relative to the total, from 63.7 per cent in 1910 to 40.9 per cent in 1967. This relative decline has been fairly consistent, except for a few years immediately following World War II when the public had an abundance of liquid assets, and since 1960, a period of rapid expansion in the contract selling of real estate which tends to enhance seller financing of real estate transfers. Despite the rapid growth of seller-financed farms, which offer sizable tax advantages to the seller, the long-term downswing in per cent of farm credit financed by non-institutional sources had not been reversed.

Farm credit supplied by the major institutional lenders has, on the other hand, increased in most decades. About 30 per cent of all farm credit was probably supplied by commercial banks during the 1910–20 decade, a declining proportion during the 1920's, and a sizable further decline during the first half of the 1930's. The per cent held by banks rose from the mid-1930's to the early 1950's and has remained about stable at near the 1910–20 proportion since 1950.

The agencies of the Farm Credit Administration, with the exception of a major bulge during the Depression of the 1930's, followed by a sharp contraction in the 1940's, have shown a fairly consistent gain in per cent of farm debt holdings. Also, insurance companies have increased their proportion of farm debt during most of the decades since 1910.

Most of the relative gain by insurance companies was made by the early 1920's when their holdings exceeded 10 per cent of the total. Since then, their share has remained within 10 to 15 per cent of the total.

Following the establishment of the Farmers Home Administration in the early 1930's,[6] its relative portion of the farm debt gained steadily until the mid-1940's. This agency, designed to provide subsidized credit to low-income farmers, held at its peak over 8 per cent of the total farm credit outstanding. By 1950, however, its share had declined to 5 per cent of the total, and it has not exceeded 5 per cent since that time.

With these data on farm credit trends by the various lending agencies as background, we can summarize farm credit supply developments as follows:

1. Farm credit, like farming itself, is becoming more commercial and less dependent on relative, friend, neighbor, and merchant relationships. Financial institutions currently supply more than 60 per cent of the total, and their portion has generally increased since 1910, with the exception of a short period following World War II when individuals, merchants, and dealers had excessive quantities of loanable funds.

2. With the entry of more financial institutions into the farm credit business and the relative decline of nonfinancial institutional lending, farm credit supplies have become less personal. This tends toward greater efficiency in the industry. Credit and credit purchased resources will flow to the more efficient users as determined by the impersonal officials of the financial agencies. Those users provide the greatest returns to capital and can more readily repay debts.

3. The closer ties of farm credit to the financial markets, as represented by the life insurance companies, the Farm Credit Administration, and to a lesser extent, commercial banks through the correspondent banking system, mean a more reliable supply of farm credit but perhaps greater fluctuations in interest rates. With such ties, credit at some price will probably be available to any farmer in the absence of legal restrictions, provided he meets the usual credit requirements of the lender. The same sources of funds, however, reflect relatively wide interest rate fluctuations, and the credit agencies which rely on such sources must ultimately reflect such rate changes in loans to farmers. In the financial markets, interest rates are determined by the demand for and supply of loanable funds nationally. The rate is thus determined by the productivity of such funds in all potential uses. To gain control of such funds the farmer must thus pay the wholesale rate plus the cost of retailing.

4. Farm credit ties to the nation's financial markets assure more uniform interest rates to farmers throughout the nation, given similar lending costs and risks. Prior to these ties, rates paid by farmers may well have been determined by local supply and demand conditions. In such isolated markets, rates may have been greater or less than rates which reflected national credit conditions. With national funds available, however, local areas where rates are relatively high will attract funds from other areas until local and national rates are equalized after allowing for risk and lending costs differentials.

5. I shall also contend that the relative decline of farm credit by nonfinancial institutional groups was not caused by a decline in competition from these groups, but is the result of increased competition for farm debt on the part of the farm credit institutions. As evidence, we have in the Farm Credit Administration one additional source of farm real estate credit (the FLB's) and one additional source of non-real estate credit (the PCA's) available to every potential farm borrower. In addition, the insurance companies have made available farm real estate credit to most potential users in the nation. Evidence also indicates that commercial banks are more aggressive in the farm credit market than during the first quarter of the century. Large numbers of banks have hired agriculturally-trained men to head farm departments. These men are specially trained for making credit available to farmers. Also, most banks now have substantial non-farm deposits to draw on for farm lending purposes. Such accounts are more stable seasonally than accounts originating in primarily farming communities. Thus, larger credit supplies are available for farm use during the seasonal shortage of farm deposit accounts. Banks also have better arrangements with city correspondents and other outside sources such as insurance companies to draw on for overlines, real estate credit, or general credit shortages.

What is the meaning of these developments to merchant and dealer credit suppliers? I believe that most farm credit demands are being adequately met at competitive rates. If good credit-risk farmers are already receiving adequate credit supplies, extensive gains in merchant and dealer credit is unlikely, except

[6] The Resettlement Administration in the early 1930's later called the Farm Security Administration.

at great risks. I would suggest that for such credit to succeed over the longer run, it must meet the following tests:

1. It must be made on a sound basis through proper credit analysis by a credit expert and not primarily by sales personnel.

2. Such credit, if tied to the sale of a particular farm input, must not create an imbalance in the farming operation. Given the fact that most farms are eligible for a limited amount of credit, if excessive amounts are used for one purpose, leaving insufficient amounts for other purposes, the excess may cause the farm to be inefficient. Thus, such credit that causes an imbalance in the farming operation may ultimately lead to failure.

3. The provision of merchant and dealer credit must be made on an efficient basis. If nonfinancial groups can supply credit as efficiently as the financial agencies, healthy competition can be maintained. On the other hand, loanable funds are a scarce resource and cannot be supplied without costs by any lender. Funds must ultimately be purchased from savers, excluding the small increments added through monetary actions. The retailing of funds also requires a margin. Such costs must be eventually covered by rates charged or absorbed in the price of goods sold. Thus, the test for who gets the credit supply business will be determined by who can purchase and sell funds most efficiently.

4. Farming is now being done on narrower margins than formerly, and risks are greater. In 1965 purchased inputs and other expenses amounted to more than three-fourths of total farm product sales. As indicated earlier, debt exposure is also greater. With the narrow margin of profit and the inability of the farmer's own and unpaid family labor to absorb the losses on modern, high-capacity farms, attention must be focused on the reliability of credit analysis. Under these conditions, success in the farm credit business is not likely to be attained through all-out exertions to build up volume alone, but through a combination of sufficient volume of business to achieve efficiency and wise selection of risk to avoid excessive losses and collection costs.

In summation, agriculture has historically been financed internally. Credit has accounted for only a small proportion of total capital. Credit as a proportion of farm assets has, however, steadily increased in recent decades. With the rising demand for farm credit new specialized farm credit agencies have been developed, and a further expansion of the other financial agencies which were already in the field has occurred. With these developments credit supplied by the noninstitutional groups such as merchants, dealers, and individuals has declined relative to the total. I believe that this decline is the result of more intensive competition in the farm credit business rather than a voluntary withdrawal of the individual, merchant, and dealer group.

Now let's return to a portion of my original subject "How can businessmen influence the paying habits of farmers?" First. I shall reiterate that there is no substitute for good credit analysis. The soundness of the credit extended is the most important factor in determining whether or not it will be repaid. I believe that the repayment habits of farmers or any group are more likely to be associated with the individuals selected and the soundness of their business operations than with other means which may be devised. Second, farm credit customers are not operating in isolation of financial markets. The good credit-risk farmers could probably obtain credit from several sources prior to becoming customers of merchants and dealers. Third, I suggest again the possibility of over-selling some inputs to some farmers and thereby causing a profitable farm to become unprofitable. Such a condition is benefical to neither lender nor borrower.

If merchants and dealers adhere to these credit principals, they will probably continue to be a major competitor in supplying farm credit. Now that most merchants and dealers represent corporations which have connections with the major money markets, they can become a major vehicle for moving funds from surplus to deficit areas, thereby performing a valuable service for farmers and the financial markets. In addition, if the credit is profitable to both lender and borrower, more efficient use of resources is achieved and total welfare is enhanced.

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 15, 1968

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

The committee met at 10:05 a.m., pursuant to adjournment, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire and Miller; Representatives Reuss, Curtis, and Widnall.

Also present: John R. Stark, executive director; James W. Knowles, director of research; and Donald A. Webster, minority staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

Our witness this morning is the distinguished Secretary of the Treasury, the Honorable Henry Fowler, who is, in my view, one of the outstanding competent officials of our time. He has been a splendid witness before, and I am sure he will be this morning.

Mr. Secretary, go right ahead.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY; ACCOMPANIED BY FREDERICK L. DEMING, UNDER SECRETARY FOR MONETARY AFFAIRS, AND ROBERT A. WALLACE, ASSISTANT SECRETARY

Secretary FOWLER. Thank you very much, Mr. Chairman and members of the Joint Economic Committee.

It is a great pleasure to be with you again this morning. These annual hearings on the President's Economic Report are most important for us in the Treasury Department. They provide us with a valuable opportunity to review with you, and to have the benefit of the review of other outstanding observers and experts, the performance of the economy, and help us to chart a course for the future.

In my view, this is the year in which economic and financial policy should be directed toward one rather simple and fundamental effort, and that is reversing decisively the trend in 1967 to increasing deficits in our internal budget and in our international balance of payments.

We should move back toward balance in our budget and our international payments—and, thereby, assure a balanced economy, properly poised to discharge our national and international responsibilities—in war or in peace, at home or abroad.

With the Nation engaged in a costly conflict abroad, we must act at home so as to maintain the stability of the economy and the strength of the dollar.

We meet after a year in which the domestic economy moved ahead, slowly at first, then at a faster pace—in fact, too fast a pace to be sustained. Meanwhile, the balance of payments, which had shown sharp improvement in 1965, and held its own in 1966 in the face of mounting foreign exchange costs resulting from the conflict in Southeast Asia, took a sharp turn for the worse in 1967. Prompt measures are needed—and are being taken—to cut the payments deficit. But, there is an equally pressing need to cut the Federal budget deficit and bring our domestic finances into better order.

Indeed, Mr. Chairman and members of the committee, these are two interrelated aspects of a common problem.

In the domestic economy, real growth resumed at a rapid rate in the last two quarters of 1967 after an anticipated inventory adjustment in the first half of the year, but it has been accompanied by far too strong a rise in costs and prices.

Moderation of the upward pressures on our costs and prices must be a continuing objective in the period ahead. Indeed, we must reverse the trend toward a spiraling inflation. An economic climate conducive to a return to stable costs and prices—in the pattern of 1961–65—would protect our trade balance against a short-term floodtide of imports and a long-term deterioration in competitive position. It would also avoid the risk of an excessive and unsustainable rate of growth that could terminate not in an inventory adjustment like early in 1967 but a recession like those of other years.

Since mid-1965, the economy has absorbed nearly a $25 billion increase in national defense spending levels without resort to wartime controls and without lasting interruption to the economy's advance. This has been a remarkable achievement. But, it has certainly not at all been smooth sailing. We have seen how a surge of demand in an economy near full employment can distort financial flows, boost interest rates, lead to excessive inventory buildup, disrupt cost-price stability, and touch off a sharp rise in imports. With total public and private spending now rising strongly, that same unwelcome pattern could begin to unfold once again.

As the President stated in his January 1 message to the Nation on the balance of payments—and this was under the heading, I might say, of, "The First Line of Defense," and it is an integral part of our balance-of-payments program. The balance-of-payments program is not confined to the direct measures that are of a temporary and emergency nature. The balance-of-payments program includes as the first line of defense dealing with our own internal domestic problem, which is the true basis for a stable international position, supplemented by the so-called direct measures, some of which are temporary, some of which are long range in nature.

The President said:

> No business before the returning Congress will be more urgent than this: To enact the anti-inflation tax which I have sought for almost a year. Coupled with our expenditure controls and appropriate monetary policy, this will help to stem the inflationary pressures which now threaten our economic prosperity and our trade surplus.

Prompt application of a degree of fiscal restraint is, indeed, essential for the health of the economy and the soundness of our financial position—at home and abroad. We dare not allow a highly stimulative fiscal policy to conjoin with increasing demand in most areas of the private sector. Whether fiscal restraint will be applied or whether we will depend exclusively on monetary restraint with its imbalancing impact is, and for some time now has been, the overriding domestic economic policy issue. Fiscal restraint is also the key to the success of our overall balance-of-payments program and the maintenance of confidence in the dollar and the international monetary system.

The Domestic Economy in 1967

Now for a few comments on the domestic economy in 1967. With the President's Economic Report before you, there is no need for me to comment on last year's domestic economic developments in any detail. I will concentrate on a few features of last year's experience that are most important for an understanding of our present situation.

As we find it now, the economy is rapidly gaining momentum, while a year ago that was far from the case. A year ago, it was clear that some adjustment of a temporarily excessive inventory position would have to take place in 1967. It was important to insure that this adjustment occurred within the context of a generally prosperous private economy. Therefore, it was decided to complement the relaxation of monetary stringency that was already in progress with a degree of fiscal support during the first half of 1967.

Between the end of 1966 and the middle of 1967, the Federal sector of the national income accounts moved from a deficit position of about $3 billion annual rate to a deficit approaching $15 billion annual rate. During the same period, monetary policy also moved to a significantly easier position. For example, the level of "free reserves" which averaged more than a minus $150 million in late 1966 rose to near a plus $300 million by mid-1967.

Contrary to the fears of those who saw recession lurking around every corner, final sales increased strongly in the first half of the year while the inventory adjustment ran its course. This was made possible, in large part, by fiscal and monetary action which had been accurately timed to the need of the economy.

During the second half of last year, the economy moved ahead briskly, with production interrupted only temporarily by work stoppages and growth in final sales tempered only by a personal saving rate rising to unusual levels. Because the first half of 1967 was relatively weak, the full extent of the economy's resurgence tends to be concealed in statistics for the full year. We seem to have a habit of looking at these things in annual terms, and I think very often when you do that you miss the implications of the swings that do not always occur on January 1. They begin to take shape at various points during the year.

For example, the gross national product in *current* prices rose at about a 6-percent annual rate between the end of 1966 and 1967. But this is the result of an annual rate rise of a little less than 3½ percent in the first half of 1967 and 8½ percent in the second half. *Real* output grew at little more than 1 percent annual rate in the first half of 1967 but at about 4½ percent in each of the last two quarters of the year.

This rebound has left only a narrow margin of unutilized efficient resources readily available which can be drawn upon to boost this year's rate of growth in output. It may appear that there is still some margin of spare manufacturing capacity with operating rates in the 85-percent range—about six points below the peak 1966 levels. But much of this unused capacity is likely to be the high cost and less efficient capacity. In any event, the utilization rate by itself is a very unreliable indication of slack because of the shortage of skilled and semiskilled labor. The overall unemployment rate has fallen to 3½ perdent—the lowest in 14 years. The rate for adult males is 2.3 percent, also as low as at any time since the early 1950's.

Despite the slow first half of 1967, the resumption of strong growth in the economy during the second half set off a sharp advance in prices. The comprehensive GNP price deflator which had increased at an annual rate of about 2⅓ percent in the first half of the year advanced at nearly a 4-percent rate in the second half. This second-half advance was the largest in more than a decade despite the fact that farm product prices were falling during much of 1967.

The economy is in grave danger of excessive overheating. Restraint or the risk of spiraling inflation are the alternatives. If we move decisively to apply restraint, we can reduce inflationary pressures and expect a year of stable growth. The economy enters the eighth year of its recordbreaking expansion in better balance than a year ago. Then there was an inventory overhang and the housing industry was depressed. Now the rate of inventory accumulation is in better relation to sales and housing has made a strong recovery. But there is still a serious imbalance domestically that must be removed. That imbalance is in the Federal sector. The Federal budget is in heavy deficit at a time when there is a need, not for steady stimulus, but for a sharp and decisive movement toward fiscal restraint.

Budgetary Policy: The Need for Restraint

Now, as to budgetary policy and the need for restraint: In the period from late 1965 to the middle of last year, the Federal fiscal position operated in a consistently stabilizing direction. Opinions may differ as to whether or not fiscal actions were always large enough or precise in their timing. But, the general profile of the Federal fiscal position was appropriately geared to the state of the economy. In the third quarter of 1965, with the Vietnam buildup barely underway, the Federal deficit on National Income Accounts (NIA) basis was running in excess of $3 billion annual rate. By the end of the year, rising revenues had pulled the NIA budget to a position of near balance. In early 1966, the rise in payroll taxes for social security and the Tax Adjustment Act, along with the revenues generated by the faster pace of activity, swung the NIA budget into a surplus of $3 billion annual rate by mid-1966.

By the third quarter of 1966, the NIA budget had moved back to a position of near neutrality. And, by the final quarter, with signs of a possible inventory adjustment appearing, that budget moved further in the direction of stimulus to a $3.3 billion rate of deficit. As the economy slowed further early in 1967, the budget moved to an even more stimulative position with an NIA deficit which approached a $15 billion annual rate by the middle of the year.

But the large Federal deficits have overstayed their time. The rate of deficit in the exuberant last half of 1967 narrowed slightly but still averaged in the $12 billion range—clearly inappropriate in a high-employment economy with private demand strong and rising. Increasingly, the effects of that deficit are being registered in rising prices, and a deteriorating trade balance.

As a consequence of the President's proposed fiscal actions, initially proposed last August 3 in his tax message and renewed this January, the Federal NIA deficit would be reduced from the $12.5 billion rate of 1967 to an estimated $5 billion for calendar 1968. In terms of fiscal years, the reduction would be from $10 billion in fiscal 1968 to $2.5 billion in fiscal 1969.

Without fiscal action, the NIA deficit would remain near its present levels and would be an excessively stimulative influence on our high-employment economy. Continuation of deficits on such a scale would greatly increase the risk of more inflation and further shortrun deterioration in our trade balance.

Also, with monetary policy now pointed in the direction of restraint, an excessively large budget deficit with a corresponding need for continuing heavy Federal borrowing would tip the odds toward a return to tight-money conditions. Interest rates are already at extremely high levels in terms of our historical experience and a move to even higher rates and reduced availability of credit for housing, State and local needs, and small business would be a very unhappy prospect.

The President's fiscal program includes expenditure restraint as well as the proposed tax increase. The expenditure cuts in specific programs totaling $4.3 billion achieved by joint congressional and Executive action late last year were in the spirit of the recommendations made by your committee in its last annual report.

The current budget also proposed program reductions and reforms, totaling $2.9 billion in fiscal 1969, with the expenditure savings spread over several years. As a result, outlays in relatively controllable civilian programs will be virtually stable between fiscal 1968 and 1969. The net rise of $0.5 billion is made up of decreases in controllable civilian outlays of $2.5 billion and increases of $3 billion. About two-thirds of the $3 billion increase is for payments on prior contracts and commitments.

The total expenditure increase for fiscal 1969, on the unified budget basis, of $10.4 billion is almost entirely accounted for by rising outlays for defense and for relatively fixed charges under present laws.

Mr. Chairman and members of the committee, while I know there will be considerable differences of opinion in the Congress and elsewhere about the choice of priorities, there has been a definite application of the principle of priorities. The prompt enactment of the proposed tax program is the only realistic way of assuring the timely reduction in the fiscal 1969 deficit of $13 billion or any sum approaching that magnitude. And every day that passes without favorable action on a tax increase adds $33 million to the fiscal 1968 deficit. Already delay has cost $4.5 billion in revenues; and, if this Congress adjourns at the end of this session without having enacted this tax bill, it will have, in my judgment, missed the grand opportunity to slash this budget deficit in fiscal year 1969 by $13 billion, and I do not believe all of their efforts in the direction of expenditure reduction will total up to anywhere near that reduction in the level of the deficit.

Over the years, the activities of this committee have done a great deal to elevate the levels of public discussion of economic issues and have contributed to much more informed attitudes on public policy. With your help we have gone beyond an earlier, and misleading, orthodoxy which did not assign fiscal policy any role in stabilizing the economy. There is a need now to demonstrate that fiscal policy can appropriately be used to restrain as well as to stimulate. Your support of the President's fiscal recommendations—on the basis of their economic logic—would be an effective and influential endorsement of the practice, as well as the theory, of stabilizing fiscal policy.

Financial Policies and Debt Management

In the financial area, we look back on a year of strong demand pressures in our money and capital markets. Because of these strong demands, interest rates moved higher despite a larger flow of savings and monetary ease during most of the year. Money market rates did decline in the first half of the year but then moved up rather steadily. Longer term interest rates dipped only temporarily in early 1967 and rose during the balance of the year.

