408

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

SECOND SESSION

FEBRUARY 16, 19, 20, AND 21, 1968

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CONTENTS

STATEMENTS

February 16, 1968

Page

Graham, Harry L., legislative representative, the National Grange 339
Prepared statement 342
McDonald, Angus, director of research, National Farmers Union 346
Prepared statement 349
Shuman, Charles B., president, American Farm Bureau Federation 357
Shafer, Gordon, chief negotiator, National Farmers Organization 363

February 19, 1968

Machlup, Fritz, Walker professor of economics and international finance, Princeton University 394
Prepared statement 399
Butler, William F., vice president and director of economic research, the Chase Manhattan Bank, New York 416
Prepared statement 417
Behrman, Jack N., professor of international business, University of North Carolina 420
Prepared statement 424

AFTERNOON SESSION

Cook, Edward W., president, Cook & Co., Memphis, Tenn 467
Prepared statement 468
Hamilton, Lyman C., treasurer, International Telephone & Telegraph Co 470
Norris, Robert M., president, National Foreign Trade Council, Inc., New York, accompanied by Melville H. Walker, vice president, National Foreign Trade Council 477
Roth, Hon. William M., President's Special Representative for Trade Negotiations, accompanied by Theodore R. Gates, Chief Economist, John Rehm, General Counsel, and William Kelly, Coordinator for New Trade Policy Study 497

February 20, 1968

Wirtz, Hon. W. Willard, Secretary of Labor, accompanied by Arthur Ross, Commissioner of the Bureau of Labor Statistics 519
Prepared statement 527

February 21, 1968

Olsen, Leif, senior vice president and economist, the First National City Bank, New York 607
O'Leary, James J., chairman of the board and chief economist, Lionel D. Edie & Co., Inc 615
Prepared statement 620
Hart, Albert G., professor of economics, Columbia University 626
Prepared statement 629

AFTERNOON SESSION

Saulnier, Raymond J., professor of economics, Barnard College, Columbia University 662
Schultze, Charles L., senior fellow, The Brookings Institution, and former Director of the Bureau of the Budget 669

Ture, Norman B., director of tax research, National Bureau of Economic Research, Inc. — Page 677
Weston, J. Fred, professor of business economics, University of California at Los Angeles — 687

ADDITIONAL INFORMATION AND EXHIBITS

Graham, Harry L.:
Where they are—Geographic analysis of Grange membership (dues paid) — 371
McDonald, Angus:
Membership list—National Farmers Union — 372
Shuman, Charles B.:
Farm Bureau membership — 374
Table: CCC sales of feed grain in relation to utilization — 378
Table: CCC sales of wheat in relation to utilization — 378
Regaining control of Federal expenditures — 388
Behrman, Jack N.:
Alternative approaches to reducing expenditures: responses to questions put forth by Representative Boggs — 440
Letter responding to Senator Jordan's question on overkill through too much taxation — 443
Wirtz, Hon. W. Willard:
Information re updating of "Dictionary of Occupational Titles" — 536
"Moonlighting—An Economic Phenomenon," reprinted from Monthly Labor Review, October 1967 — 542
Information relating to number of persons not in current labor force — 553
"Reasons for Nonparticipation in the Labor Force," Special Labor Force Report No. 86 — 555
Supplemental statement containing answers to questions by Representative Curtis re Human Investment Act, and Employment Incentive Act bills — 580
Table: Neighborhood Youth Corps summer jobs funded in 50 selected cities, fiscal year 1967 — 590
Reply to questions concerning cost-effectiveness study of manpower training programs — 593
Possible effect of surtax upon personal income — 598
Table: Percent change and contribution to total change, selected Consumer Price Index components, December 1966 to December 1967 — 600
Table: Wholesale Price Indexes in the United States and other major industrial countries, 1955–67 — 601
Table: Unemployment rates of eight industrial countries adjusted to U.S. concepts, 1965–67 — 602
Curtis, Hon. Thomas B.:
H.R. 13777, a bill to increase employment opportunities, etc — 576
Proxmire, Hon. William:
"War, Inflation and Taxes," editorial reprinted from Washington Post, February 21, 1968 — 660
Questious subsequently supplied to Department of Labor and responses thereto — 599

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 16, 1968

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

The committee met at 2 p.m., pursuant to adjournment, in room S-228, the Capitol, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Javits, and Jordan.

Also present: William H. Moore, senior staff economist.

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

We are honored and delighted to have such an impressive panel of witnesses representing the great farm organizations of our Nation before us.

As I have said to some of you gentlemen, many of us on the committee are concerned about the lack of adequate expressions of policy with regard to our farm economy in the message of the President and the statement of the Council of Economic Advisers.