The financial demands of the private sector were strong even while the economy was moving more slowly in early 1967. Partly in reaction to the credit squeeze of 1966, efforts were made to rebuild liquidity and provide for possible future credit needs. As the year progressed, an upturn in planned business plant and equipment expenditures and a rise in inventory investment were adding to corporate financial requirements. Long-term corporate security offerings and placements—including refundings—reached $24 billion in 1967, about 36 percent above the sizable 1966 total. State and local issues in 1967 are estimated at $14½ billion, about 27 percent above 1966. Net additions to mortgage debt at $22 billion were only slightly above the 1966 total, but were rising throughout the year as savings inflows to mortgage lenders continued in large volume.

With private demands strong all year, the major change was in the Federal fiscal position which swung from debt repayment to heavy net borrowing. In terms of the new budget concept of the Federal sector's net financing demand on the economy, which includes the Federal Reserve System with the private sector, there was a net repayment of $5½ billion in the January–June 1967 period. Adding the financing activities of the Federal home loan banks and the Federal land banks and subtracting security purchases of the Federal Reserve, there was a net repayment of $11 billion to the private sectors. In contrast, repayments to the private sectors were only $2 billion in January–June 1966 and $4½ billion in January–June 1965.

In the second half of last year, the Federal sector made net credit demands on the private sector of about $18 billion. This was sharply above the net credit demands of roughly $5 billion each in the July–December period of 1964, 1965, and 1966; and, therefore, in the simplest terms of supply-demand pressures in the capital markets, the combination of the very strong private and Government demands for credit exerted strong upward pressure on interest rates during the second half of 1967.

Fortunately, though, there was no large-scale diversion of funds away from the mortgage market last year as there had been in 1966. However, saving inflows at thrift institutions have been slowing down and there is no room for complacency. Prompt tax action is still the best insurance of a continued recovery in housing.

For the current half-year, even with prompt action on the tax bill, the Federal sector, including the home loan banks and the land banks, may make a contraseasonal net credit demand of $5 billion or more on the rest of the economy, including the Federal Reserve.

Borrowing requirements in fiscal 1969 will, of course, depend very much on the outcome of the President's fiscal proposals. In the absence of tax action, the fiscal 1969 deficit on the new unified budget basis would exceed $20 billion and require roughly that amount of borrowing.

Mr. Chairman and members of the committee, when I was asked at the press briefing on the budget what contingency plan I had for meeting this situation if the tax bill was not enacted, I had to reply "simply borrow the money," and that is the significance of this figure, the $20 billion of borrowing that will be required, and our problem in terms of the credit markets is to reduce that amount and pay for our bills, including the cost of the war, out of current revenues to a greater degree than we have and, therefore, diminish the level of our borrowing.

To this $20 billion would be added the home loan banks and land bank requirements and the amount of FNMA borrowing for secondary market operations in its proposed new private ownership status. The impact of such a volume of Federal borrowing may be judged from the following comparison. In the period fiscal 1961 through fiscal 1967, Federal borrowing averaged less than $5 billion annually.

Large-scale deficit financing in overstrained financial markets diverts credit flows and drives up interest rates. It is not a question of whether or not the Government will get its money—of course, it will. But, in the process, the cost of all credit is driven up and many private borrowers are knocked entirely out of the market. At the present time, most interest rates are below their end-of-1957 levels, but they have begun rising again.

Recently, the Treasury has undertaken sizable refunding, prerefunding, and cash financing operations, all of which have been successful. But the new securities had to carry historically high rates of interest in order to attract investors. Thus, prompt and favorable action is needed on the President's tax proposals to raise $16 billion in fiscal 1968 and 1969. This would shrink the budget deficits and hold Federal borrowing to manageable levels.

The Need for a Return to Cost-Price Stability

I was reminded the other day of a statement of a former colleague of yours, Mr. Chairman, the Senator from Virginia, Senator Robertson, who once said: even though you may be within 1 mile of hell, if you reverse your direction and start back toward Heaven again, that is a much more comfortable position to be in than if you continue your first direction, and, with that bit of borrowed Virginia wisdom, I would like to turn to this question of a return in the direction of cost-price stability.

It may take us some time to get there, but it is very important which direction we are moving in.

Our overall price record since the current expansion began in early 1961 remains a good one, looked at in longer term perspective. During this period the average percentage rise in U.S. consumer prices has been less than in any other major country. Even since mid-1965 our record is better than that of most major industrial countries. But, there are clear warning signs that this good record is in danger.

One of last year's most disturbing developments was the much faster advance of prices after midyear. The gain in gross national product in the second half of 1967 was impressive—a rise of $32 billion despite a sizable loss because of the auto strike. But nearly half of the $32 billion rise was eaten up in the form of higher prices. By way of contrast, in the period from early 1961 to mid-1965 less than one-quarter of the gain in GNP reflected higher prices. And, even from mid-1965 to mid-1967, the proportion of GNP gain attributable to rising prices was less than it has been recently.

Since mid-1965, there have been three fairly distinct periods as far as price changes are concerned. From mid-1965 through September 1966, both consumer and industrial prices rose strongly. The rise was triggered by the burst of demand which quickly carried the economy to near-capacity levels of operation. This set off a process in which wage advances and price increases began to interact. From about September 1966, through the middle of last year, there was some relief from the rapid rate of price advance as the pace of economic advance slowed temporarily, but costs continued to move up. Finally, in the second half of last year, as demand strengthened, the rate of price advance accelerated once more.

We are now at the point where so-called demand-pull and cost-push factors are threatening to interact with one another in a dangerous manner. Once an inflationary process is well established, any distinction between demand-pull and cost-push breaks down entirely. Rises in costs are reflected in higher prices and money incomes which contribute to increased spending, which drives up costs and prices, and so on. Fiscal and monetary restraint can slow this upward spiral by cutting back demand, but the measures may have to be very severe if the inflationary process is allowed to gain momentum. This we must avoid.

The real risk of recession, Mr. Chairman, does not lie in the prospect of too much fiscal restraint in the President's program. Rather it lies in the threat that fiscal inaction and too much demand will aggravate the inflationary pressures that are already all too apparent. The prompt application of fiscal restraint is our best insurance against further inflation and the risk of an eventual return to "boom and bust."

Balance of Payments

As you know, the immediate background of the action program to bring our payments to, or close to, equilibrium this year which the President announced in his New Year's Day message included the following—and I find that in much of the discussion of some of the measures that are proposed to deal with the problem, we seem to have forgotten the fact that we have a balance-of-payments problem. We move directly to an assessment of the individual measures without appraising the background out of which these measures necessarily emerge.

Now, what are these factors?

The devaluation of the British pound with its disturbing impact on the international monetary system and the value of all currencies.

A sharp increase in our gold sales during the final quarter of 1967, reflecting the uncertainty and unrest on international foreign exchange markets associated with the devaluation of the British pound.

Mr. Chairman, just to give you the contrast of this factor, in the first 9 months of calendar 1967 we sold to foreigners $56 million in gold, but the impact of this factor that I have just mentioned on confidence in currencies throughout the world resulted in a loss of gold in the last quarter of the year in the neighborhood of $1 billion from our own reserves.

A third factor was the indication of a very sharp deterioration also, during the fourth quarter, in our payments deficit, following some increase in the second and third quarters from the levels of 1965 and 1966.

The preliminary figures on our fourth quarter and full year 1967 payments deficit appear in the regular quarterly Department of Commerce press release being issued today. They show:

A deficit for the year, on the liquidity basis, of $3,572 million—which is near the lower end of the $3.5–$4 billion range anticipated in the President's New Year's Day message but, nevertheless, represents a deterioration of $2.2 billion compared with the 1966 results. The deficit for the year, on the official settlements basis, was $3.4 billion.

A seasonally adjusted liquidity deficit for the fourth quarter alone of $1,832 million. This represents a rate of deficit more than three times as large as the $580 million seasonally adjusted average for the first three quarters of the year; and the worst deficit we have experienced in any single quarter, at least since the third quarter of 1950 following the outbreak of the Korean War.

Another factor was a sharp deterioration in our merchandise trade account during the final quarter, resulting in a trade surplus for the full year 1967 virtually identical with that of 1966 in place of the moderate improvement which we had expected and hoped for on the basis of the experience of the first three quarters.

The details of this increase in our fourth-quarter payments deficit will not be available for several weeks. But it is clear that the most worrisome element in the picture was the drop in our trade surplus. Imports rose over $500 million while exports dropped nearly $200 million from the January–September averages. Our trade picture thus accounted for more than half of the increase in our liquidity deficit above the levels of the first three quarters.

A second major development in the fourth quarter of a different character was the liquidation by the United Kingdom Government of the $570 million remaining balance from its long-term investments in U.S. securities, both private and public. This action was, of course, taken in connection with the devaluation crisis, and the need of the United Kingdom Government to reduce its holdings and take them into its reserves.

Unfortunately, as noted earlier, the detail necessary to evaluate other factors simply is not yet available. Such other categories of our international payments for which preliminary figures are now available show generally rather small—and largely offsetting—changes as compared with the first three quarters of the year.

Mr. Chairman, I released a Treasury Department report early in the month of January, which, I think, perhaps you have a copy of, entitled "Maintaining the Strength of the United States Dollar in a Strong Free World Economy."* This document details the background and reasons for the action program announced by the President. It describes what we have done to date, and what we would propose to do, both over the short and long term, and since copies of this report have been made available to each member of the committee, I shall try to confine my discussion of the balance of payments to several additional observations.

The President's action program underlines the urgent need for a tight lid on expenditures, appropriate monetary policy and a more effective voluntary program of wage-price restraint. As the President's Economic Report points out:

> The avoidance of excessive demand in our economy is crucial to the strength of the dollar as well as to our domestic prosperity.
>
> If we place too much pressure on our resources, U.S. buyers will turn abroad for supplies and our imports will soar. And if our prices rise, we will weaken our export competitiveness and attract even more imports—not just immediately, but for years to come. (P. 14.)

I shall not review in detail the various selective measures through which we seek an improvement of $3 billion in our balance of payments during the year 1968. They are set forth clearly in the Presidential statement which appears at the beginning of the Treasury report on the action program, and they are developed in detail in the various chapters of the report itself dealing with the individual segments of the program.

The United States recognizes its responsibility for adjusting its own balance of payments, and it does not intend to shirk this responsibility. At the same time, it must be recognized that the U.S. balance of payments is part of a world pattern of payments. The counterparts of the deficits of some countries are the surpluses of other countries. Because of the chronic concentration of these payments surpluses in continental Western Europe, it is primarily to this group of countries that we must look for cooperative actions facilitating the progress toward international equilibrium that the U.S. program would make possible. The relationship of the U.S. deficit and the persistent surpluses of these countries is examined in chapter IX of the Treasury report.

However, I should interject that this problem of surpluses is not confined to Western Europe, and we are intending to look at the rising level of reserves in other countries and relate the general problems of reserve management outside that area to various cooperative actions that we think will go for a better adjustment process.

We have undertaken both bilateral and multilateral consultations with other countries regarding our action program. Broadly speaking, the response of the continental European countries has been gratifying. Indeed, I think it is no secret that many of those countries, the top financial authorities and economic authorities, felt that the emergence of an urgent new program for our balance of payments was an indispensable element in stabilizing the international monetary situation

*Available from Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402. 162 pages, 70 cents.

and putting us back again on the road to stability in financial and foreign exchange markets.

These countries, therefore, recognize and accept the fact that their surpluses must fall along with the correction of the U.S. deficit. There is some concern regarding the more favorable treatment of noncontinental countries in several phases of our program but there is appreciation that a nondifferentiated program would have created painful adjustment problems for countries least able to make these adjustments. These are very encouraging indications of a general readiness on the part of individual countries to adjust their fiscal and monetary policies to the new situation created by the U.S. program.

Indeed, I might interject, Secretary Deming attended the most recent meeting of Working Party 3, which is the collection of top financial and economic officials of the primary financial countries and the reports that came back from that meeting were that it was WP-3's finest hour. This regular exchange every 6 weeks that has been going on now for some years, has given a mutual understanding and appreciation at the top levels in governments and central banks of the interwoven international financial patterns of cooperation that are necessary to the wise and constructive solution of the kind of problem that we have, and that the United Kingdom has had.

However, the European nations strongly emphasize that the full objectives of that program will not be achieved without the primary and essential component of restraint on the U.S. economy through fiscal and monetary policy, supplemented by intelligent and responsible actions by management and labor to limit the rise in unit costs to a noninflationary level. In particular, action on the tax increase has become a critical and symbolic test, in European eyes, of our ability to control domestic inflationary pressures.

I know, Mr. Chairman, your committee is conscious of this because Senator Javits has told me, and I noticed in the hearings, that as a result of his travel in early January in Western Europe he came back confirming this very impression which we have had through other private and official sources.

Action on the tax increase proposal, either in the form proposed or some adaption of it, is the acid test of fiscal responsibility, and of confidence in the future of the dollar in financial circles here and abroad.

International Finance

Now, finally, in the field of international finance in which, Mr. Chairman and members of the committee, the reports and analyses of the Joint Committee last year and in preceding years, and the work of the Subcommittee of the Joint Committee on International Exchange and payments has been one of the very great constructive contributions of the committee, with respect to developments in this area, I want to express my appreciation here on this occasion for——

Chairman Proxmire. If I may interrupt at this point, Mr. Secretary, I can agree wholeheartedly because I had very little to do with it. Congressman Reuss was the chairman of the subcommittee, and made a marvelous contribution.

Secretary Fowler. Well, on both sides of the aisle the initial bipartisan impetus was given. It emphasized some emergent problems back in 1965, which I was glad to take up because I had the responsibility for doing so. The encouragement that has been given to the very difficult and painful processes of negotiation has been very helpful, and I do want to thank the committee and the Members on both sides of the aisle for their very constructive movement in this direction.

One of the difficulties faced in the discussion of our balance-of-payments problem is that it is hard to put in terms that are analogous to the familiar financial problems of doing business in the United States. The President's Economic Report on pages 12 and 13 makes a pass at that. It says that the United States can be likened to a large trader and investor. It is also a most important international banking center. About half of our liquid liabilities of $33 billion are holdings of foreign monetary authorities, the United States acting as a bank.

The official dollar holdings of foreign countries are part, and in many cases a large part, of the ultimate national reserves that foreign nations hold to meet unforeseen contingencies. Thus, we have the responsibility that falls upon a bank to maintain at all times the unquestioned confidence of the depositors in its liquidity as well as its solvency.

We need to have reserves that will assure that our depositors can spend their dollars in all the major countries of the world. Some of these countries, notably in continental Europe, will expect the United States as a bank to pay them, in effect, not in dollars but in gold or in claims on the International Monetary Fund as they acquire dollars beyond their customary official holdings of dollars. They have the alternative of reinvesting some or all of these dollar receipts in private markets—and this alternative can be particularly helpful when borrowing demands in the European capital markets are heavy—but there is likely at times to be some cashing of dollars into gold.

Although the world has come a long way toward accepting dollars as a regular and normal proportion of world reserves, it is still true that gold comprises about $40 billion of the total world reserves of something over $70 billion. The gold ratio is substantially higher for some countries, particularly in Europe. And our depositors, in some cases, feel the need of assurance that their reserves in the form of dollars are adequately protected by large and available reserves of gold—or the equivalent in claims on the IMF.

The importance of the factor of confidence in a major currency was demonstrated by the recent experience of sterling. The international monetary system was put to a severe test by the devaluation of sterling and its aftermath. This challenge was met, and the results demonstrated the resilience and the resistance of the system to a difficult series of political and financial events. The private markets for gold had shown nervousness since the Mideast crisis in the spring, and the devaluation of sterling triggered a heavy run on gold.

A statement by the gold pool contributors or their representatives made in Frankfurt the weekend after devaluation served to calm the market substantially. But later, rumors again flooded the market—the size of the pool's losses, the possible withdrawal of support of the pool and the possibility of limitations of some sort being placed on the market.

A further statement by me as Secretary of the Treasury and by the Chairman of the Federal Reserve Board, made with the support of the other gold pool members, again restored comparative calm. But the factor that brought more enduring strength to the gold market was the announcement on January 1 by the President of a forceful U.S. balance-of-payments program. With only a few exceptional days the market has been much better balanced in 1968.

The events of 1967 accentuated the need for prompt implementation of the International Monetary Fund plan for multilateral creation of supplementary reserve asset. The strenuous efforts being made by the United Kingdom and the United States to eliminate their deficits should have the effect of markedly reducing additions to dollar and sterling reserves held by other countries. At the same time the unreliability of new gold supplies as significant additions to the world's monetary reserves has been amply demonstrated. The world's monetary gold stocks may actually have declined by as much as $1 billion in 1967.

The restoration of a calmer atmosphere in the gold market could ultimately lead to some additions of gold to monetary reserves. But, the world now faces the prospect of a limited rate of growth in reserves. The Subcommittee on International Exchange and Payments of your committee has taken a leading part in drawing attention to this situation.

The problem of inadequate growth of reserves can be met by creating special drawing rights in the International Monetary Fund, under a plan unanimously approved by the Fund Governors last September. Under the plan, all the participating members would obtain the newly created assets in proportion to their quotas in the Fund. The amount of drawing rights to be created would be determined from time to time, normally for intervals of 5 years in advance, in such a way as to assure an adequate but not excessive rate of growth in global reserves.

There is ample safeguard against excessive use of this authority in the provision that the managing director will make a proposal for creation of the new drawing rights only after extensive consultation, and proposals will require the approval of 85 percent of the weighted votes of participating countries.

In order to make sure that the special drawing rights will serve effectively as supplementary reserve assets, countries undertake obligations to accept them up to an amount that will always equal three times the amount of special drawing rights that may be created for them. It is these obligations to accept the new instrument that give it its assured backing; countries may also accept larger amounts voluntarily and will probably do so as the instrument becomes more familiar in the years to come.

I will not go into further detail here on the special drawing rights, except to note that I made a statement before the Subcommittee on International Exchange and Payments of this Committee on September 14, 1967, and placed in the record the outline plan that was approved in September at Rio de Janeiro. (See *New Plan for International Monetary Reserves*, Hearing before the Subcommittee on International Exchange and Payments of the Joint Economic Committee, September 14, 1967, pp. 3–6.)

I am pleased to report that the process of drafting amendments to bring the plan into effect is going forward in the Fund. After their completion by the executive board, scheduled for March 31, 1968, by the resolution at Rio, the amendments will be submitted to the Governors of the Fund to approve, by a simple weighted majority, submission to governments for acceptance. If all goes as scheduled, it will be possible to present the amendments to the Congress for its consideration in the spring of this year.

The plan will become effective in the constitutional sense when the amendments have been accepted by three-fifths of the members of the Fund having 80 percent of the weighted votes. At this stage, which might take place in late 1968 or early 1969, the managing director and the members can make a determination that initial activation should take place. This will require the approval of 85 percent of the weighted vote of the participating members.

I should also mention that the executive directors will prepare a second report dealing with a number of proposals for amendments directly related to the special drawing rights plan, put forward for study primarily by the members of the European Economic Community.

There are several controversial proposals, and all are under active discussion in the executive board of the Fund. There is a typing error, Mr. Chairman, in the sentence I have just read. Those other amendments are only indirectly related to the special drawing rights. The text reads, "directly." They are really not related. Unrelated would be the more appropriate description. They have been put forward, however, in the same frame of time, and some of them are controversial, but all under active discussion by the executive board of the Fund.

A report on these unrelated amendments will also be made to the Governors by March 31, 1968, and we do not yet know to what extent some questions may require further consideration after that date. We would strongly hope that the controversial issues in these proposals, if not settled promptly, would not delay ratification of the special drawing rights plan.

Conclusion

The need for fiscal restraint is the dominant feature of our economic situation, combined with less inflationary wage-price decisions and direct balance-of-payments, measures, some short term and some long term. In the present setting, there is no conflict between the policy prescription for both the domestic economy and the balance of payments.

Each would be improved by a prompt transition to a less inflationary environment. Both our budget and our balance-of-payments deficits are far too large and both must be reduced. The action program to shrink the balance-of-payments deficit by $3 billion is already in motion. Corresponding action is urgently required on the President's tax program, which would cut our budget deficits in fiscal 1968 and 1969 by $16 billion over the next year and a half.

Thank you, Mr. Chairman.

Chairman Proxmire. Thank you very much, Mr. Secretary, for your usual effective and forceful statement.

You contend in the body of your statement that if the tax bill is not enacted that we would have a $13 billion greater deficit in fiscal 1969. I think that virtually all of us would agree that we want to reduce the deficit as much as we possibly can and, indeed, you have made a very strong and persuasive case that the deficit should be reduced for economic as well as other reasons.

Secretary Fowler. Mr. Chairman, $13 billion is not the hard figure. It is a reduction in the deficit in that range. Clearly, actions by the Congress in the appropriations process could reduce expenditures further than contemplated.

Chairman Proxmire. I am coming to that; I am coming to that right now.

I notice in the breakdown in the budget the $13.157 billion is only in part reduced by the passage of the surtax.

Secretary Fowler. That is right.

Chairman Proxmire. $9.8 billion is the surtax share, as I recall.

Now, in view of the fact that the polls—to the extent they are accurate—show a very strong opposition to the surtax by an overwhelming majority of the American people and in view of the obvious reluctance of Members of this Congress this year to vote a surtax, I am wondering if we cannot achieve the same objective with some kind of a compromise; something like this: No. 1, perhaps a modest corporation surtax of 5 percent, instead of 10 percent. This would raise $1.5 billion.

I might start off by saying that if you enact all of the proposals that you have here which, I understand, the chairman of the Ways and Means Committee and others are favorable to—the excise tax extension, the corporate speedup, the user charges, and so forth—these would raise about a quarter of what you want, and would raise close to $3.3 billion, or $3.4 billion.

No. 2, a modest corporation surtax that would raise $1½ billion; No. 3, a modest beginning on tax reform. Obviously, you cannot have a big tax reform program come through swiftly, but there are some measures which seem to have some general acceptance.

Finally, a substantial cut in spending, not $15 billion—I agree we are not going to achieve that, although I think we could, but we are not going to—but a cut of, perhaps, $7½ billion.

This would mean that 60 percent or so of your reduction in deficit would come from a spending cut, 40 percent from the revenue side. It would be a compromise, which, it would seem to me, would be politically realistic and would enable you to get it enacted, get action on it rather much more swiftly, and would have roughly the same fiscal effect as the kind of package that has originally been recommended to Congress.

Secretary Fowler. Mr. Chairman, let me deal with your question in two parts. One, the reality of achievement; second, the psychological consequences of failure to take prompt action, failure already which has gone for a period of months to reduce the magnitude of these deficits appreciably.

Obviously, I would agree with you that if tomorrow the level of expenditures, not the composition of a number of cuts here that might be counteracted by a number of increases that were occurring while you were making special cuts, but a cut in the level of expenditures in the order or magnitude of $9.8 billion, if that could be quickly and promptly achieved and demonstrated to the world, it would have, in general, economic consequences of a tax increase in the fiscal terms in which we are discussing it.

Now, let me take up the first point. As Senator Javits and others have said, and as I tried to stress in my statement, the willingness of the

American people and the U.S. Congress, as their representatives, to pay in part for the war that they are fighting in South Vietnam out of current revenues, by a tax increase, has become the symbol of fiscal responsibility in financial circles abroad and financial circles at home.

Chairman PROXMIRE. If I can interrupt at that point, I would agree there is something to that, and I would agree wholeheartedly also that you could make a strong case for some kind of a tax increase.

But I would also like to point out the Federal Government has increased its spending in the last 3 years in nondefense public works, for example, in 1967, it was $9.2 billion; 1968, $9.6 billion; this coming year it is recommended at $10.1 billion.

What I am suggesting is that we could take some of this sacrifice, some of this cut, out of spending programs of that kind, also the space program, supersonic transport, and a number of others. But I think most of it, perhaps, should be out of public works. I know this is hard, but I would like to point out Congress did it last year; the Congress did make a cut last year. As you know, the cut was—what was it, $4.7 billion in expenditures, $9 billion in appropriations. Congress made the cut, and it made the cut against administration recommendations.

It seems to me with administration recommendations, the Congress could very well act promptly, and there are areas that I think could be cut without diminishing essential services that we can get agreement on.

Secretary FOWLER. Several things, Mr. Chairman. First, as a matter for the record, the cuts that you referred to were made with administration recommendations. They were proposed in the hearing before the Ways and Means Committee in so-called title II of the tax bill at that time, in which title I was to be the tax increase, and title II was the reductions which eventually emerged as a part of the continuing Appropriations Act which became law in December.

But let me take Congressman Curtis' side of this brief for the moment. We had this colloquy over in the Ways and Means Committee, and I am going to take the way Congressman Curtis looks at it.

While, in light of the situation that was disclosed by the President's message on August 3, the seriousness of the situation as indicated at that time, and his suggestion, urging, and recommendation that you have a two-pronged program, "Go ahead and reduce expenditures in every way that you can, Members of Congress, that is not inconsistent with security and economic soundness, but give me this tax increase."

Months passed, and we came to December and, as a result of the normal appropriation processes by the Congress, cuts in specific appropriations totaling about $5.8 billion, which would be reflected in reductions in expenditures of about a billion and a half in those specific programs, had been effected.

But, as Congressman Curtis points out, while that was going on, and you were making your individual records over here on specific appropriation cuts, other expenditures were being increased so that the level——

Chairman PROXMIRE. The administration recommended increased expenditures.

Secretary Fowler. Wait just a minute, let me complete this. So that the level of appropriations, as Congressman Curtis points out that we were confronted with in December, was the level we were confronted with in August for the fiscal year 1968, even though cuts in specific programs totaling about $4.3 billion in expenditures and about $10 billion in obligations looking to future years, had been enacted by law.

Chairman Proxmire. I understand. But, you see——

Secretary Fowler. So, I just do not have the confidence, Senator Proxmire, in light of the last 6 months of watching this debate go on about expenditures, and watching cutting here and cutting there and cutting in another place, while other events also begin to have their impact on the situation, I do not have the confidence, and I do not believe the world has the confidence, that you are going to end up with an expenditure level in this budget $10 billion less.

Chairman Proxmire. Well, I would agree with that. But what I was talking about was a $7 or $8 billion cut. But, I am also saying that Congress does have a device which may or may not be a good one, but it does get results, and that would be simply to limit expenditures.

Now, Senator Williams has introduced a measure of that kind. Senator Javits, I understand, favors a measure of that kind.

Say, we limit expenditures to $178 or $180 billion. Somehow, someway, the administration would have to find a way to live within that limitation.

You see, what concerns me is that the estimate that this 10-percent surtax will raise $10 billion and do all the other things that have been estimated, it seems to me, does not add up. Again and again I have asked the Council of Economic Advisers to justify and show how a 10-percent surtax would raise it. They have to make the assumption it would have very little effect in diminishing the gross national product.

If you do that, it won't have any effect on inflation.

Secretary Fowler. I do not accept that. I think it will have a definite effect.

Chairman Proxmire. If you apply the 10-percent surtax to revenues that would not be raised without it, obviously you won't raise 10 percent more or anything like 10 percent more. It will be fortunate if it raises 5 percent more.

On the other hand, a spending reduction can be precisely what the Congress and the President decided it should be, and it can be legislated. It was last year. It may not be an acceptable way to do it. We may not have confidence in the Congress that they really mean it, but once we put that into law, it seems to me, everybody has to live with it.

Secretary Fowler. Well, Senator Proxmire, I will suggest to you an alternative formula, and that is, let us go ahead with this tax program and be assured that we are going to reduce this deficit by $13 billion in fiscal 1969, and then if, as a result of the appropriation processes that go on or amendments on spending limitations, or whatever else you gentlemen of Congress determine, you can reduce that $8 billion deficit a little bit further, Godspeed to you.

But let us get this assured, let us get the bird in the hand that we have been playing around with for about 6 months, and make a very real reality of it.

I would commend to you the attitude of Congressman Herlong the other day in the Ways and Means Committee, and I do not want to take the time, your time, to read it, but I would like to put it in the record, because he is just as concerned about expenditures as you are.

Chairman PROXMIRE. It seems to be a brief statement, and without objection, it will be printed at this point in the record.

(The statement above referred to, follows:)

WAYS AND MEANS COMMITTEE HEARING OF FEBRUARY 6, 1968

Mr. HERLONG. I do want to take just a minute, if I may, Mr. Chairman, to get into this area of the budget situation which we find ourselves in. The President submitted a budget. I am not satisfied with that budget. I don't think many of us up here on this side of the table are satisfied with it.

I think it is much bigger than it needs to be and I think we can save some money on it. I think we probably have gotten ourselves into a situation of which comes first, the chicken or the egg, in this respect, and I may shock some people in what I have to say in this connection, but in the final analysis whether we give the President what he wants in the spending program is really up to the Congress itself and it is our responsibility to see that we do hold down some of these programs.

I am thinking particularly about some programs now of $2.100 million to create some 500,000 new jobs at a time when Mr. Ackley testified before our committee that unemployment was at the lowest level that it had even been or had been in many years, and also that unemployment rates were too low at this time.

I am sure there must be some sophisticated rationalizing of this position where on the one hand they say unemployment is too low and on the other hand they want to spend $2,100 million to create new jobs and to subsidize private industry and employ people who are really not employable.

I don't know what the rationalization is, but I would hope in that respect that the Congress, and each one of us here has only one vote on these appropriations, would take steps to eliminate some of these programs or certainly substantially reduce some of them so that we can do what the administration has failed to do.

The fact that they downtown haven't done their job, so to speak, doesn't excuse us from doing ours, and any contribution that we can make toward lowering this line or narrowing the gap between the expanding Government expenditures and expanding Government revenues is going to be helpful.

I am perfectly willing, even if we don't get what we want, to vote for a tax increase at this time in order to help narrow that gap because to the extent that we don't it is going to widen the gap, but I just hope that the Congress will see the light and reduce the expenditures because if we don't do it we really haven't accomplished anything except stayed right where we are.

Secretary FOWLER. He says, let us go ahead and cut this deficit in a real and meaningful way right now, and argue about additional expenditure cuts in the remaining session of Congress.

Now, every day's delay in enactment of the surcharges you see, increases the deficit by $33 million, and every day that we get closer to the end of this session of the Congress, there is a growing skepticism which has been fed by the 6 months of inactivity on a very serious situation that was presented by the President's message on August 3, and the subject of very intensive hearings. There is a very great skepticism that you are going to be able to accomplish the expenditure reduction that I know you have been very conscientiously arguing for, and I say it is time to try the other approach, and instead of—to reverse the cycle—instead of cutting expenditures first and then increasing taxes, why don't you go ahead and increase taxes and then cut expenditures.

Chairman PROXMIRE. My time is up. I will be back.

Representative CURTIS. I had intended to begin on another subject, but I cannot let this matter which you raised rest, Mr. Secretary.

Some of what you said is music to my ears. This business of the Congress and the Executive having cut $9 billion in new obligational authority and $4.7 billion in expenditures, of course, is out of context with what had been done before, and what the President's budget message given to us last January asked for.

The total of NOA voted by the last session of Congress was $157 billion, $143 billion for fiscal 1968, $14 billion supplementary for the then current fiscal year 1967.

Now, that is in contrast to the $139 billion voted by the Congress that was supposed to have been the President's pet, the second session of the 89th Congress.

In other words, if there was a cut of $9 billion NOA, I can tell you it was from a figure that was at least $9 billion more than was projected in the budget message last January.

Furthermore, the so-called expenditure cut came from a level of expenditures that was considerably beyond the figure of $135 billion expenditure given to us in the President's budget message for fiscal 1968.

We are spending now at a level on the economic indicators of around $144 billion, not the $138.7 billion which the administration gives us.

Now, some of that differential is, as you and I have discussed——

Secretary FOWLER. Seasonal.

Representative CURTIS. There are participation certificates. But, nonetheless, this is not a cut from the $135 billion back to $130 billion.

Now, this must be in context with the fact that in fiscal 1967 we spent $125 billion.

Now, the other thing I am saying, and this is where we disagree, of course, but I must make the record on it, the President has the power to set the spending levels. He did it in fiscal 1965, when people like myself said that in order for the tax cut of 1964 to be effective, expenditure levels had to be controlled. We thought it would be effective by removing impediments to economic growth and not replacing it with greater impediments through inflation. Expenditure levels had to be, we said, $97 billion in fiscal 1964; and $98 billion in fiscal 1965.

The President did do pretty well in fiscal 1964, $97.7 billion; and then in fiscal 1965 he did us one better, $96.5 billion.

But all this was in the context of the administration continuing attempts to get from the Congress more obligational authority. So, the carryover balances of power to spend were increasing at a greater rate of around $20 billion. Although the President had the power to hold the level at $96.5 billion, he did go up to $105 billion, to my regret, in September 1965.

The thing I am pointing out is that it is about time the President faced up to what his powers are, which he knows he has. This is why I cannot go along with a President who, No. 1, does not face up to this; No. 2, while he is criticizing the Congress for appropriations in his speeches and messages to the Congress, continues to whet the people's appetite and the Congress' appetite for these kinds of spending programs.

In your statement you use the words "expenditure restraint," and this is the terms the administration has used. I think this is false rhetoric, because you are talking about an increase of expenditures of $10 billion. In relation to the previous year the increase was around $20 billion. We have had these discussions before, and I am just making the record here. It comes down to your term, "relatively controllable civilian programs," and "controllable." This is where we all need to exercise our judgment as to what is really relatively controllable. This is my debate with the Director of the Bureau of the Budget.

He does not want to discuss the terms of what is controllable and what is not. I maintain that certain things are controllable which he has refused to discuss and says are not.

Now, one final thing. You say here the $10.4 billion increase is almost entirely accounted for by rising outlays for defense and for relatively fixed charges under present law. My quarrel is, again, over the term "relatively fixed charges." Here is the gist of it. You are, in effect, saying we can have guns and butter, because you are saying that you impose the $10.4 billion defense increases on top of your butter.

Those who argue that we have reached the point where we cannot have both say that in order to make way for this $10.4 billion, there must be cutbacks. Not a $10.4 billion increase.

So, Mr. Secretary, I think that our failure to cut has produced the situation which we both identify as the danger to the size of the deficit, that our failure to cut expenditures still lies at the base. Even after cutting back, I would say, that probably a tax increase would still be necessary, and I would be willing to undertake it.

Our disagreement is, you say, "Go ahead and give us the tax increase." I say that is putting the cart before the horse. If we do that, as far as I am concerned that will be the end of any discipline, whatever discipline there is, and there is precious little, in my opinion, on the part of the Executive to cut back.

On the other hand, if we will keep the tax increase possibility as a carrot, as it were, maybe the administration will really zero-in on these expenditure areas.

Secretary Fowler. Mr. Curtis, let me make three comments.

Representative Curtis. Surely.

Secretary Fowler. My problem, as Secretary of the Treasury, is that while you are waiting, and you are waiting, and you are waiting, we have lost $4.5 billion or revenue on this particular gamble of what was going to happen to expenditures; and the deficit for fiscal 1968 is going to be $4.5 billion more than it would have been if we had acted on the tax bill last fall.

Representative Curtis. That is right.

Secretary Fowler. And I just hate to see this process, as a treasurer, continue; because I have got to go out and borrow the money and pay the bills.

Now I share the general concern that I know many of you have, that the totals, the overall levels of budget expenditures are increasing. But I do want to point out that that fact does not diminish in anyway the desirability of a tax increase to help finance this war in Vietnam out of current revenues, rather than borrowed money.

The second comment I would like to make is—I think on pages 20 to 22 of the Budget, there is a table of budget program reductions and reforms. Their choice is certainly subject to debate.

The extent and magnitude of the cuts in those listed programs which have thereby been determined to be of a lesser order of priority or could be deferred under current conditions, that certainly is a considerable matter of debate; and the process which I know this committee is interested in, of a better method and a more completely effective method of program evaluation and screening out the outworn and the less desirable ones, is something that we should pay more attention to.

I would like to note, after that table, pages 20 to 22 of the Budget Message, the listed program reductions, the President's statement:

> There have been suggestions for a long-range study of Federal programs, evaluating their effectiveness and proposing reforms. Clearly, more study of potential program reforms is needed. My proposals this year represent a first step on which we can and should act now.
>
> Throughout the years it has been easier to discuss the need to restructure older Government programs, than actually to change them. I urge the Congress to take prompt and favorable action in support of these proposals to cull out lower priority programs.

Now, if the Congress cuts out either this selection of lower priority programs or its own selection of lower priority programs, I think it would give the country and the world encouragement to go forward on this longer range program of effort of program evaluation.

As I said in the House Ways and Means Committee on November 29, as did the Director of the Budget:

> The President is prepared to establish a bipartisan task force of outstanding Americans to take a look at long-range Federal program priorities. This task force would examine (1) the effectiveness of each such program or activity in the context of its present and projected costs; (2) whether and at what level the program or activity should be continued; and (3) the relative priority it should be assigned in the allocation of Federal funds.

I think the effort, whether conducted by the Director of the Budget, whether conducted by the appropriate committees of Congress, or whether conducted by an outside group, would be a very constructive thing.

But you are not going to get the kind of response to it if, every time a proposal is made for a program reduction or reform, such as the bill of particulars given in this budget, nothing happens.

Representative CURTIS. I see my time has expired. But let me say, Mr. Secretary, I think probably the only answer is to get yourself a Republican Congress because these committees that are failing to function are under the chairmanship and controlled by the majority, the President's own party. Isn't it about time that the President quit whipping his own party people?

I could not agree more that such efforts that you mentioned should have been done a long time ago by the Congress. I happen to be the ranking Republican of the bipartisan Joint Committee on the Organization of the Congress. Our unanimous proposal which passed the Senate contains a great deal of study directed to giving the Congress the machinery to move. This bill has been bottled up in the House because of the objections of the Democratic leadership of the House of Representatives.

Now, in all fairness, the President is supposed to be the leader, not only as President but of his own party. I am tired, frankly, as a minority member to have the President whipping the Congress when it is really under the control of his own party leaders.

Now, let us have a Republican Congress and we can move forward in these areas, and we can do this.

In the meantime, what is going to happen? I just despair over what is going to happen.

Secretary FOWLER. Mr. Curtis, obviously, I cannot, as Secretary of the Treasury, participate and respond in a partisan discussion.

Representative CURTIS. I appreciate that.

Secretary FOWLER. I am in the position of a fellow who needs help from both Republicans and Democrats, and I will leave it up to the party leaders and those who carry on these debates on the floor to assess these problems.

Representative CURTIS. Mr. Secretary, I did not mean this to embarrass you, but I do think it needs to be said because I am tired of listening to your reports in which the blame is clearly resting on Congress. I agree that Congress is blameworthy. But, believe me, this is so serious that the Executive has an equal share of blame, and we are in a heck of a mess because of——

Secretary FOWLER. I am really not trying to assess the blame. I am really trying to get that deficit reduced in the sharpest, quickest, most decisive and impressive way that I can.

Representative CURTIS. But the purpose of assessing the blame is to find out where the responsibility lies for not moving. I use "blame" in that sense only. I am saying this: There is a lack of leadership in this administration, and there is obviously a lack of leadership in the Congress.

Secretary FOWLER. Well, I just look at the deficit, Mr. Curtis, and there it is. It is big. It was big last August as we looked at it. It was big in November. It is big now. It continues to look big through fiscal 1969, and unless we have this tax bill—and to me that is step No. 1—I would like to see it given a priority position and, as you know, I have never been one of those who has been at all resistant to expenditure reduction. I participated in a number of those exercises myself.

Chairman PROXMIRE. Mr. Reuss?

Representative REUSS. Thank you, Mr. Chairman.

I was exhilarated by your call, Congressman Curtis, for a Republican Congress. But I wonder, have you given up on a Republican President? [Laughter.]

Representative CURTIS. I assumed that that would be in existence, but you need a good Congress, too.

Representative REUSS. I want to join with Chairman Proxmire, Secretary Fowler, in expressing my appreciation of the wonderful job that you and your associates here are doing. I think you are a fine Secretary of the Treasury. Keep on doing what you are doing.

Secretary FOWLER. Thank you, sir.

Representative REUSS. I want to switch the conversation to our foreign sphere, the balance of payments.

Did you get, Mr. Secretary, the little three-page document that I prepared——

Secretary FOWLER. Yes.

Representative REUSS (continuing). Called "Statistical Basis for Questions on the U.S. Balance of Payments"?

Secretary FOWLER. Yes, sir; I have it in front of me.

Representative REUSS. I prepared it merely for our convenience and if at any point in my questions I use a figure which you do not think is right, please call it to my attention. I do not think——

Secretary FOWLER. My experience with figures has been that we can usually catch up with them later in the record, and I am not going to worry about momentary inconsistencies.

Representative REUSS. Fine. I think they are not subject to controversy.