That is why the committee decided it would be desirable to have both the Secretary of Agriculture and the leading farm organizations appear before us this afternoon.

The Secretary of Agriculture appeared Wednesday and you gentlemen, of course, are here today.

One difficulty is that as we stated—the staff stated in the letter which I sent out, and I take responsibility for it—that statements should be confined to 25 minutes. As you can see, we have a four-man panel, and we want to have time for questions, so I would appreciate it very, very much if you could possibly abbreviate your statements as much as you can; and if you could confine your statements to 15 minutes, it would be most helpful.

Without question, your full statements will be printed in the record and will be made available, of course, to members of the committee and to Members of the Congress.

So, we will proceed as the witnesses are listed, with Mr. Harry Graham, the legislative representative of the National Grange, first. Mr. Graham.

STATEMENT OF HARRY L. GRAHAM, LEGISLATIVE REPRESENTATIVE, THE NATIONAL GRANGE

Mr. GRAHAM. Thank you, Mr. Chairman.

I will be delighted to try to hold this to 15 minutes, and I will try to watch the clock. It probably is handier for me than for you to watch it, and if I do not, you know what your gavel is for.

We appreciate the opportunity that you have given us for the Grange, and I am sure this is shared by the rest of the Grange organization, to appear before this distinguished committee of the Congress and the Senate, and we appreciate the concern which you have had which motivated the panel meeting; of the graciousness which you have extended to us in this invitation to appear before you.

There are many parts of the President's report that we would like to talk about, but none of them, obviously, we can go into in detail in this time limitation which, I think, is very reasonable.

I would say, first, though, that the letter of transmittal which the President sent along with the report of the Council, that the President pointed out some very substantial and spectacular gains in the general prosperity of the Nation during the last 7 years.

They show up in almost all areas, with the highest number of employed people with the highest average earnings on record.

It shows an unemployment rate of 3.8 percent, a rate that has not been lower except twice in 169 months. With total employee compensation up $33 billion, and total consumer income after taxes up $35.5 billion, combined with an alltime high in industrial production with a yearly rate of growth in the gross national product of 4.5 percent, this is a continuation of the longest period of uninterrupted growth in our history.

We see undistributed profits in the nonfarm corporate businesses of $20.5 billion, and net working capital of $196.3 billion. This is after bond yields have increased for the triple A bonds by 38 cents, and for the triple B bonds by 60 cents during the last year, with total liquid assets up $47.1 billion.

These are solid economic accomplishments, but they leave some problems.

One is the relaxing of, in our opinion, the wage-price guidelines which were solidly based on productivity.

In the farm sector, we are concerned because the agricultural sector has not shared equitably in the returns for the contribution that they have made toward the total growth of our economy, both in GNP and also almost of as much importance to the contribution we make to the net balance of trade by the extremely high level of agricultural exports, which have been based primarily on the ability of the American farmer to produce in competition, through their technology, with almost any country in the world.

This, in turn, gives us another concern. If I go back for a minute in the relationship of the farm dollar to the rest of the economy, that is one of our concerns. Only the dairy industry showed an improvement in their parity ratio last year, it being up from 114 to 119. The Senator from Wisconsin, I am sure, is interested in that one. From previous experience I know of his concern.

Poultry and eggs were down from 102 to 84; food grains were down from 87 to 84; feed was down from 112 to 108, while tobacco was up to 114, its highest level.

The result was that cash receipts were down 17 points and net farm income was down $283 million, while the output was up from 113 to 117, with output per man-hour up 6 points to 167.

I wanted to particularly emphasize this one because if we are going to talk about income on the basis of production and the increase in

production, then certainly agriculture has a claim that is not less than other parts of our economy, and certainly greater than some.

We noted with approval the deletion of the reference to farm income last year which proposed no interference with the law of supply and demand as the determinant for the allocation of the resources in agriculture. We hope that the statement previously referred to that Federal economic policy no longer relies primarily on the "automatic stabilizers" built into our system or waits for a recession or serious inflation to occur before measures are taken, includes agriculture with the rest of the economy.

In the international picture with which the report deals at some length, we have a very great concern because of the development of the protectionist attitude in the United States, and because this protectionist attitude, in our judgment, is based on some rather unsound economics.

I spent 2 weeks in Germany in November as a member of a delegation from the United States studying the effects of the Marshall plan after 20 years of their history. While we were there, there was a great deal of dissatisfaction in the coal area because of their closing down of a great share of their production because of inefficient and not needed production—dropping their coal production as quickly as they can, from 143 million tons down to somewhere around 80 million tons, and importing coal from the United States. With our technology we can produce it and ship it to Bremen cheaper than they can ship it from the Ruhr to Bremen, which is economic efficiency working as it should.