Let me call your attention, first, to the total military account balance-of-payments deficit in calendar 1967, of $4.25 billion. This is a sum actually in excess of the total overall balance-of-payments deficit, is it not, which balance-of-payments deficit comes out at something probably less than $3.5 billion?

Secretary FOWLER. To bring out an extraneous subject, it is roughly the same amount that we spend in our gross expenditures on travel. The two problems are pretty nearly equal in mathematical seriousness.

Representative REUSS. Right.

It is also true, is it not, if you take the conventional items in our balance-of-payments account, investment overseas less investment income, exports less imports, tourism overseas less tourism here, you come up, on those conventional accounts taken together, with at least a balance of a modest surplus—a little favorable balance on trade——

Secretary FOWLER. Yes.

Representative REUSS (continuing). With a little favorable balance on investments, a little deficit on tourism, and put them all together, you have got a modest surplus on those accounts.

Secretary FOWLER. I think we have, in the so-called Blue Book, on pages 62 and 89 of the Treasury paper, set out some of the statistics relative to that. However, balances like this drawn up for slightly different purposes may call for somewhat different combinations of the various items, and, therefore, any one of these compilations may never be precisely suited to the particular purpose on hand. It is clear that there is a net balance-of-payments cost for the total of Government sector transactions that is on the minus side. I think in most years there has been at least a small plus on the private side, if you net the private sector surplus on current account only against the net outflows of private U.S. capital. But, in some years, at least, this, too, may have contributed a little bit to our deficit.

Representative REUSS. Let us look at our military balance-of-payments deficit in Western Europe, and particularly that part of it, about $800 million, attributable to our troop presence, some 200,000 troops in West Germany.

We spend in budgetary cost, in maintaining those troops there, a total of about $4 billion, according to the figure I have pulled out, which I think is about right.

Secretary FOWLER. Perhaps.

Representative REUSS. Certainly, those troops there, while they do the U.S. security a great deal of good, are not wholly valueless to the members of NATO, are they?

Secretary FOWLER. Certainly not. They are of very great value to the members of NATO.

Representative REUSS. I cannot——

Secretary FOWLER. It is a mutual security operation, as we know.

Representative REUSS. I cannot, for the life of me, see why the United States does not ask the members of NATO, less France, which does not want our troops there, to pick up the foreign exchange cost, the $800 million.

All of those countries have adequate or superadequate reserves. Most of them have been running surpluses.

It seems to me that without any particular pain, they could, in this next year, give the United States a check for $800 million so as to wipe out the balance-of-payments costs.

If that were done, and I recognize it takes a domestic budgetary contribution by these countries, we would be paying 80 percent overall of the costs of our troops in Europe. The other 14 NATO powers, or however many there are, would be paying 20 percent. I do not think that is an unreasonable request.

What worries me is that we are not asking for anything like that. As I understand it, and Mr. Deming can, perhaps, fill me in on this, all we are asking for is that the West Germans accept an obligation from the United States of $800 million, repayable by us in 4 years, and with interest meanwhile.

I do not really think that is doing anything for us. They are not demanding gold anyway, and what better vehicle for our obligation to them can they have than interest-bearing U.S. Treasury securities?

So my question is, Why don't we ask the NATO countries which benefit from our troops in Europe to bear a modest part of the cost; that is, about 20 percent of the cost of those troops there, by taking up the foreign exchange component of our troop presence, and remitting to us the $800 million-odd, which is the measure of our balance-of-payments deficit item?

Secretary FOWLER. Before answering your question, Congressman Reuss, may I tell you what my own position is on this problem. I approach it from a balance-of-payments standpoint, and for some time I have been contending publicly and privately that ways must be found to neutralize the foreign exchange costs of our participation in alliances such as NATO.

It seems to me alliances, and I have said this publicly, and I will quote from a public utterance last March in a speech at the American bankers meeting in California:

> Alliances which rest on important political, social, economic, and military plans should not be made vulnerable because foreign exchange financing problems have not been resolved. We should be able—indeed we must find ways—to work constructively with our allies on forms of multilateral financial arrangements designed to neutralize the foreign exchange consequences of the location of our troops and those of our allies. The arrangements should be long-term and provide financial viability to our alliances.

The President, in his New Year's Day message said, and I know you are cognizant of this, with reference to the problem of Government expenditures overseas:

> To this end I am taking three steps:
>
> First; I have directed the Secretary of State to initiate prompt negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Europe. Our allies can help in a number of ways, including:
>
> —the purchase in the United States of more of their defense needs;
>
> —investments in long-term United States securities.

He goes on then with other measures.

Representative REUSS. If I may interrupt at that point, I really think that is the trouble with us, and that is why we get hornswoggled in this international game. Neither of those things are really very helpful; if the Europeans want to buy military equipment from us they will do it, and it really is not an offset at all. When they get tired of buying it from us because they can make it at home more cheaply, they buy it at home, which is precisely what has happened with the Federal Republic of Germany today.

As far as long-term investments are concerned, how does that help us? We have to repay the long-term obligations out of the sweat and treasure of the American people.

Secretary FOWLER. Let me say that the medium-term character of the securities, if we are talking about the German securities of 4½ years, make them practically like any other capital inflow, just like capital investments which are made in real estate or in industry.

Representative REUSS. But we end up owing it to a foreign central bank.

Secretary FOWLER. Sure, but we encourage foreign direct investment in the United States. We encourage foreign purchase of American securities.

These funds are now often held in the reserves of these countries in short-term Treasury securities, to be sure, which costs us interest, so that the cost of the interest on the medium-term securities is only slightly more than the cost which we would have in any event, and we have a much better liquidity position.

Representative REUSS. Yes; but you have to get it back.

Secretary FOWLER. Yes; but these troops, their costs over there, their budgetary costs, are for our defense as well as the defense of the people over there. They are part of a mutual security arrangement.

Representative REUSS. We pay 100 percent of it. I am suggesting that we should pay only 80 percent and they should pay 20.

Secretary FOWLER. They say, "We pay 100 percent of the troops we put up budgetwise and you pay 100 percent of the troops you put up budgetwise."

But the point which is wrong in the present situation, in my judgment, from a financial point of view, and equity and every other consideration, is that the accident of geography determines that there will be a balance-of-payments windfall to the country in which, for strategic reasons, you locate the forces. It is dealing with this balance-of-payments adjustment process and these windfalls which are related to mutual security considerations that seems to me to be the important and the vulnerable point of the preexisting arrangements.

Now, as far as the sharing of budgetary costs, whether there is any basis of equity or whether you would like it, or I would like it, or the American people would like it, I think if we presented the proposition that they have to pick up our budgetary costs, we will get absolutely nowhere, we will get no further than Secretary Robert B. Anderson and Under Secretary Douglas Dillon did in 1960 when they went to Bonn in the wake of that gold situation that existed at that time.

Representative REUSS. I was not suggesting that we ask them to pick up our budgetary costs, which are about $4 billion. I was suggesting that we should ask them to pick up the foreign exchange component, about 20 percent of that, about $800 million.

Secretary FOWLER. As I understand it, that would take the form of paying us dollars.

Representative REUSS. Oh, right.

Secretary FOWLER. Which would also be, in effect, picking up our budgetary costs to that degree.

Representative REUSS. Twenty percent of it.

Secretary FOWLER. Yes.

Representative REUSS. Well, and I will now come to my question—my first 10 minutes are up.

You reject the suggestion that we ought to ask——

Secretary FOWLER. I do not think it is——

Representative REUSS (continuing). That we ought to ask the NATO authorities to pick up, pay, remit to us, and not demand that we repay it, the foreign exchange component of our troop position in Europe. You say we should not ask for it?

Secretary FOWLER. My objective is at this time to secure action which takes care of the foreign exchange impact on our balance of payments of these military costs abroad. That, to me, is the necessary and indispensable ingredient to financial viability in terms of these long-term alliances.

The question you raise is one that I do not want to reject, obviously, out of hand. I can only say that the path down which we have been going in dealing with this problem, which we think is the realistic one in the light of past experiences, and past reactions to this situation, is the one that, we think, offers the greatest promise for prompt and effective alleviation of our balance-of-payments problem insofar as military expenditures abroad are concerned.

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Secretary, I would like to clarify your understanding of the term "expenditure cuts." In your statement you claim $4.3 billion of cuts late last year.

Yet, last January, expenditures for fiscal 1968 were estimated at $135 billion. This January, for the same fiscal year, they were estimated at over $137 billion. Would you clarify your statement?

Secretary FOWLER. I tried to do that in the colloquy, previously, with Mr. Curtis, but I will repeat it again.

Representative WIDNALL. I did not understand that your answers did.

Secretary FOWLER. But I will repeat it again.

My reference to expenditure cuts refers to the total of specific cuts in specific programs, and is quite distinct from an expression that there was a cut in the overall level of budgetary expenditure of $4.3 billion, or whatever the figure is. Let me go on to say, just to drive this home, what is involved is this: that these reductions which were a consequence of the various actions of the Congress on specific appropriations, and Public Law No. 90–218 cut back specific expenditures in non-Vietnam defense programs and controllable civilian programs which totaled, when you added up the specific cuts, $4.3 billion.

These programs were such items as cutting back farm operating loans, REA loans, canceling some agricultural research projects, spreading the Corps of Engineers new construction starts, voted in 1968 by Congress, over 2 years. It is a total of about 30 or 40 such illustrative actions that give you your $4.3 billion.

As I observed to Congressman Curtis, while this was going on in these particular programs in fiscal 1968, increased expenditures were occurring, unavoidable, most of them, in other elements of the budget which in effect, looking at the level of the budget expenditures, served to nullify the reduction in level that might otherwise have been achieved.

Representative WIDNALL. I believe I understand what you mean.

In your statement, you said that the European nations "strongly emphasize that the full objectives of the program will not be achieved without a primary and essential component of restraint on the U.S. economy through fiscal and monetary policy, supplemented by intelligent and responsible actions by management and labor to limit the rise in unit cost to a noninflationary level."

What do you mean by "responsible actions" here? The wage-price guidelines have been abandoned by the administration. Are there new guidelines; is there a new percentage?

Secretary FOWLER. No. I think, referring again to the European authorities, as the statement does, all of these countries have had a good deal of experience with what they call incomes policy, which is their phrase for what we have termed the maintenance of wage-price guidelines, relating the increases in costs to increases in productivity.

These various attempts at incomes policy, effective incomes policy, have not been successful. I do not think if you gathered around the table the representatives of all these countries you would find anyone getting up and beating his breast and saying, "We have solved this problem. We have got the method that deals with it."

But they all recognize that it is a key and a basic element in this eternal process of trying to achieve economic objectives of full employment, a healthy growth rate, and a maintenance of price stability.

This problem of relating cost increases in the wage field to productivity is one of the key unsolved elements in the situation, and while they do not have any particular prescription to offer to us in that area, they assert to us, as they assert to themselves, this is a pursuit which must be continued until some more effective way is found of dealing with the problem.

Representative WIDNALL. Mr. Secretary, is it not true that a couple of the latest settlements made between management and labor have been at a rate higher in percentage than the increase in productivity?

Secretary FOWLER. Much higher.

Representative WIDNALL. In your opinion, do you have any maximum that you are setting now? We started out on that with wage-price guidelines, which for a while seemed successful.

Secretary FOWLER. Well, I think I would like to confine my comments to two observations. One, I think this effort is an important and indispensable element not only in our domestic stability but as related to our balance-of-payments program.

In the President's message on New Year's Day, he said:

> No challenge before business and labor is more urgent than this, to exercise the utmost responsibility in their wage-price decisions which affect so directly our competitive position at home and in world markets.

I have directed the Secretaries of Commerce and Labor and the Chairman of the Council of Economic Advisers, to work with the leaders of business and labor to make more effective our voluntary programs of wage-price restraint.

I know that Chairman Ackley has discussed this question with the committee, and I do not believe I can add anything to the exchanges that have already gone on on this subject, except to reiterate once again my deep conviction that better and more effective solutions of this problem of voluntary programs of wage-price restraint are and will continue to be an indispensable element in sound economic policy.

Representative WIDNALL. Mr. Secretary, that sounds very well, but I still do not know what the administration is doing about limiting——

Secretary FOWLER. As I say, Chairman Ackley has described for the administration—he dealt with this in his report, and I cannot add anything that is of moment or consequence to the Economic Report and to the rather extended exchanges that were held between Mr. Ackley and the members of the committee last week.

Representative WIDNALL. Mr. Secretary, the United States forbids its own citizens from owning gold. Yet, through our participation in the gold pool, we supply our gold to wealthy foreign individuals for hoarding and speculation.

When our own gold stock is under such pressure, can this policy continue to be justified, or should we multilaterally seek a new policy?

Secretary FOWLER. Mr. Widnall, our participation in the gold pool serves a very useful and constructive purpose in maintaining the stability of the relationship between gold and the dollar at $35 an ounce, which is the basis of the system of fixed exchange rates under the Bretton Woods agreement, and the very reasons and circumstances that gave rise to the informal development of the gold pool operations; namely, the breakout in price in October 1960, which was a threat to the international monetary system, are good and sufficient reasons for the maintenance of the pool in its present method of operation.

I would like to take this opportunity to submit for the record a description of the gold pool, how it operates, and why the United States sells gold to private persons abroad through the pool, in specific answer to your question.

It is short; perhaps I can just give it to you now. This arrangement has provided for the participants on agreed shares to sell gold in the market when it appeared that the price would otherwise rise to levels that would trigger speculation and cast doubt on the stability of the monetary price of gold.

Conversely, the members would buy gold in the market in an orderly fashion when the supply exceeded the demand.

The formation of the pool followed the outbreak in the London market price in 1960, which triggered a large amount of speculation in gold and foreign exchange to the detriment of the dollar and our gold stock.

The market in London, and those such as in Switzerland, that feed into London, have existed for many, many years, and we have to deal with the situation as it exists.

I might note that up until devaluation of the pound just over 2 months ago, the pool was on a net basis—a purchaser and not a seller of gold, looked at over the years of its operation.

In addition, by calming speculation in this market we minimized fears as to a change in the monetary price of gold, and minimized the pressures quite evident in 1960 that were brought directly on our gold stock through central bank purchases from the United States at that time.

Representative WIDNALL. Mr. Secretary, my time has expired.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Mr. Secretary, is it not true that over the last 7 years the purchasing power of the dollar has declined from roughly 47 cents to roughly 40 cents today?

Secretary FOWLER. I do not have the exact figures at hand, but—did you say the last 7 years? There has been a decline, Senator Miller, in the so-called purchasing power of the dollar from 47 to 42 cents, related to the 1939 dollars. This is customary with all currencies that I know of in the world today, and since 1960, the United States has had the best record in this regard of any major country in the world.

Indeed, there are only three small Latin American countries in which the value of their currencies for reasons not known to me, did not decline as much. This is why the dollar has been and continues to be the world's transaction currency, because it tends to maintain and hold its value to a far greater degree than any other major currency that could be traded.

Senator MILLER. May I say that the figures I used were obtained from your Department.

Secretary FOWLER. Yes, sir. They ought to be correct.

Senator MILLER. I say, in the last 7 years it declined from approximately 47 to 40 cents.

We hear a lot of concern expressed by the administration that we should take certain measures, including a tax surcharge, to preserve the confidence of foreign nationals in our dollar. With the slippage in the dollar to which I have referred, does this not indicate a basis for a decline in confidence in the dollar?

Secretary FOWLER. No; because people who are looking at where they put their money look at other currencies, and from 1960 through 1966 the U.S. cost-of-living record was much better than that of any of the other major currencies. For example, there are some charts I have here which show this. The U.S. cost-of-living record was much better than the major countries, other major countries, during this 6-year period.

It had been rising at about a 2-percent rate in the 1955-60 period. It advanced at a slower rate, of approximately 1.6 percent, in the 1960-66 period, compared with during that period a French increase of nearly 4 percent, a German increase of 3½ percent, and an Italian increase in excess of 4 percent, and a United Kingdom increase of nearly 4 percent.

So, compared to those, the record of 1.6 percent that characterized that 6-year period was a much more favorable one than the other major countries.

In terms——

Senator MILLER. You, in effect, replied that they have not lost confidence in the dollar with respect to other currencies; did you not? I am not necessarily confining my question to the confidence of foreign nations in our currency vis-a-vis other currencies.

I would certainly expect to include vis-a-vis gold.

Secretary FOWLER. I would just add to that that, given the figures you have described for the first 6 years of this decade, in the first 9 months of 1967, despite the war and all the other factors, we lost only to foreign purchasers $56 million of gold which was, by far, the best record we had had in any year except in 1964, over the last 10 years.

Senator MILLER. Well, may I say, I was delighted at that 9-month record.

But, it seems to me, Mr. Secretary, that with the decline in the stockpile of our gold from $18 billion down to under $12 billion today, that the long term shows a diminution in confidence of the holders of our dollar credits vis-a-vis gold, and I must say I cannot blame foreign central banks when they see the purchasing power of the dollar going down, as it has, for asking for gold instead of our dollar.

Secretary FOWLER. Well, you must remember that during this same period from, say, the early 1950's when the same general pattern of annual decline in the purchasing power of the dollar was occurring, central banks of the countries of the world have steadily accumulated and added to their reserves billions and billions of dollars which they treat as part of their reserves, along with gold.

So, while they have built up their reserves partially buying our gold, they have also taken into their reserves and treated as a component part, a very large block of dollars—amounting currently to a total of at least $16 billion, to be exact, as we sit here today.

Senator MILLER. Well, may I say that that is very interesting.

Secretary FOWLER. We want to keep——

Senator MILLER. The important thing is what is happening now. There are undoubtedly many different reasons for this, and I think you and I could talk about those all afternoon.

The important thing though is that just a year ago when you were sitting in that very chair, I asked you whether there were any plans over in your Department to come over to the Congress to ask us to repeal the gold cover for our currency, and your response was, "No."

Now, since that time, quite obviously, plans have been drawn up, and finally they were crystallized in the President's request that the Congress repeal the gold cover.

Mr. Secretary, I hear a lot of concern expressed about this request, and it comes up in the form of a statement:

> Well, if they repeal the gold cover then there will be no discipline to prevent the turning on the printing presses to turn out steadily diminishing values of currency.

Will it be true that our discipline will be gone?

Secretary FOWLER. No, not at all.

As the hearings before the Senate Banking and Currency Committee, and the House Banking and Currency Committee indicated, the amount of money supply that is created has long since been deemed by all the monetary authorities to be not restrained in any meaningful way by the so-called gold cover.

It is generally agreed by Chairman Martin, by all of his colleagues on the Federal Reserve Board, by all the members of the Federal Reserve System, and most of the knowledgeable banking authorities, that the money supply, which includes in addition to currency demand deposits rises and falls largely unrelated to the question of the gold cover; that it is an anachronism so far as domestic money supply is concerned, and that the element of discipline that we must depend on in relation to money supply creation is not the amount of gold we have but the policies and performance of that Federal Reserve System.

Senator MILLER. So, you are saying that the gold cover requirement exerts no discipline of any consequence to the amount of money supply.

Secretary FOWLER. On the amount, the growth of the money supply, none.

Senator Bennett has made a very, I think, perceptive and intelligent analysis of just this point. He made a speech some weeks ago for the record, and it was the subject of this very point, which was the subject of a good deal of exchange in the hearings before the Senate Banking and Currency Committee, and I would like to supply some of the excerpts of that exchange for the record on this point.

(The material mentioned above, follows:)

SENATE BANKING AND CURRENCY HEARING, JANUARY 30, 1968

Senator BENNETT. It is a little presumptuous of me, but on page 3 of your statement, Mr. Secretary, you say in the middle of the page:

"Today, the strength of the dollar is not a function of this legal tie to gold—a tie which is only applicable to one portion of our total money supply."

In the material I inserted in the record earlier, these figures appear, and I thought I would like to amplify this statement.

Secretary FOWLER. I read your very interesting and very useful development of this point in the record. I believe it was in Friday's record. And I think it would be very useful to have that here.

Senator BENNETT. Well, at the end of 1967, if you interpret our money supply to include currency and demand deposits only, our supply of gold is a reserve of only 7.5 percent.

Secretary FOWLER. Yes.

Senator BENNETT. But if you interpret the money supply to be total currency and total bank deposits, then the reserve ratio drops to 3.1 percent.

And I think this is important, because when we talk of currency or talk of money in circulation most people think only of the printed money that we use for convenience and forget the bank credit money in which most of our transactions are carried out.

Secretary FOWLER. Yes.

Senator BENNETT. So we have actually gone without comment to a point where the actual relation of gold to our usable money is very, very much less than 25 percent?

Secretary FOWLER. Very tenuous, indeed, as the figures you give indicate.

Senator BENNETT. On page 6 of your statement you say that only three other countries in the Group of Ten plus Switzerland still maintain some link between their domestic currencies and gold. For the record could you give us the names of those countries?

Secretary FOWLER. Yes. They are Belgium, the Netherlands, and Switzerland—in fact, the requirement in the Netherlands can be met by either gold or foreign exchange.

Mr. MARTIN. This is right.

Senator BENNETT. I think the record should contain that.

* * * * * * *

The CHAIRMAN. Senator Tower.

Senator TOWER. Mr. Chairman, in your testimony before this committee on February 2, 1965, on S. 797, which removed the gold cover from deposits, you said:

"By retaining the traditional gold backing for Federal Reserve notes, the proposal will be reassuring to those who in their continuing concern for the stability of the dollar see in a gold cover requirement an important element of strength.

The value of any currency is so much a product of confidence that one should not disregard this advantage of S. 797."

I take it then that you now feel that gold is no longer an element of confidence or that it is not required that we have it to maintain confidence.

Mr. MARTIN. It has not served, Senator, as the disciplinary measure that I had hoped it would.

And I can truthfully say that at no time in the deliberations of the Federal Reserve Board has our determination of what monetary policy should be been affected by gold per se.

To me the gold cover requirement is very much in the same category as the debt ceiling that we have that constrains the Treasury. They are faced with the problem of having the Congress vote appropriations in excess of receipts, and then Treasury faces a ceiling on the amount they can borrow to make up the difference.

When this first came up—I used to argue this with Senator Byrd, who is now gone—but when it first came up, I think that this debt ceiling did serve some disciplinary purpose.

In recent years—and this is perhaps because I was an Assistant Secretary of the Treasury for a while and suffered with this—I have come to think that it is largely a harassment and not basically dealing with a fundamental.

And I feel the same way toward this gold-cover requirement. We have moved in the world's history to the point where it's obvious that the supplies of gold in the world are not going to be adequate for world liquidity. And we do need a supplement to reserves in the form of the special drawing rights which the Secretary in a marvelous way has negotiated against insuperable difficulties through the Group of Ten meeting and the meeting at Rio de Janeiro. But so far as actually being a disciplinary weapon and serving a useful purpose, I don't really believe that the gold cover requirement does any more.

Therefore, I have changed my view from that time and believe this is an anachronism, as I say in my statement.

Senator TOWER. That pretty well answered my second question, which was to take up another quotation from your testimony:

"Hence, the need to conserve our gold stock will continue to exert disciplinary influence on monetary and other policies, and the statutory gold reserve requirement for notes will serve to emphasize this need."

You believe that this has been proven to be wrong now?

Mr. MARTIN. I do.

Senator TOWER. Thank you, Mr. Chairman, Mr. Secretary.

Senator MILLER. If the gold cover is repealed, could you give us a recommendation for some kind of a mechanism that could be attached to that repeal which would assure us that there would be no loss of any discipline such as might exist from the gold cover?

Secretary FOWLER. Well, I could give you, I can supply you, the statement based on the colloquy and the observations, the arithmetic and the mathematics of gold supply that I think would be useful in considering this question.

Senator MILLER. I would appreciate it.

(Information subsequently supplied appears below:)

The gold cover requirement, which it is proposed be removed, presently applies only to the currency issue not to the overall money supply. The bulk of the money supply, which is the important economic factor, is in the form of bank deposits. The issuance of notes does not affect the overall money supply. Notes are issued only as the public decides it wishes hand-to-hand money in lieu of bank deposits. The notes issued are paid for by reduction in deposits so that only the composition, not the total money supply is changed.

For all practical purposes the money supply has, since the adoption of the Federal Reserve System in 1913, been regulated by the responsible operations of that institution and has not been an automatic counterpart of the inflow and outflow of gold. Removal of the gold cover will, therefore, have no effect whatever on the management of the United States money supply.

It should be noted that the Government cannot meet its bills simply by printing notes. It has no authority for such a procedure and removal of the gold cover requirement in no way affects this limitation.

There is, therefore, no loss of discipline as a result of repeal of the gold cover requirement and no amendment to that legislation is necessary or desirable.

Further, the simple arithmetic of this matter clearly demonstrates that repeal of the cover requirement is necessary quite aside from the very important international aspects of freeing our gold supply. Even if there were no further gold losses whatever for international purposes, we would still have to seek repeal of the cover requirement. At the beginning of this year we had approximately $12 billion in gold against which the note cover requirements tied up about $10.7 billion. The balance of so-called free gold was thus only $1.3 billion.

The normal increased issuance of notes to cover the needs of an expanding economy absorbs over $500 million annually as the cover requirement increases. A further $150 million or more will be absorbed each year for domestic, artistic and industrial purposes. These two factors together mean that about $700 million a year of our gold will be absorbed for these purely domestic purposes and the legislation we seek is clearly a necessity as there is, at most, two years of grace.

Senator MILLER. One final question, Mr. Secretary:

What would happen if, instead of repealing the gold cover, we disdained paying gold in exchange for dollar claims?

Secretary FOWLER. You mean, if we just stopped——

Senator MILLER. We just said, "We are sorry, we are down to $12 billion of gold and, therefore, we do not see fit to pay gold in response to your demand."

Secretary FOWLER. Well, it is always hard to predict what would happen in these hypothetical questions.

I can give you my best answer to it. I certainly would not want to be the Secretary of the Treasury who took that position because I think it would take us into an unknown period in which we would have abandoned the system of fixed exchange rates which was developed and is incorporated in the operations of the International Monetary Fund, which has been a major contributing factor to the greatest growth of trade and development and capital flows over the last 20 years that the free world has ever seen.

I would not be one for changing a system which has worked, and has worked well and effectively and produced those results, for some unknown and unexplored and theoretical and hypothetical system in which the underpinnings of the existing system were substantially dislodged.

Now, I can give you, Senator Miller, a more extended answer to this. Just let me say, I am for a policy of trying to improve the existing system and to take care of the imperfections in the existing system, of evolving a better and improved system along the lines we currently have, which is, I think, typified by the recommendations of this committee and others for the creation of a supplementary reserve asset, taking that approach rather than abandoning the system we have.

Chairman PROXMIRE. Would the Senator yield on that point? I think it is an excellent question, and I think it would be very helpful if the Secretary would file for the committee more extended remarks, because this is something that troubles this Senator very much. and I think the Senate and the country, especially the economic profession. They have suggested a floating exchange rate.

I am concerned about it, and I think it would be helpful to have the principal financial officer of the Government file his views on this.

(Secretary Fowler feels that his response in the following exchange represents the extension of his views as requested by the chairman:)

Senator MILLER. You see, Mr. Secretary, we are being asked to vote on this, and, I think, before I cast my vote—and I guess a good many of my colleagues feel that way, too—I would like to know to where it might lead. We realize it is an unknown, but we would ask your staff to go into it.

Secretary FOWLER. I would be glad to go into it. I did the other day for a while before the Ways and Means Committee.

This is a question, a proposal, that many academic people are writing about and talking about. But, to my knowledge, there is no head of any central bank in the world today or in an important official financial position, who is concerned with the maintenance of the progress that we have made in world trade and development, who would concur in and approve of this alternative that some of our very useful academic scholars exchange views about.

Senator MILLER. You see, I would just like to clear this up, Mr. Secretary. It looks like we are buying time, and if things continue as they have gone, it will only be a few years until we won't have any gold at all, and then we will not be able to make any payments.

So I think it would be well to explore the ramifications of the failure to deliver gold upon demand.

I would appreciate it, and I know my chairman would, if we could have a very full discussion of this. I do not want to take up the time of the committee to have you go into it now, but if we could have it for the record, I would appreciate it.

Secretary FOWLER. Could I say that I do not agree at all with the premise that it is just a matter of time that we will be out of gold. That depends entirely, in my judgment, on what we do. I think if we bring our balance of payments into equilibrium or close to equilibrium, and keep it there, if we move forward along the lines of the creation of special drawing rights by an amendment to the articles of the International Monetary Fund, I see no reason why the procedures and the methods and the arrangements which have provided a system of fixed exchange rates relating to gold and the dollar at $35 an ounce, cannot be indefinitely maintained to the benefit of world trade and continuing world development.

Senator MILLER. May I say I certainly hope you are right. I have been sitting around here now for over 7 years listening to hopeful discussions about the balance-of-payments deficit problem, and it does not look like it is solved yet. It seems to be a long way from us.

We ought to look down the road and take into account some possible contingencies, Mr. Secretary.

Secretary FOWLER. We do that constantly. Life in the Treasury is nothing but contingency planning.

But let me say, before we leave this point, that this present arrangement which has served us so well is a system that we must, in our efforts, exert ourselves to maintain. You cannot just take all these hypothetical alternatives as an easy out on facing up to the real problem, which is bringing our balance of payments into equilibrium and keeping it there, and if you go to a system of fluctuating exchange rates, you won't solve that problem in that fashion either. You will still have the problem of maintaining balance in your amounts.

Moreover, any change of this sort would not be consistent with the articles of agreement or the spirit of the International Monetary Fund. If rates were allowed to float, which is what the suggestion is, and particularly the rate for the world's major reserve currency, there would no longer be any fixed point for those engaged in international business to determine the costs involved in such businesses and trade would suffer.

I think, Mr. Chairman, if you will talk with any businessman who is engaged actively in the practical day-to-day business of world trade, you would find that the trading, the banking, the other business communities are all strong advocates of a fixed rate, and it is only in the academic circles that this idea of so-called floating rates is under any consideration.

Floating rates have been rejected by the International Monetary Fund, by the Group of Ten in its extensive liquidity studies, over the last 4 or 5 years, and by ourselves as being a satisfactory answer to any problem that confronts us.

It is quite true that the world cannot count on a sufficient supply of gold and dollars in the future to supply the growing needs for liquidity, and that is why we have stressed, and why this committee has stressed, going forward to a plan for an amendment to provide a new asset to supplement, not to displace, not to rule out, but to supplement, gold and the dollar as reserve assets.

I believe the future problems that we face now, and problems that we face in the future can be met without any fundamental and revolutionary change in the system, such as the one that has been mentioned.

Chairman PROXMIRE. I would like to ask you, Mr. Secretary, concerning the University of Michigan model which they have constructed to test what they think would be the effect of a tax hike on inflation and it shows a far, far lesser effect of a tax increase on inflation than the Council of Economic Advisers shows. The council estimates the surtax might effect a 1-percent reduction in the increase in inflation. The University of Michigan model shows less than a third of that.

Now, if you are going to get a greater impact on inflation from a tax hike, the process—as I understand it—is that you have to reduce demand, reduce economic activity, reduce the production and sale of goods, reduce the number of jobs, reduce income, and in doing so you reduce revenues.

You see, this is what I was trying to get at in saying that we have never been given, to my knowledge, in any part of Congress, a thorough analysis of precisely how the 10-percent surtax would raise this $10 billion, what the assumptions are.

We do know that when taxes were decreased in 1964, even with lower tax rates, revenues increased. It is theoretically possible, although I would agree it is not likely at all under present circumstances, that this tax hike theoretically would not raise any additional money. I think that is unreasonable. I think it is also unreasonable to estimate that it will raise $10 billion. I think there is a real possibility of raising $3, $4, $5 billion less.

Unless we have the assumptions clearly in front of us as to what happens to prices, what happens to physical production, what happens to jobs, it is not going to be possible for us to make conclusions.

Secretary FOWLER. The assumptions are right there, developed in precise detail in the President's budget and in the Economic Report and in the Report of the Council.

Chairman PROXMIRE. How many jobs would be reduced by the tax increase?

Secretary FOWLER. Let us talk about revenue, something that is in my field, that I should know something about anyway.

The assumptions are there. Assuming this tax surcharge, the 10-percent surcharge is effective, the estimate we have arrived at in the administration, and it does not differ markedly, indeed it is quite close to the estimate of the Federal Reserve Board, you would have a gross national product for calendar year 1968 of $846 billion. You would have an increase in personal income of substantially much greater than the previous year; you would have a corporate rate, profit——

Chairman PROXMIRE. What would be the gross national product absent the surtax; what would it be without the surtax?

Secretary FOWLER. I think Chairman Ackley has written you in detail of our views as to what it would be. I think, at the end of the year, it would be running at a rate of about $14 billion, as I recall his letter, in excess of the rate that one assumes without the surtax.

However, you must take into account that Chairman Ackley's prognostication assumed that monetary policy remained the same, and that is purely a hpyothetical assumption.

Chairman PROXMIRE. Exactly.

Secretary FOWLER. And monetary policy——

Chairman PROXMIRE. If monetary policy does not remain the same, one of the purposes of the tax hike is that we can get a somewhat easier monetary policy than we can have without it, and, therefore, get stimulation of the housing industry. If you have that, if the economy goes along with roughly the same or a very similar GNP, then the impact on inflation will be very little.

In other words, you cannot have everything. I do not think you can have a tax increase that will reduce interest rates and reduce prices and solve the balance-of-payments problem, all at once.

Secretary FOWLER. No. But you get the kind of an economy that is so highly unbalanced in the impact of the restraint that it is very, very inequitable, and our past experience has been that when we get out of one, when we have to apply restraint, primarily through the monetary channel rather than a mix of fiscal and monetary restraint, you usually end up in a recession.

Now, that is what happened in 1957–58. It is conventional wisdom, Mr. Chairman, not only in this country, but, certainly, among all of the people that Mr. Deming goes over and exchanges views with. They all feel that from their point of view in their respective countries, a combination of fiscal restraint and monetary restraint to deal with an inflationary situation is preferable to depending entirely on one or the other. That is the emphasis on the so-called fiscal-monetary mix, and that is what we do not have if you do not have this fiscal restraint.

You have a complete reliance on monetary restraint, and that produces an unbalanced pattern of restraint, and the inequitable pattern of restraint, a recession, a deep recession, such as we had last year in the housing industry, and has a tendency to end up in a full recession.

Chairman PROXMIRE. Let me get into something else briefly. You state your case very strongly.

Let me get into the very serious problem of the restraint on spending abroad of various kinds. Suppose, assume now, that the Congress provides the kind of restraints you have called for on investment abroad, and the kind of additional restraints the President has directed toward the Federal Reserve on bank lending abroad—assuming you get a tax on airline and shipping travel, and your limit, as I understand it, is $10 instead of $100 on goods brought in from abroad—but assume you do not get this graduated tax on travel.

Now, I have a table in front of me which shows that the deficit on travel in Europe and the Mediterranean area is $700 million in 1966. Unfortunately, we do not have statistics more recent than that.

Secretary FOWLER. That is just the travel expenditure. It does not take into account the transportation. If you add that in, it would be certainly several hundred million more than that—probably more than $1 billion.

Chairman PROXMIRE. Yes. Transportation is $0.56 billion, but transportation, I assume, would be somewhat affected by an increase in the tax on airline and shipping travel.

Secretary FOWLER. Not much.

Chairman PROXMIRE. I am just wondering if Congress gave you everything except this graduated tax on travel, what would be the loss as compared with the program you are asking in our balance of payments?

Secretary FOWLER. I think—I do not trust figures too much in this general area, Senator Proxmire, but the estimates we gave the House Ways and Means Committee, which wanted some estimate made, our estimate would be that the failure to enact the tax proposals would mean about $300 million.

Chairman PROXMIRE. Around $300 million, as far as the——

Secretary FOWLER. If you included the customs figures in it, it would be about $400 million, which is the result of the legislative measures that are proposed, wholly apart from the response to the President's request to forgo nonessential travel.

Chairman PROXMIRE. Is it possible for you, practical in your view, to pick up any substantial part of this $300 or $400 million, whatever it is, by greater restrictions either in the investment area or in the trade area or some other similar area?

Secretary FOWLER. We have gone through this year after year after year, when we had a problem of whatever the sector was that might be affected by any measure, of hearing, "Well now, I know you have got a general problem, but please take care of it by dealing with it in some manner that doesn't affect me."

So, in drawing this together we decided we just had to have a balanced program that dealt with every major component that went into this.

Chairman PROXMIRE. I understand, but it would be perfectly proper for Congress to say we may feel as a matter of policy judgment it is so important that our people be able to travel abroad that this is the one section of the package that we may not—we may be reluctant to go along with.

Secretary FOWLER. I would beg you to understand that the direction of this travel tax program is not to cause any major cancellation of trips.

What its impact will be, will be to be conducive to modest expenditures by those who go ahead and make the trips.

Chairman PROXMIRE. Certainly, it would have some effect in that area.

Secretary FOWLER. It would have some marginal——

Chairman PROXMIRE. Some students and some teachers and some people who have saved for a lifetime to travel abroad might very well find that a 30-percent tax——

Secretary FOWLER. I do not think any student or teacher, unless he expects to stay in the Ritz Hotel in Paris, who expects to stay in a pension or a modest hotel, is going to be deterred from taking that trip by reason of the consequences of the tax.

Chairman PROXMIRE. $7 a day is not the Ritz Hotel.

Secretary FOWLER. Yes, but from $7 to $15.

Chairman PROXMIRE. Breakfast, maybe.

Secretary FOWLER. You figure the impact of the 15-percent tax on that margin between $7 and $15, and if you stay 30 days or whatever it comes to, this is not in any sense a prohibitive tax so far as travel is concerned.

What it does do is say to the traveler, "When you expend money beyond given limits, you are going to also, in addition to paying for the article, pay an additional tax."

Chairman PROXMIRE. So, you would expect this not to deter travel; you would expect the same amount of travel, in which case you would not save on transportation, but you would think savings would come by persons spending less abroad than absent the tax. Is there any experience with that kind of thing?

Once people get abroad, I just wonder if any reasonable tax would deter the amount they would be likely to spend. Maybe it would, but I wonder if there is any experience in this area?

Secretary FOWLER. Well, if you get over 15, the 30 percent rate would be a little deterrent as far as I am concerned.

Chairman PROXMIRE. The New York Times had what I thought was an extraordinarily strong and persuasive editorial in which they said that the trouble with this tax is it is very difficult to administer; it would tend to encourage deception and avoidance and in view of the fact we rely so heavily on voluntary payment of our income tax it could have a very adverse and long-term effect because Americans have done probably the best job of any people in the world on income taxes.

What is your answer to that?

Secretary FOWLER. Could I comment on that? That comment that it would make a mockery out of the established principles of voluntary compliance, I know there is some concern on that. But, as examples, it pointed to the requirement that the traveler before departure would estimate his travel payments and pay an estimated tax on that basis.

Well, the procedure of paying estimated taxes is a long-standing practice in the income tax for both corporations and individuals, with significant nonwage income. There is absolutely no reason to believe that taxpayers will react to the estimated tax in connection with travel any differently than their reaction to the same procedure existing under the income tax.

Indeed, I think the average traveler does make estimates of his expenditures abroad when he goes into American Express or his bank and buys his traveler's checks.

Now, to come to your point, in order to make it completely unnecessary for travelers to keep detailed records of foreign travel expenditures a travel tax would be computed on the so-called travel net worth basis. Thus, for most travelers the tax base would simply consist of the difference between the amount of money and traveler's checks they took with them and the amount that they returned with.

Why is this complicated and full of holes?

The spotchecks—and we will only make spotchecks—mentioned would be carried out to verify the accuracy of the record and to this extent would be quite similar to the income tax audit, that we go through with a certain small percentage of the population.

As with any tax, and here to come to the heart of it, there will be, of course, certain people who will attempt to evade it. However, it is because of the fine record of the American taxpayer in voluntary compliance, that we are able to give heavier weight to the equity aspects of the proposal to tax than to the simpler, but more inequitable alternatives.

Just as with the income tax, there are penalties on those few who would be tempted to cheat.

When you look at the alternatives that you might turn to, you do see the inequities that would emerge, of the simpler systems.

For example, a flat tax per trip or a flat tax per day, because its amount has no relation to the traveler's ability to pay or the cost of his trip, the inevitable effect of any flat tax is to obtain the balance-of-payments savings by deterring large numbers of low income people from traveling while having much effect on the marginal spending by the higher income people. That is a heavy price to pay for simplicity. We chose to forgo that simple and inequitable method of trying to deter people from traveling by reason of these tax measures in favor of the more equitable measure which has its impact on marginal spending.

Now, in that sense, we do take into account and take this decision because of the experience we have with the voluntary compliance practices and patterns of the American citizen.

Chairman PROXMIRE. My time is up. I will just conclude by saying that frankly, I have been surprised by the overwhelming protest I have received against this. I get 150 to 200 letters a day protesting it. This is very, very large, and I think this is common in the Congressmen's and Senators' offices all over the Hill.

Secretary FOWLER. Of course, let me comment. And it is because the people who are writing those letters are approaching it purely from the standpoint of their own personal concern about travel.

They are not aware, as you are, Senator, of the balance-of-payments problem. They are not aware of the seriousness of, the urgency of, the emergency character of the situation we face, and did face in December. They are not aware of the desirability of having a balanced program to deal with this problem.

Why, Congressman Reuss asked me a moment ago about the $4 billion of military expenditures abroad. Of course, that is a serious component in the balance-of-payments ledger of the $49 billion that we spent abroad in 1966, that is an important element.

But the $4 billion of gross travel expenditures is also a serious element, and when you deal with a problem of this sort you can't ignore——

Chairman PROXMIRE. We are dealing with less than a billion dollars of it, though. You omit Canada and Mexico in this hemisphere.

Secretary FOWLER. You are trying to get a balanced program. You are trying not to put it all on direct investment, not to put it all on bank lending abroad, not to put it all on the various, on the easy targets, so to speak.

You are trying to get a balanced program, a fair program in which you try to deal with all of the component elements in this balance-of-payments equation.

Now, it has been said, and we will continue to repeat saying it, that the long-term answer to this travel aspect of our balance-of-payments problem is to encourage foreign travel to this country. But that process of effectively merchandising and organizing the low-cost travel that will be necessary in order to tap the market that exists in Western Europe for travel in the United States, that is going to take time and it is going to take effort.

What we are confronted with today, and what we were confronted with in December, was an emergency, and we had to take some temporary and drastic steps that are unwelcome—unwelcome to me, unwelcome to the President, unwelcome to any government.

But you can't solve a problem of this sort by just blowing soap bubbles.

You have to tackle the problems where they are, and one of them is this particular area.

Now, there will be a report released shortly, a very constructive report, of the Task Force on Travel, which is focusing on various ways and means of making a better market in the United States for overseas tourism. But while that report is being assessed and put into effect and cooperation is being secured, we have got to do something about this part of the ledger.

Chairman PROXMIRE. Congressman Curtis?

Representative CURTIS. Mr. Secretary, you blame the people on this. I would make this observation. How can the people be aware of this problem when the President asks for more Government spending abroad and chastises the Congress when, for example, in just a mild way, it cut back in the field of the new authorizations for AID?

This is your problem, and it creates the credibility gap.

Frankly, I think the people are entirely right in wondering why the Federal Government asks them to bear these burdens when it does nothing itself in this area. It is the same problem in regard to the request for increased taxes.

Secretary FOWLER. Mr. Curtis, that is not——

Representative CURTIS. I am talking about the people, and I am responding to your statement. We are in the business of politics, both of us.

Secretary FOWLER. Yes.

Representative CURTIS. And when you start to blame the people for not understanding——

Secretary FOWLER. I wasn't blaming the people.

Representative CURTIS. No? All right, we will use your term. You said it was the people who didn't understand as this committee understood.

Secretary FOWLER. That is right.

Representative CURTIS. And I am responding by saying that the people, of course, don't understand. I remember I was criticized by some of my Democrat leaders when I referred to the fact that President Johnson symbolically, and I emphasize the word "symbolically," by flying to his ranch down in Texas, was creating the wrong symbol to get the people aware of these serious fiscal problems. I contrasted it to the time when symbolically he talked about turning the lights out in the White House.

Of course, then I was accused of trying to attack the President personally; and doesn't he have a right to travel? I said, of course, he does.

I am talking about symbolism, and how the message gets across to the people as to whether or not there is the serious fiscal problem facing us, which you and I agree upon. I can't get excited about this travel proposal either in light of the budget message or in light of the other requests that are being made for Government spending abroad. I can't even get excited about your attempts to cut back private spending when I see, for example, that the Export-Import Bank, the other day, received an increase of $4 billion. It was pointed out clearly in debate that the Ex-Im Bank has been diverted to a degree from its essential function as a commercial bank, to where it is financing purchases of munitions by these countries abroad and, therefore, is really part of this parcel of foreign aid, military expenditures, et cetera, et cetera, on the part of the Government spending money abroad.

Now, in fairness, until this administration starts symbolically and actually understanding what the words "restricted budget" or austere budget are, instead of misusing words, as I say, and talking about fiscal restraint, I don't think the people are going to go along. The Congress to the extent that it is a mirror that reflects the people's thinking—and it is pretty good that way—isn't going to go along either.

So, if the administration feels as strongly as I know you do about the seriousness of these things, we have got to discuss expenditure programs, both abroad and domestic, and bring the Congress into it.

Secretary FOWLER. Mr. Chairman, could I have an opportunity to comment on that?

Representative CURTIS. Surely; but let me make this observation. You come in, Mr. Secretary, with a lengthy statement of 31 pages or more, which I appreciate. These are just a few opportunities I have of getting the record balanced. It isn't quite as unfair as you might think it to be for me to make these statements for the record.

Secretary FOWLER. No; I know. I have no objection to that as long as I get a minute or two.

Representative CURTIS. To make these counterobjections.

Secretary FOWLER. I would like to put into the record on this point material that is not included in the Blue Book on the Government expenditure side. It is a memorandum of January 11 from the President to William Gaud, the AID Administrator, detailing additional steps to reduce the balance-of-payments costs of the aid program.

Chairman PROXMIRE. Without objection, that will be printed.
(The document referred to follows:)

MEMORANDUM FROM THE PRESIDENT TO HON. WILLIAM S. GAUD (ADMINISTRATOR, AID)

Subject: Additional Steps to Reduce Balance of Payments Costs.

Your agency has made notable progress over the past few years in reducing expenditures made outside of the United States under the economic assistance program. Expenditures for goods and services purchased abroad declined from 27 percent of total aid expenditures in 1963 to 10 percent in 1967. At present, all development loans are used exclusively for procurement in the United States. Eighty percent of grants for technical and supporting assistance and other expenses are used to pay for U.S. goods and services.

In the current situation, however, we cannot rest on this record. I recently outlined a broad program to correct the balance of payments deficit. As a part of the government actions under this program, we must take even more stringent steps to minimize the balance of payments costs of our aid programs. I therefore request that you take steps to reduce your expenditures overseas in calendar 1968 by a minimum of $100 million below what they were in 1967.

To achieve this reduction you should take steps to:

Reduce offshore expenditures for commodities, cash payments, technicians, and other services to the bare minimum;

Increase the use of U.S.-owned local currencies that are excess or near excess to our needs;

Increase the contributions of AID receiving countries in the financing of our technicians and related costs;

Carefully review the requirements for personnel stationed abroad financed with U.S. funds.

In addition, I would like you to review and improve the effectiveness of our arrangements with individual countries to assure that AID-financed goods are additional to U.S. commercial exports.

I know that the additional measure called for will be difficult, coming on top of the very substantial efforts of the last few years. I am confident, however, that with ingenuity and resolve we can put into effect the arrangements necessary to carry on the economic aid program, which is vital to our interests and to the well-being of so many people in developing countries, with even less balance of payments impact.

LYNDON B. JOHNSON.

Secretary FOWLER. I also would like to include a memorandum from the President to the heads of executive department and establishments on reduction of overseas personnel and official travel to indicate the nature and magnitude of the program being carried out there. Congressman Curtis, as you and I know, the dollar amounts that are involved may not be substantial but they are really symbolic and meaningful of the seriousness which this part of the program on the Government expenditure side is being taken.

(The documents referred to above, follow:)

MEMORANDUM FROM THE PRESIDENT TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

Subject: Reduction of Overseas Personnel and Official Travel

Today I sent the attached memorandum to the Secretary of State and the Director of the Bureau of the Budget directing them to undertake a four-part program to reduce United States personnel overseas. I expect each Department and agency to cooperate fully in this endeavor.

In addition, I hereby direct the head of each Department and agency to take steps to reduce U.S. official travel overseas to the minimum consistent with the orderly conduct of the Government's business abroad. I have asked private U.S. citizens to curtail their own travel outside the Western Hemisphere in the interest of reducing our balance of payments deficit. Federal agencies should participate in this effort.

The policy applies particularly to travel to international conferences held overseas. Heads of Departments and agencies will take immediate measures to—

reduce the number of such conferences attended.

hold our attendance to a minimum and use U.S. personnel located at or near conference site to the extent possible.

schedule conferences, where possible, in the U.S. or countries in which excess currencies can be used.

You should present your plans for travel to international conferences held overseas to the Secretary of State, who, with the Director of the Budget, will undertake a special review of this matter.

This directive shall not apply to—

travel necessary for permanent change-of-station for U.S. employees, for their home leave, and for medical and rest and recuperative leave.

travel made necessary by measures to reduce U.S. employment overseas outlined in the attached memorandum.

travel financed from available excess foreign currencies.

You are requested to submit to the Director of the Budget, not later than March 15, a statement on the actions you have taken to reduce all types of overseas travel, the results expected from such actions, and your recommendations as to any additional measures that might be taken.

LYNDON B. JOHNSON.

THE WHITE HOUSE,
Washington, January 18, 1968.

Memorandum for the Secretary of State and Director, Bureau of the Budget.
Subject: Reduction in U.S. employees and official travel overseas.

As a part of my program for dealing with our balance of payments problem, announced on New Year's Day, I would like you jointly to take the specific measures to reduce U.S. employment and curtail official travel abroad, as outlined herein. Within the Department of State, the Senior Interdepartmental Group, chaired by Under Secretary Katzenbach, shall serve as the focal point for carrying out this directive.

You should make these reductions in a way which maintains the effectiveness of our international programs. I would like you to give particular attention to personnel reductions which can be made through relocation and regrouping of functions, the elimination of overlapping and duplication, the discontinuance of outdated and marginal activities, and a general streamlining of operations.

I. REDUCTION IN U.S. PERSONNEL OVERSEAS

This directive applies to all employees under the jurisdiction of U.S. diplomatic missions and includes the representatives of all U.S. civilian agencies which have programs or activities overseas. It also includes military attaches, Military Assistance Advisory Groups, and other military personnel serving under the Ambassadors. It does not apply to U.S. personnel in Vietnam.

The Secretary of Defense has already initiated measures to reduce staffing of the military assistance program. I am asking the Secretary to complete these studies in time to support the goals outlined below.

You are directed to take the following actions:

1. *As a first step, you should proceed, with appropriate participation by U.S. Ambassadors and agencies, to reduce the total number of American personnel overseas by 10 percent,* with reductions of at least this magnitude applied to all missions of over 100. Similar reductions should be made in employment of foreign nationals and contract personnel. Your decisions on this first phase, which shall be final, shall be completed by April 1.
2. *You should also initiate a special intensive review of our activities and staffing in 10 countries with very large U.S. missions.* Your objective, in this second step, should be to reduce U.S. employment by substantially more than the 10 percent immediate reduction taken in the first step. Your final decisions should be made on this phase by August 1.
3. *As a third step, you should proceed to extend these intensive reviews of U.S. activities to other countries beyond the first 10 as rapidly as feasible.*
4. *Simultaneously, you should initiate special studies from Washington of functional areas* aimed at reducing instructions, assignments, and activities which unnecessarily create the need for maintaining or increasing

overseas staff, e.g., reporting requirements, consular work, and administrative support.

Clearly, reductions of this magnitude will involve major changes in agency staffing and personnel plans. I am asking Chairman Macy of the Civil Service Commission to assist agencies in solving attendant personnel problems and in facilitating the reassignment of employees returning to the United States.

II. CURTAILMENT IN OFFICIAL TRAVEL

I am requesting all Department and agency heads to reduce official travel outside the U.S. to the minimum consistent with orderly conduct of the Government's business. I would like you to give special attention to measures to minimize travel to international conferences.

By April 1, I would like you to report on the actions taken in this regard and to recommend any additional steps required.

LYNDON B. JOHNSON.

Representative CURTIS. Just a minute. Again, this illustrates my point. On that, you used the word "symbolic." I would say "diversionary," because your material is meant to indicate that something substantial is being done when indeed nothing substantial has been done, Mr. Secretary, in dollar amounts, and it is dollar amounts that make a difference.

Just like on travel, you are talking about hundreds of millions of dollars when our problem here is in terms of billions, $3.5 to $4 billion.

Now, this is the whole point. This is a misuse of symbolism. You are using it not to reveal what truly is going on, but rather to distract the public's attention to the fact that no reform really is coming about.

Secretary FOWLER. Mr. Curtis, I obviously don't accept that.

I also would like to call attention in the Blue Book to chapter 5 which describes in detail what the Government has done and has attempted to do, and is now undertaking in the field of reducing the balance-of-payments impact of Government expenditures.

I also would like to note a detailed recital in tab B of the actions of the Defense Department over the past 6 years to deal with that phase of the problem, and of tab C, "AID and the Balance of Payments," which is designed to describe the many steps that have been taken to diminish the foreign exchange consequences of aid.

Now, more of this can be done and should be done.

Representative CURTIS. Let me have an opportunity for interrogation, please.

These are the usual diversionary tactics, I might say, when I try to interrogate. These data have been available to this committee, the Ways and Means Committee and everybody else for some time. Sure, put it in the record again but don't let's waste our time on this thing. Let's hopefully get to the issues.

Mr. Secretary, I think you referred to pages in the President's Economic Report where he was recommending a comprehensive review of expenditure policy.

Secretary FOWLER. It was in the budget message.

Representative CURTIS. It was in the budget message?

Secretary FOWLER. Right after the table on pages 20 to 22 where he set forth a number of——

Representative CURTIS. Yes, I recall it. This is on the intermediate sized budget?

Secretary FOWLER. My page references are to the larger volume.

Representative CURTIS. The telephone directory?

Secretary FOWLER. No; it is this size.

Representative CURTIS. That is the one, on page 22?

Secretary FOWLER. The bottom.

Representative CURTIS. Yes. "There have been suggestions for long-range studies of Federal programs evaluating the effectiveness," and so forth, "clearly more study of potential program reforms is needed," et cetera. This is a first step.

Now, Mr. Chairman, I would like to put in the record at this point the recommendations that were made by the Republicans on the Joint Economic Committee in 1963, and then reduced to bill form which I introduced on January 20, 1964, H.R. 9669, to establish a commission on Federal expenditure policy; this was joined in by all the Republican members here. I would also like to insert the remarks that I placed in the Record on page 581, January 20, 1964, the Commission on Expenditure Policy, along with a copy of the letter I wrote to the President of the United States on January 10, 1964, requesting that he support this proposal, and then in the Record of April 23, 1964, on page A2058, my remarks, "administration rejects proposal for expenditure policy review," and which I put into the record, the reply by the then Secretary of the Treasury, and I will read just one sentence from this:

> It would seem unrealistic and unwise to assign to a bipartisan commission a task so broad that it encompasses virtually the whole of the agenda of government.

Now, the point of this is, of course——

Secretary FOWLER. Who was that then?

Representative CURTIS. That was Secretary Dillon, your predecessor as Secretary of the Treasury.

To me it is tragic that this kind of review still has not come about, and the President in his budget message, as you point out, says that this is a needed first step.

Chairman Mills, as you know, has introduced in the last session of Congress something along this line to try to establish this comprehensive look on priorities, and this seems to get no further along.

(All of the materials submitted by Representative Curtis, follow:)

(The following bill was cosponsored by all the minority members of the Joint Economic Committee:)

[H.R. 9669, 88th Cong., 2d sess.]

A BILL To establish a Commission on Federal Expenditure Policy

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, recognizing the profound influence which the composition and level of Federal expenditures and their relationship to revenues have on the Nation's economic growth and stability, it is hereby declared to be the intent of Congress to initiate a far-reaching objective, and bipartisan review of Federal expenditure policy. This goal can be most effectively achieved by—

(1) the establishment of spending priorities among Federal programs. separating the desirable from those that are essential, in order to serve as a guide to the President in drawing up the budget, particularly in years of expected deficits;

(2) the appraisal of Federal activities in order to identify those programs which tend to retard economic growth and for which expenditures should be reduced or eliminated;

(3) the improvement of the Federal budgeting and appropriations process in order to increase the effective control of expenditures;

(4) the examination of responsibilities and functions which are now assumed by the Federal Government, but which could be better performed and with superior effectiveness by the private economy;

(5) the review of Federal responsibility and functions in order to determine which could be better performed at the State and local levels;

(6) the improvement of Government organization and procedures in order to increase efficiency and promote savings, including a review of the recommendations of the Hoover Commission in order to determine how those already implemented have worked out in practice and whether those not yet implemented should be given further consideration;

(7) the determination of policies with regard to the level of user charges and fees to be made for special services furnished to members of the public by the Government.

ESTABLISHMENT OF THE COMMISSION ON FEDERAL EXPENDITURE POLICY

SEC. 2. (a) For the purpose of carrying out the intent set forth in the first section of this Act, there is hereby established a commission to be known as the Commission on Federal Expenditure Policy (referred to hereinafter as the "Commission").

(b) The Commission shall be composed of sixteen members as follows:

(1) Four appointed by the President of the United States, two from the executive branch of the Government, including the Director of the Bureau of the Budget, and two from private life who have distinguished careers in labor, the professions, industry, local and State government, or higher education;

(2) Six appointed by the President of the Senate, four from the Senate, including two members of the Committee on Appropriations, and two members of the Committee on Finance of the Senate, and two from private life;

(3) Six appointed by the Speaker of the House of Representatives, four from the House of Representatives, including two from the Committee on Appropriations, and two from the Committee on Ways and Means of the House of Representatives, and two from private life.

(c) Of each class of two members mentioned in subsection (b) of this section, not more than one member shall be from each of the two major political parties.

(d) Any vacancy in the Commission shall not affect its powers, but shall be filled in the same manner in which the original appointment was made.

(e) Service of an individual as a member of the Commission or employment of any individual by the Commission as an attorney or expert in any business or professional field, on a part-time or full-time basis, with or without compensation, shall not be considered as service or employment bringing such individual within the provisions of sections 203, 204, 205, 207, 208, and 209 of title 18 of the United States Code.

(f) The Commission shall elect a Chairman and a Vice Chairman from among its members.

(g) Nine members of the Commission shall constitute a quorum.

ADVISORY PANEL TO THE COMMISSION

SEC. 3. The Commission may establish an Advisory Panel which shall consist of persons of exceptional competence and experience in the fields of economics, political science, or both such fields. Such Advisory Panel members shall be drawn equally from the Government, private industry, and nonprofit educational institutions, and shall be available to act as consultants for the Commission.

STAFF OF THE COMMISSION

SEC. 4. (a) The Commission may appoint and fix the compensation of such persons as it deems advisable in accordance with the provisions of the civil service laws and the Classification Act of 1949.

(b) The Commission may procure, without regard to the civil service laws and the classification laws, temporary and intermittent services (including those of members of the Advisory Panel) to the same extent as authorized for any department by section 15 of the Act of August 2, 1946 (60 Stat. 810; 5 U.S.C. 55a), but at rates not to exceed $75 per diem for individuals.

DUTIES OF THE COMMISSION

SEC. 5. (a) The Commission shall make a comprehensive and impartial study and investigation of the programs and policies of the Federal Government to determine the most effective ways by which it can promote the purposes and objectives set forth in the first section of this Act.

(b) During the course of its study and investigation the Commission may submit to the President and the Congress such reports as the Commission may consider advisable. The Commission shall submit to the President and the Congress a final report with respect to its findings and recommendations not later than January 1, 1966.

POWERS OF THE COMMISSION

SEC. 6. (a) (1) The Commission or, on the authorization of the Commission, any subcommittee thereof, may, for the purpose of carrying out its functions and duties, hold such hearings and sit and act at such times and places, administer such oaths, and require, by subpena or otherwise, the attendance and testimony of such witnesses, and the production of such books, records, correspondence, memorandums, papers, and documents as the Commission or such subcommittee may deem advisable. Subpenas may be issued under the signature of the Chairman or Vice Chairman, or any duly designated member, and may be served by any person designated by the Chairman, the Vice Chairman, or such member.

(2) In case of contumacy or refusal to obey a subpena issued under paragraph (1) of this subsection, any district court of the United States or the United States court of any possession, or the United States District Court for the District of Columbia, within the jurisdiction of which the inquiry is being carried on or within the jurisdiction of which the person guilty of contumacy or refusal to obey is found or resides or transacts business, upon application by the Attorney General of the United States shall have jurisdiction to issue to such person an order requiring such person to appear before the Commission of a subcommittee thereof, there to produce evidence if so ordered, or there to give testimony touching the matter after inquiry; and any failure to obey such order of the court may be punished by the court as a contempt thereof.

(b) Each department, agency, and instrumentality of the executive branch of the Government, including independent agencies, is authorized and directed to furnish to the Commission, upon request made by the Chairman or Vice Chairman, such information as the Commission deems necessary to carry out its functions under this Act.

EXPENSES OF THE COMMISSION

SEC. 7. There are hereby authorized to be appropriated to the Commission, out of any money in the Treasury not otherwise appropriated, such sums as may be necessary to carry out the provisions of this Act.

EXPIRATION OF THE COMMISSION

SEC. 8. The Commission shall cease to exist thirty days after the submission of its final report.

[Reprinted from Congressional Record—Appendix, Apr. 23, 1964]

ADMINISTRATION REJECTS PROPOSAL FOR EXPENDITURE POLICY REVIEW

Mr. CURTIS. Mr. Speaker, on January 10, 1964, the minority members of the Joint Economic Committee wrote to President Johnson suggesting that a bipartisan Presidential Advisory Commission on Federal Expenditure Policy be established with the purpose of making an objective study in this area. I inserted a copy of that letter to President Johnson in the Congressional Record on January 20, 1964, pages 581–582.

In a letter of April 11, Secretary Dillon has rejected the suggestion of the Joint Economic Committee minority. I ask unanimous consent that a copy of Secretary Dillon's letter, as well as my reply to him, be included in the Record for the information of those who wish to follow this discussion to its conclusion.

The letters follow:

THE SECRETARY OF THE TREASURY,
Washington, D.C., April 11, 1964.

Hon. THOMAS B. CURTIS,
House of Representatives,
Washington, D.C.

DEAR MR. CURTIS: The President has asked me to reply to the letter of January 10, 1964, from the minority members of the Joint Economic Committee. Your concern over expenditure policy is entirely appropriate, and we appreciate the constructive and thoughtful approach which has gone into your recommendation for a special advisory commission to review Federal activities and expenditures.

The President's firm position on the importance of expenditure control along with tax reduction in stimulating the sound growth of our economy is, of course, now well known. His determination to eliminate waste and efficiency through a continual review by the executive branch of the usefulness of existing programs and the establishment of priorities among needed and desirable new programs was unambiguously set forth in his first budget. I am sure you agree that the progress we are making toward a balanced budget, as a result of his strict economy measures and the exhaustive screening of existing programs, was an important factor in the early enactment this year of the tax reduction legislation.

It is, of course, a basic and necessary part of the President's duty under the Budget and Accounting Act to propose in each budget the amounts which, in his judgment, are necessary for the support of the Government. The Congress has a similar responsibility when it is considering the President's budget recommendations.

Expenditure policy is, in fact, program policy. It encompasses practically the entire range of matters with which the executive branch and the Congress deal, including national security and domestic economic and social policy. Under our form of government these responsibilities rest with elected officials, the President and the Members of the Congress. Theirs is the basic responsibility for formulating and deciding matters which relate to the nature, size, and relative priority of Government programs and outlays. It would seem unrealistic and unwise to assign to a bipartisan commission a task so broad that it encompasses virtually the whole of the agenda of government.

To be sure, expertise on a more specialized basis—dealing with specific programs or with matters of organization and procedures—can and has in the past been of value both to the President and the Congress. Expert knowledge has also been useful in obtaining greater economy and efficiency in selected operations. The President and his operating officials have called in the past for such advice as circumstances warrant, and will continue to do so in the future.

In the final analysis, however, I believe the greatest progress can be made toward your objectives if we concentrate on improving program and management appraisals and reviews within the existing framework—both legislative and executive—rather than through a large temporary commission with broad and far-ranging terms of reference.

Certainly the Joint Economic Committee can, as in the past, contribute to such efforts. I can assure you that the President and each of his agency officials intend to press ahead to improve on the accomplishments we have made to date in careful determinations of priorities, in ever greater attention to efficiency, and in the elimination of any and all unnecessary expenditures.

Sincerely yours,

DOUGLAS DILLON.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., April 22, 1964.

Hon. C. DOUGLAS DILLON,
Secretary, U.S. Treasury Department,
Washington, D.C.

DEAR MR. SECRETARY: Thank you for your letter of April 11, 1964, replying to a letter of January 10, 1964, sent to the President by the minority members of the Joint Economic Committee and suggesting the establishment of a Presidential Advisory Commission on Federal Expenditure Policy.

I regret that the administration has rejected the idea of an objective and bipartisan review of expenditure policy by a Commission of experts outside of the Government. However, I do agree with you that efforts in this area should move forward by improvements of the existing legislative and executive framework.

In the light of the difficulties in altering established patterns of thought and procedure within Government, however, the Joint Economic Committee minority felt that the recommendations of a blue-ribbon Commission would help to stimulate needed action within the existing framework.

You may be certain that I will continue to press for improvements in the existing expenditure policy machinery. I would be course, welcome the full support of the administration in those efforts since the chances of making meaningful improvements without administration backing are slight.

Since the January 10 letter to the President was placed in the Congressional Record. I intend to place your reply as well as this letter in the Record so that those who are interested may follow the discussion to its conclusion.

Sincerely yours,

THOMAS B. CURTIS.

[Reprinted from Congressional Record—House, Jan. 20, 1964, pp. 581, 582]

COMMISSION ON EXPENDITURE POLICY

(Mr. Curtis (at the request of Mr. Sibal) was granted permission to extend his remarks at this point in the Record and to include extraneous matter.)

Mr. CURTIS. Mr. Speaker, I am today introducing, along with my minority colleagues on the Joint Economic Committee, legislation to establish a Commission on Federal Expenditure Policy. Identical bills are being introduced in the House by the gentleman from New York [Mr. Kilburn] and the gentleman from New Jersey [Mr. Widnall]; and the legislation is being introduced in the Senate by Senator Jacob K. Javits, the senior Senate Republican on the Joint Economic Committee, and by Senator Jack Miller of Iowa and Senator Len B. Jordan of Idaho.

The bill would establish a 16-member bipartisan Commission composed of members from the executive branch, Congress, and private life, which would begin the vital task of reviewing expenditure policy of the Federal Government. Much attention has been directed to the effects of the Government's tax policy upon our economic growth and employment. Little or no attention has been paid to expenditure policy. Yet there is no doubt that expenditure policy is at least as important as tax policy in its effects on our economy.

The Commission would be entrusted with the task of bringing some of the Nation's best minds to bear on the crucial issues of expenditure policy. It would be established on the model of the two Hoover Commissions, which did such excellent work for the Nation some years ago.

It should be emphasized that the Commission is not simply designed to seek and eliminate waste and inefficiency in Government. The art of expenditure policy is that of establishing priorities among needed and efficient programs. Eliminating waste and inefficiency is simply a matter of identification. Establishing priorities between good programs requires careful study and good judgment.

A blue-ribbon Commission, such as this bill would set up, would provide useful guidance for the executive and the Congress as they grapple with the issues of Federal expenditures in coming years. The reductions that have been announced in the estimates for the fiscal 1965 budget represent but a first step forward. It remains to examine expenditure policy from a broader and more long-range point of view. Specifically, the Commission would make studies and policy recommendations in the following areas:

First. Establishment of spending priorities among Federal programs, separating the desirable from those that are essential, in order to serve as a guide to the administration in drawing up the budget, particularly in years of expected deficits.

Second. Appraisal of Federal activities in order to identify those programs which tend to retard economic growth and for which expenditures should be reduced or eliminated.

Third. Improvement of the Federal budgeting and appropriations process in order to increase the effective control of expenditures.

Fourth. Examination of responsibilities and functions which are now assumed by the Federal Government, but which could be better performed and with superior effectiveness by the private economy.

Fifth. Review of Federal responsibility and functions in order to determine which could be better performed at the State and local levels.

Sixth. Improvement of Government organization and procedure in order to increase efficiency and promote savings, including a review of the recommendations of the Hoover Commission in order to determine how those already implemented have worked out in practice and whether those not yet implemented should be given further consideration.

Seventh. Determination of policies with regard to the level of user charges and fees to be made for special services furnished to members of the public by the Government.

The sponsors of the legislation earnestly hope that President Johnson will give the bill his complete support. I ask unanimous consent that a copy of our letter to President Johnson dated January 10, requesting his backing of the bill, as well as a copy of the bill itself, be included in the RECORD.

CONGRESS OF THE UNITED STATES.
JOINT ECONOMIC COMMITTEE,
January 10, 1964.

The PRESIDENT,
The White House,
Washington, D.C.

Mr. PRESIDENT: As the minority members of the Joint Economic Committee, we have had a lively interest in the national economic debate which was touched off when the late President Kennedy early last year submitted a program to cut taxes and increase spending at a time of already large budget deficits.

In our minority views on the Joint Economic Committee's 1963 annual report, we expressed our support of tax reductions and reform. At the same time, however, we urged the administration to undertake a firm and effective program of expenditure control and to review thoroughly the Government's expenditure policy.

Expenditure policy—which is too often neglected—is at least as important as tax policy in its impact on our Nation's economic growth and well-being. We believe that final passage of the tax bill by Congress would lend added urgency to the long overdue review of expenditure policy.

In a letter to President Kennedy dated March 19, 1963, as well as in our minority views already referred to, we suggested one means to this end. We urged the President to appoint a Presidential Advisory Commission on Federal Expenditures which would conduct a thorough, objective, and nonpartisan review of expenditure policy.

In a letter dated May 25, 1963, Budget Director Kermit Gordon rejected our suggestion. Mr. Gordon said that "established procedure" was satisfactory and that an advisory commission probably could not make "a direct or significant contribution" to resolving the issues of public policy involved. Mr. Gordon said, in fact, that the efforts to such a commission "by obscuring public understanding as to the locus of responsibility for resolving such issues * * * might well lead to an opposite result."

We find Mr. Gordon's confidence in "established procedure" difficult to share in view of the chronic budget deficits which plague the Government. The Commission we suggest would not overturn established budget procedures, but rather it would supplement and, hopefully, improve upon them.

Mr. Gordon's second point totally ignores the highly useful services performed by a large number of Presidential advisory commissions. To name but a few, the Clay Commission, the Advisory Commission on Labor-Management Policy, the two Hoover Commissions, and the Randall Commission, have clearly made important contributions to the development of sound public policy.

Since the Budget Director's letter last spring public and congressional concern over expenditure policy has become even more widespread. It should be emphasized that this concern embraces more than simply the elimination of waste and inefficiency in Government. Once waste or inefficiency is identified, there is little difficulty in getting general agreement to eliminate it. More difficult and more important in terms of savings is the task of continually reviewing the usefulness of outstanding programs and of establishing priorities among needed and desirable new programs.

Because of this widespread concern over expenditure policy, we are once again putting forward our suggestion for a Commission on Federal Expenditure Policy. The title has now been embodied in identical bills which we are introducing in the House and the Senate. Such a Commission would serve as a logical expression of your own concern over the level and trend of Federal expenditures in recent years, and we earnestly hope you will give it your full support. The reductions made in the estimates for the fiscal 1965 budget represent but a first step forward. It is now time to examine expenditure policy from a broader and more long-range point of view. It is this function which the Commission we suggest would perform.

We envision that the Commission would be composed of Government members, private citizens from business, labor, education, the professions, and Members of Congress equally from both parties. The work of the Commission assisted by a professional staff, should parallel the 2-year period over which the pending taxes are scheduled to take effect. During this period, the Commission should conduct studies and periodically make public its recommendations in the following areas:

(a) Establishment of spending priorities among Federal programs, separating the desirable from those that are essential, in order to serve as a guide to the administration in drawing up the budget, particularly in years of expected deficits.

(b) Appraisal of Federal activities in order to identify those programs which tend to retard economic growth and for which expenditures should be reduced or eliminated.

(c) Improvement of the Federal budgeting and appropriations process in order to increase the effective control of expenditures.

(d) Examination of responsibilities and functions which are now assumed by the Federal Government, but which could be better performed and with superior effectiveness by the private economy.

(e) Review of Federal responsibility and functions in order to determine which could be better performed at the State and local levels.

(f) Improvement of Government organization and procedures in order to increase efficiency and promote savings, including a review of the recommendations of the Hoover Commission in order to determine how those already implemented have worked out in practice and whether those not yet implemented should be given further consideration.

(g) Determination of policies with regard to the level of user charges and fees to be made for special services furnished to members of the public by the Government.

The recommendations of an objective and bipartisan Commission of the kind described should command widespread support among the public and within the Congress. Its proposals would offer a sound basis upon which to begin the reform of Federal expenditure policy.

We earnestly hope you will give this recommendation your early and favorable consideration.

Respectfully yours,

THOMAS B. CURTIS.
CLARENCE E. KILBURN.
WILLIAM B. WIDNALL.
JACOB K. JAVITS.
JACK MILLER.
LEN B. JORDAN.

Representative CURTIS. Now, Mr. Secretary, the Council of Economic Advisers has said even with the adoption of tax surtax, and other revenue measures, that inflation will still be 3 percent and over during this present fiscal year; am I correct?

Secretary FOWLER. I don't know, but I would think so, since the current rate is about 4 percent and the present fiscal year will be over in only 4½ months.

Representative CURTIS. Well, not only did the Chairman of the Council of Economic Advisers respond under my interrogation a couple of weeks ago along this line, but it is also in the President's Economic Report.

Now, it seems to me that not only are we too late and the remedy is too little, I happen to agree with you that we are too late to get at this problem of fiscal deficit to the extent that we are now experiencing inflation, and it is causing great damage. We are also experiencing high-interest rates. But in light of the CEA statement isn't the remedy too little? In other words, just a surtax, in context of your expenditure budget?

Secretary FOWLER. I would entertain very seriously a proposal, proposals to increase the level of the surtax.

Representative CURTIS. No; I was thinking in the other area of cutting deficits.

Secretary FOWLER. I have already said, go ahead with the 10-percent surtax and if Congress can reduce expenditures and find areas where it will do so, why, I think more, some more restraint would not be dangerous.

Representative CURTIS. Well, now, that is not responsive to the question. I am asking whether or not 3 percent plus inflation for 1968 is really too much for this economy to handle. In other words, your remedies, even if the Congress were to accept them, namely the surtax, are insufficient to meet the problem.

Secretary FOWLER. I think this is the question of the turnaround and the importance I place on moving in the right direction, and the question of at what date one gets back to a pattern of price stability.

Representative CURTIS. Let's relate it to that so I can point up my question a little better. Let's relate it to the problem of imports versus exports but primarily the problem of imports which then come in as a result of this kind of inflation. This is a real thing, Mr. Secretary, and is creating pressures on the Congress to have some sort of a border tax or to have some sort of a surcharge on imports. This, as you know, during Ways and Means Committee hearings, prompted the chairman to request Mr. Roth, and I guess you also, to be ready to report back to the committee along these lines.

Now, these pressures are, to some degree, a result of the inflation that we have had, and inflation that we are facing. I am directing it to this specific point. Is the 3 percent plus that we can anticipate, even with your tax, too much as far as generating the prices that would possibly end up with a border tax or possibly some surcharge on imports?

Secretary FOWLER. Well, I think, Congressman Curtis, there are two aspects of the import problem. One is the immediate flooding in of imports when an economy is expanding at an excessive rate of speed, and I think that the enactment of the surcharge to hold back the economy from advancing at a higher rate of speed than it otherwise would, would be highly desirable in arresting this floodtide of imports now on the——

Representative CURTIS. You are recommending a surcharge on imports?

Secretary FOWLER. No; I said the surcharge on income tax is holding down an excessive increase in growth.

Representative CURTIS. I still ask the question, You are surely not recommending that we have a surcharge on imports, are you?

Secretary FOWLER. No, no. I am talking about the income tax surcharge.

Representative CURTIS. I understand that. But then, because this is in context with what I am saying and to what the Ways and Means Committee chairman directed attention to, I am leading into this other phase of the question——

Secretary FOWLER. I don't have any position on that at the moment, Congressman Curtis, which is any different from that stated in the President's message and expressed by Ambassador Roth to the committee the other day.

Representative CURTIS. But you are certainly not in favor of it?

Secretary FOWLER. I stand on the position taken in the President's statement——

Representative CURTIS. But things have happened since then, Mr. Secretary. There have been hearings before the Ways and Means Committee, there has been interrogation, and a request on the part of the chairman of the Ways and Means Committee to look into these areas. This has got our people in this country very much concerned as well as the people abroad, so I think——

Secretary FOWLER (continuing). And Mr. Roth, in his discussion, and I will not go beyond that, reflected the President's statement that, "these discussions will examine proposals for prompt cooperative action among all parties to minimize the disadvantages to our trade which arise from differences among national tax systems. We are also preparing legislative measures in this area whose scope and nature will depend upon the outcome of these discussions."

These discussions, as Ambassador Roth indicated, have been going forward and are continuing to go forward, and until they have been completed, I will take no position on their outcome.

Representative CURTIS. My time is up but I must observe, of course, this all relates to leadership—or lack of it—on the part of the administration in a matter which you properly defined as a serious emergency. This is what I must take as leadership.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Back to the military balance of payments, I just want to recapitulate my position on that $800 million balance-of-payments loss to Europe and my advice, for whatever it is worth, is that this $800 million represents a real loss to the American people, that it is really no use sending Mr. Deming or Mr. Rostow over to Europe to try to get the Germans to invest for 4 years at the going rates of interest a similar amount in the United States. That is to their advantage anyway; you don't really have to beg them to do that, and it doesn't solve anything because in 3 or 4 years the note comes due, and there we are again.

I think, furthermore——

Secretary FOWLER. They may continue. It is not unlikely that they might be renewed.

Representative REUSS. Maybe, but we have to continue paying interest and we owe the money.

Secretary FOWLER. It is just like we have a whole program for encouraging foreign investment in the United States in portfolio securities.

Representative REUSS. That is great. I am all for encouraging foreign investment, but I don't want the American people to continue to bear the terrible burden of losing $800 million a year in real wealth as a result of our troop disposition in Europe.

I think that it is entirely fair to ask the Europeans, particularly the Germans, the Belgians, the Dutch, and the Italians who are rich on reserves, to pick up a very small portion of our total $4 billion budgetary cost, I would say 20 percent, $800 million, which happens to be the exact foreign exchange component of it, have them plunk it down in counterpart funds, we have all the techniques available to use francs, deutsche marks, whatever. That to me would be some fair burden sharing.

We don't ask the NATO people to pay for the cost of U.S. troops in the United States over at Fort Myer, but I don't think there is anything outrageous to ask them, where they are able to do so, to pay 20 percent of the cost, $800 million, the foreign exchange component of the troop presence there.

So, where I differ quite markedly with the administration, is that I think we should ask.

I am sorry the administration didn't ask.

Let's turn to——

Secretary FOWLER. Judgments have to be made as to what is negotiable and what isn't, Mr. Reuss, in this business all the time.

Representative REUSS. I think we keep from the people the true facts if we act as if a continued investment in the United States is in any way an offset. It isn't. It is nice to have their investments but meanwhile we have lost $800 million and keep doing it every year.

Secretary FOWLER. Well, we have got a degree of security for it, and it is part of the insurance policy, it is the premium on the insurance policy that the American people pay. I recognize it is debatable as to whether that premium is too high or whether it should be reduced by bringing additional troops home, that is clearly a debatable issue.

Representative REUSS. May I say that I haven't suggested that.

Secretary FOWLER. No.

Representative REUSS. I take for the purposes of the Joint Economic Committee the military situation as given. If the Joint Chiefs of Staff say we need 205,000 troops in Germany, that is how many we are going to have there.

But, given our financial situations, I really can't see why it is so out of order for us Americans to ask the NATO powers who get, I am sure, one-fifth of the benefit of our troops' presence there, to pick up, as they well can, that part of the burden. I just disagree with the administration, and my advice is——

Secretary FOWLER. Let me say, if there is implicit in your comment and in this exchange that this is all that we ask in the way of cooperation, I think that should be corrected.

There are a variety of alternative ways of neutralizing these balance-of-payments costs, and while the two that stand out most prominently in terms of the magnitude are the purchase in the United States of more of their defense needs, and the investment in long-term U.S. securities, there are additional measures which are being explored and discussed in many of these countries.

Representative REUSS. I hope you will explore the one meaningful and straightforward one, ask them to pay our balance-of-payments costs of our troop presence in Europe, and that is where I and my Government differ. We don't seem to be asking them. You don't seem to want to ask them.

Secretary FOWLER. Well, it may happen to be that $800 million is part of your balance-of-payments costs, but it also happens to be a part of your budgetary costs——

Representative REUSS. Right. So what's wrong with asking them to——

Secretary FOWLER (continuing). That they will not undertake.

This was made very clear in 1960 by the then German Government.

Representative REUSS. Well, enough on that. Let's go to Vietnam where early in 1965 we started getting involved in a very costly war. I notice that since that time—while the American international reserves have gone down and down and down—in Vietnam, a country we are supposed to be helping, their international reserves have gone up and up and up. As my little fact sheet shows, they have gone from $141 million in December 1964, that was right before the escalation started, to $334 million today. That is more than double. Is it not a fact, I ask you, that while our reserves have been going down very largely as a result of the war in Vietnam, the Government of South Vietnam reserves have been going up?

Secretary FOWLER. That is a fact.

Representative REUSS. Let me turn to the effective rate of the South Vietnamese piastre.

Secretary FOWLER. May I make two comments on that?

Representative REUSS. Sure.

Secretary FOWLER. Apart from the efforts to hold down the balance-of-payments costs of our military expenditures in that area, the policy you referred to which we have begun in East Asia, in Vietnam, is to encourage the investment of official reserves in longer term investments in the United States comparable to the policy with respect to Germany.

We believe that in Southeast Asia this is mutually beneficial. It is helpful to us in terms of our liquidity position. We believe it is also helpful to the nations out there in making investments, putting aside reserves for the future, their future, and for the longer term problems of hopefully peaceful economic development which they must turn to when this conflict is over.

I would like very much to see our own reserves increasing and accumulating, obviously. I am very much concerned with the facts that our reserves are decreasing. But, I do take some comfort from the fact that a financial basis for reconstruction in that area is being laid, in terms of these countries themselves and their reserves, and I am, therefore, not unhappy about that particular result.

Representative REUSS. For reconstruction, if they reconstruct.

If they fritter away in corruption, then that is not as good; is it?

Secretary FOWLER. The question answers itself.

Representative REUSS. Let me now turn to the effective exchange rate. We buy piastres from the South Vietnamese Government at 118 to the dollar. I believe it is correct that this exchange rate rather sharply overvalues the piastre, and that one can buy 150 or 160 piastres for a dollar almost anywhere in Asia, including in the unofficial market in Saigon, banks in Korea, in Japan, and Bangkok, and so on.

Secretary FOWLER. There is a black-market rate at about, I think, actually 165 to 1 now.

Representative REUSS. Whatever it is, 160, 165.

Secretary FOWLER. As compared to the effective legal rate of 118 to 1.

Representative REUSS. Now, when we buy these piastres from the Vietnamese Government at a 118 figure, as opposed to the black market, free market figure of 165 which is what the rest of the world seems to value them at, we are in effect overpaying the Vietnamese Government and adding to their international reserves; are we not?

Secretary FOWLER. Yes; but we are dealing with a sovereign government which sets its own legal and official rates for its currency with respect to foreign currencies. I might say that it did this and fixed the 118 piastre rate in consultation with and approval of the International Monetary Fund which sent a mission out there, and it has set this rate as the rate of exchange applying to all transactions except a small volume of student remittances.

The other rates, the higher rates, are black market rates. They are illegal, and we don't believe that the United States should purchase piastres at this rate since it would have to do so from people who are violating the Vietnamese law.

Now, this does leave open the question as to whether or not there should be a further evaluation of the piastre rate from that which was fixed some time ago after consultations with the International Monetary Fund. But so long as that is the official rate, I think we ought to abide by it.

Representative REUSS. If it is an unrealistic rate, as it apparently is because of the existence of this free market vastly different from the official rate, aren't the principal victims of it the American soldiers in Vietnam, who, when they turn in their military payment certificates for piastres are given them only at the official fixed rate of 118 to the dollar, and are not able to do what others do—go into a bank in Korea or Thailand, and get them at 165 to the dollar; and isn't this in effect a sales tax on the GI?

Secretary FOWLER. It does amount to this; that those who deal in the legal market take a penalty and those who deal in the black market get a benefit. I think all of us who have traveled abroad where black markets are the vogue—and I recall being confronted by this problem in the 1940's—we always make our own decisions as to whether or not we are going to deal in the black market or whether we are going to deal in the regular market.

Now, I do think that the reevaluation of the piastre rate, that did take place under the aegis of the International Monetary Fund, was a healthy and constructive move; and I regret that there is a black market and there is that disparity in rates.

However, I think those of us who have been in wartime conditions and operated in wartime atmospheres will recognize this as nothing particularly unusual and unique about the existence of a black market associated with war.

Representative REUSS. Having in mind our conversation on this point of our balance-of-payments costs in Vietnam, is it not a fact that if the Government of South Vietnam were willing and able to tax its people more effectively, to refrain from the excess creation of money by its central bank, and to cut down on the leakage in the system generally, if it were able to do that, this would very markedly help us in the foreign exchange cost——

Secretary FOWLER. That is right.

Representative REUSS (continuing). Of the Vietnam operation?

Secretary FOWLER. If the Finance Minister of South Vietnam were able to accomplish that, I would ask him to come over and lead a technical mission to the United States to assist me in accomplishing the same general results here.

Representative REUSS. Yes, but you don't think we have corruption on the scale here which exists in South Vietnam?

Secretary FOWLER. No. I am talking about getting a tax increase.

Representative REUSS. Do you think that the——

Secretary FOWLER. It is not so easy, I have found.

Representative REUSS. Do you think the United States and South Vietnam are comparable in their fiscal problems?

Secretary FOWLER. No; but I think the common problem is that finance ministers all over the world find it difficult to get taxes increased at a particular time when they think it would be for the good of the country to get them increased.

Representative REUSS. Just one more question, a point that Senator Proxmire raised, and I will ask you if you would be good enough to supply this for the record. With respect to your balance-of-payments saving on the President's proposed travel program, I believe that in the breakdown of how you are going to save $500 million, $300 million will be saved by the tourist expenditure tax, $100 million by the diminution of the duty-free customs' allowance, and $100 million by the President's moral suasion to stay in the Western Hemisphere.

Secretary FOWLER. The first two figures are right. We have not, obviously, attempted to price out the President's request that people forgo nonessential travel outside the Western Hemisphere; we believe that there will be a response to that, and just what its order of magnitude is I don't know; but we are hopeful as a result of the combination of the two things that the half-billion-dollar target of a reduction in the travel deficit could be achieved this year.

Representative REUSS. What I would like to have you supply, then, for the record at this point, is a breakdown through worksheets or in any other way of just how these savings will come about, what was the methodology you used.

Secretary FOWLER. I would be glad to do that.

Representative REUSS. And I will say, in conclusion, that since I have been fooling around with estimates pro and con on tourism myself, I recognize the difficulty, and I will not be shocked if you aren't able to demonstrate to the last penny just how much you are going to save.

Secretary FOWLER. I would not attempt to demonstrate that. This is a matter with which technicians have been struggling and struggling, in consultation with similar technicians from airlines and other groups who have some experience and know-how; but it is something for technicians and I would not attempt to prove to this committee $300 million or $350 million or $275 million. However, this is the advice we get as to the likely range of effect of the measures proposed.

Representative REUSS. Fine. I will be grateful if we can see the data on which they constructed that.

Thank you.

(The material which follows was subsequently supplied by the Treasury Department:)

FEBRUARY 26, 1968.

Estimated foreign exchange savings on projected 1968 levels of travel outside the Western Hemisphere: ticket tax of 5 percent; expenditure tax of 15 percent on expenditures abroad of $7.01 to $15 a day and 30 percent on expenditures in excess of $15 a day.

The starting point for the estimation of foreign exchange savings from the travel tax proposal is the estimates of foreign travel expenditures published in the June 1967 *Survey of Current Business*. This article, and previous annual articles in the *Survey*, provide estimates for a number of years of amounts paid for travel to foreign countries and amounts spent abroad by American residents. Also included is information on the number of travelers. For Europe and the Mediterranean area, data are provided as to the average length of stay, the average amount spent per day, and the average amount spent for fares by sea and by air.

The data in the *Survey* were used to estimate 1968 foreign travel expenditures (if there were no travel tax) utilizing past trends as to the relationship of foreign travel expenditures to national income and historical trends in daily expenditures and length of trip. In the case of trips to Europe and the Mediterranean area, which account for over 80 percent of expenditures for travel expenditures outside the Western Hemisphere, these adjustments resulted in an estimated cost for trips planned to this area in 1968 of $1,000, with $450 being for transportation. The average stay abroad of trips planned for Europe and the Mediterranean area (exclusive of travel time) was estimated at 33 days. However, indications are that the length of stay varies inversely with income. For the 1968 estimates, the range used was 51 days for those with incomes under $5,000 to 26 days for those with incomes over $20,000. Average daily expenditures abroad increase with income and for 1968 are estimated to range upward from $9.63 for the lowest income group to $25.39 for those in the over $20,000 income category.

Application of the proposed tax rates to the estimated distribution of planned trips by length of trip and the amount spent per day gave a figure for the potential tax on trips planned for 1968 outside the Western Hemisphere. The potential tax provided only a starting point for determining the possible foreign exchange savings from the proposed tax. Then, using estimates regarding the elasticity of demand for travel, the tax potential was converted to an expenditure reduction. The estimate of consequent foreign exchange savings is given as a range of from $250 million to $300 million. This range takes into account the judgmental factors necessarily involved in estimates of this nature.

Office of the Secretary of the Treasury, Office of Tax Analysis.

February 26, 1968.

Estimated foreign exchange savings from reduction from $100 to $10 of duty-free exemption for U.S. residents returning from countries other than Canada, Mexico and the Caribbean area; [1] and reduction from $10 to $1 of duty-free gift provision for articles arriving from abroad by mail.[2]

During 1967, the total value of foreign acquisitions made by returning U.S. residents arriving from all foreign countries was estimated to be in excess of $362 million. Of this total, persons arriving from Canada, Mexico and the Caribbean countries (including Caribbean cruise passengers) accounted for slightly over $162 million. The value of articles acquired by returning U.S. residents arriving from other countries was approximately $200 million.

The total reduction in foreign acquisitions as a result of reducing the tourist exemption to $10 is estimated to be approximately $50 million. Of the total, it is estimated that the value of foreign acquisitions by persons now bringing in less than $100 each will be reduced by $45 million, or approximately 40 percent of the total purchases made by this group.

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[1] Foreign purchases accompanying the returning tourist, not otherwise free under the Tariff schedules, would be dutiable at a flat 25 percent of the wholesale value if the total value of the purchases exceeded $10 at retail but was not over $500 in wholesale value. Articles totaling in excess of $500 at wholesale values would be taxed at the standard rates of duty.

[2] A flat charge of $2 would be collected on dutiable mail shipments valued at retail at over $1 and not over $10. The special exemption for gifts valued at less than $50 mailed by servicemen in combat areas would be retained.

It is estimated that the total value of the 55 million mail parcels which arrived in the U.S. during 1967 was approximately $500 million. Of this 55 million total, an estimated 11 million parcels were gifts or purported gifts said to be valued at less than $10; 4 million were gifts valued at less than $50 from servicemen in combat areas; and 25 million were "flats," newspapers, periodicals, samples, and shipments of insignificant value. Of the remaining 15 million parcels duty was assessed on 1,600,000 parcels. However, our studies indicate that approximately one-third of the 15,000,000 parcel total would have been dutiable if adequate manpower was available to properly handle them.

Of the 11 million gift parcels under $10, an estimated 4 million from U.S. tourists would be discouraged if the existing gift exemption were eliminated. This would result in curtailment of foreign expenditures by approximately $28 million.

The application of a flat rate of duty to the remaining noncommercial shipments, by simplifying Customs' administrative task, would allow it to assess duty on an appreciable number of packages which now escape duty because Customs manpower cannot cope adequately with the number of packages involved. Changing this result will probably deter the sending of a number of these packages.

The aggregate reduction in foreign exchange costs as a result of the proposed changes in the Customs rates and processing of foreign mail parcels is estimated to be $40 million.

Office of the Secretary of the Treasury, Office of Tax Analysis.

Chairman PROXMIRE. Any further questions? The hour is late.

Representative CURTIS. Yes.

Mr. Secretary, my line of questions was leading up to an article that I saw in the Washington Post this morning, a column by Evans and Novak, with the headline, "Administration's Travel Tax Plan Becomes Fowler's Frankenstein."

Have you seen that yet, Mr. Fowler?

Secretary FOWLER. Yes; I usually read the Post coming in in the morning and I have read it.

Representative CURTIS. I would be glad to have the record open for your fuller comment.

Secretary FOWLER. I never comment on columns, Mr. Curtis. If you want to ask me a question, I will answer it.

Representative CURTIS. Yes; I do.

It says:

> Fowler is privately agreeing to congressional demands for a tariff surcharge to get Congress to swallow the administration's bitter travel tax.

Is this true?

It also says:

> In private conversations with Congressmen, Fowler has hinted he would be willing to pay this price.

It refers back to bloating up an original border tax. It was alleged you advocated a 2-percent border tax, bloated up by Congressman Byrnes and other Congressmen to the 10- and 15-percent surcharge.

This is what I was asking, whether you had a position on that.

Secretary FOWLER. No; I have no position. The positions I have had and continue to have are those reflected in the President's message.

Representative CURTIS. Is there any truth——

Secretary FOWLER. I will not go beyond that.

Representative CURTIS. Is there any truth in these statements?

Secretary FOWLER. What is that?

Representative CURTIS. Is there any truth to the statements that you have been agreeing with certain influential Congressmen on this committee to anything of this nature?

Secretary FOWLER. We haven't been agreeing to anything. I have been in consultation with members of the committee but I haven't agreed.

Representative CURTIS. You know, Mr. Secretary——

Secretary FOWLER. I can't agree, Mr. Curtis——

Representative CURTIS. I know you can't. I think the proper forum for discussing these things is the Ways and Means Committee when all of us are present and not private consultations. You and I have had this discussion before. Whatever has to be said that involves the serious future of this country ought to be said——

Secretary FOWLER. Mr. Curtis——

Representative CURTIS. Now, let me finish—Should be said in public hearings. I interrogated you and others along this line. If there is any truth at all to this business of private agreements or working out private——

Secretary FOWLER. No.

Representative CURTIS (continuing). Working out private deals of this nature——

Secretary FOWLER. No.

Representative CURTIS. You say there is none?

Secretary FOWLER. No. The consultations that I referred to and are referred to there, are the same kind of consultations—I believe Ambassador Roth talked to you some time in late December, that is, at least, my recollection—exploring this general problem, and that is the nature of the general exploration.

Representative CURTIS. Just a discussion of what the facts are and what the problems are and so forth, not discussion on what an actual program would be?

Secretary FOWLER. No, no.

Representative CURTIS. Because, you see, there are these pressures, and I know you are aware of them. Witness the number of import bills that have been introduced in the Senate and the House, and there are some very serious problems that have been part of our domestic industries, aggravated, I point out, by the inflation that we experienced last year, and to be aggravated further by, even with your tax package, of inflation of about 3 percent. I know these pressures are great on my colleagues.

These things should be discussed in the open, in my judgment. Not in an unsympathetic way, but in a way to try to zero in on these things.

Well, Mr. Chairman, in order to have this discussion in context, and only for that purpose, I would like unanimous consent to put this article in the record to which I referred, and——

Chairman PROXMIRE. Without objection, so ordered.

Representative CURTIS. If the Secretary would want to reply further, I would be very happy.

(The article from the Washington Post, referred to by Representative Curtis, follows:)

[From the Washington (D.C.) Post, Feb. 15, 1968]

ADMINISTRATION'S TRAVEL TAX PLAN BECOMES FOWLER'S "FRANKENSTEIN"

(By Rowland Evans and Robert Novak)

The latest lethal byproduct of the balance-of-payments concoction let loose by President Johnson and Secretary of the Treasury Henry H. Fowler on New Year's Day is a hidden but intense struggle inside the Administration over trade policy.

Fowler is privately agreeing to congressional demands for a tariff surcharge to get Congress to swallow the Administration's bitter travel tax. But he is running into strong opposition within the Administration from trade negotiators, State Department and Commerce Department policymakers, and even some of Fowler's own Treasury lieutenants.

What they are haggling about boils down to this: Is the plan to cut down on the flow of dollars from this country worth taking a sharp turn toward protectionism and economic isolationism? Fowler to the contrary notwithstanding, many Administration policymakers are saying "no." But the issue may be out of control in the halls of Congress.

Indeed, the New Year's Day plan intended to ease the balance-of-payments puzzle without going through long-range international monetary reforms may turn out to be Joe Fowler's "Frankenstein Monster." Its uncanny growth may undermine this country's longstanding liberal trade policy without really curbing the dollar outflow as intended.

Starting point for the trouble is the travel tax scheme sketchily outlined in the New Year's Day message. There is no doubt that the Treasury originally intended a prohibitive head tax on U.S. travelers intended to keep them out of Europe the next two years. But the Administration, as well as some congressional leaders, badly miscalculated how much protest it would provoke.

Constituents bombarded congressional offices with complaints. Parents grumbled that students' plans for European vacations would be ruined. Voters intending to visit relatives in the old country—including the politically potent Italian and Polish ethnic blocs—howled. Lobbyists for Pan American and TWA advised the Treasury the scheme would put them out of business.

The Treasury hastily retreated from a prohibitive tax, submitting instead a Rube Goldberg contraption taxing the amount of money spent by Americans in Europe on a graduated basis. Even if simplified by the House Ways and Means Committee, however, this scheme is so unpopular that it could not pass on the House floor on its own merits.

There is where the protectionist question comes in. Rep. Wilbur D. Mills of Arkansas, the all-powerful chairman of the House Ways and Means Committee, has advised the Administration that a travel tax simply cannot pass without a protectionist trade gimmick attached.

In fact, Rep. John Byrnes of Wisconsin, the Committee's senior Republican, makes clear he will not give the travel tax his needed backing without a tariff surcharge of between 10 and 15 per cent on all imports.

Herein lies the Frankenstein nature of the original Fowler package. It contained a relatively modest 2 per cent "border tax"—a euphemism for an across-the-board tariff—to provide revenue for tax rebates for American exporters. This has been bloated up by Byrnes and other Congressmen to the 10 to 15 per cent surcharge.

In private conversations with Congressmen, Fowler has hinted he would be willing to pay this price. But there is sharp dissent and debate within the Administration. Secretary of State Dean Rusk is uneasy about higher tariffs in interagency discussions. William Roth, chief U.S. Trade Negotiator, is dead set against it. Even Stanley Surrey, Fowler's own Assistant Secretary for Taxation, tends to be opposed on theoretical grounds.

The determination of the Administration's final position is still very much in doubt.

The balance may be tipped by Mills. Long a free trader, Mills is now advising the Administration a tariff surcharge of the kind proposed by Byrnes is necessary to stave off a succession of individual commodity quotas roaring through in a congressional Orgy of Protectionism.

Actually, there are some exponents of free trade who believe quotas on textiles and other commodities might be preferable to a tariff surcharge. They feel that passage of a tariff surcharge would threaten severe retaliation not only from Europe but Canada and Japan as well.

There are some LBJ policymakers who confess in whispers that they would just as soon dump the travel restrictions and forget the whole mess. But once a monster is hatched, they are finding, it cannot be easily forgotten.

Representative CURTIS. Could I ask one other unanimous consent? Yesterday I was engaged in a colloquy with Secretary Freeman regarding the problem of farm credits. At the time I had not read this article that appeared in the Federal Reserve Bank of St. Louis, February 1968, entitled "Changing Sources of Farm Credit." It is a speech by Darrell Francis, President of the Federal Reserve Bank, and it, along with tables, has an excellent discussion of this problem, and I would like unanimous consent that it be put in the record during the colloquy with Secretary Freeman.

Chairman PROXMIRE. Without objection, it will be so done.

(The article referred to is included in the record of yesterday's proceedings; see p. 268.)

Chairman PROXMIRE. Mr. Secretary, we want to thank you for another one of your fine performances. We appreciate it very much. It has been a very helpful morning.

Secretary FOWLER. Thank you, sir. It is a pleasure to be here.

Chairman PROXMIRE. The committee will stand in adjournment until tomorrow, Friday, at 2 p.m., when we will meet in this room to hear a panel of agricultural experts.

(Whereupon, at 1:15 p.m., the committee recessed, to reconvene at 2 p.m. Friday, Feb. 16, 1968.)

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