At the same time, the steel workers and the steel industry, along with the Government, were pounding out an agreement whereby they were not going to increase wages nor profits during the coming year or during the term of their contract that they were working on, because they felt that this would be an adverse factor in their attempt to maintain the markets that they already developed in the world. Over against this we are concerned, as I think everybody has to be concerned, about the threat of a rather serious increase in steel wages, and with the continued high level of profits that the steel industry is making, to the point where they can no longer compete in some types of steel right in their own area with the steel coming in from Japan and Germany. The failure of our American industry to plow back its profits into the industry, with the exception of National Steel, which has the only really modern steel complex in the United States, comparable to those in Germany and Japan, means that we are simply pricing ourselves out of our own market by maintaining an inefficient system.

In our judgment, protectionism that is being talked about today will put the burden of this upon the most efficient part of our industry, which is agriculture, and by this method the burdens which properly should be borne by the industry, are unreasonably shifted to agriculture and to the consuming public.

This is a matter of more than casual concern, and I will leave it at that, having more completely expressed it in the statement.

In terms of the budget and taxes, we have consistently stood in the Grange for enough taxes to pay the cost of government, especially at a time when there is still a substantial threat to inflation. We believe we have waited longer than we should to pass the surtax bill, but we believe it still should be passed, if not from the standpoint of stopping infla-

tion, at least for the purposes of restoring confidence in the dollar among our trading partners around the world.

If there is consistency in the advice we have been getting from our financial friends, it is that if we are going to restore confidence in the dollar we are going to have to do something about balancing our domestic budget. These people are perfectly candid with us, and I do not think that we can just ignore the advice of the people who have taken part in the International Monetary Fund, the agreements in Rio, and the other action that has been taken to stabilize the dollar, especially after the devaluation of the pound.

I found in Europe a very great concern about this part of our American financial situation at the present time especially as it relates to Government finances and in balancing the budget.

We have the resources to produce enough goods to pay our debts to other countries. This concern is not expressed. What they are afraid of is our liquidity will get to the point where we will have difficulty even in maintaining this kind of productive system and I share the concern, and I know there are a great many people who share that same concern.

This, in general, Mr. Chairman, is a quick summary of the major concerns which we have, as we have expressed in this statement which the committee has, and which I am sure you are going to consider and maybe you already have.

Thank you.

(The prepared statement of Mr. Graham follows:)

PREPARED STATEMENT OF HARRY L. GRAHAM

In his letter of transmittal of the Annual Report of the Council of Economic Advisers to the Joint Economic Committee of the Congress, the President pointed out some very substantial and spectacular gains in the general prosperity of the Nation during the last seven years. These show up in almost all areas with the highest number of employed people at the highest average earnings on record. The Report showed an unemployment rate of 3.8 percent, a rate that has not been lower except twice in 169 months. With total employee compensation up $33 billion, and total consumer income after taxes up $35.5 billion, combined with an all time high in industrial production with a yearly rate of growth in the Gross National Product of 4.5 percent, this is a continuation of the longest period of uninterrupted growth in our history.

On the industrial side, we see undistributed profits on the non-farm corporate businesses of $20.5 billion and net working capital of $196.3 billion. This is after bond yields have increased for the Aaa bonds by 38¢ and for the Bbb bonds by 60¢ during the last year with total liquid assets up $47.1 billion.

These are solid economic accomplishments, brought about by the reluctance of the Administration to "rely primarily on the 'automatic stabilizers' built into our system or to wait for a recession or serious inflation to occur before measures are taken." However, all of these gains have not been without some losses, and there are some danger signals which have been hoisted into the air and possible gale warnings are ahead of us. One of these is the relaxing of the wage-price guidelines which were solidly based on increases in productivity. While average earnings of factory workers were increasing by $4.80 per week, the automotive-industrial production index was down 13.7 percent and the machinery index was down 0.4 percent.

These figures, connected with the ones previously given concerning bond yields, indicate that both industry and labor are engaged in profit-taking actually beyond their real earnings in terms of production, and that these increased profits and wages are being passed on to the consumer in the form of higher prices—the underlying cause of the present inflationary pressure.

THE FARM SECTOR

This is particularly pertinent to the problems which beset American farmers trying to retain some semblance of equity with the rest of our economy when the economy is expanding at a relatively rapid rate. In this regard, last year's accomplishments were not spectacular. The index of prices paid by farmers for their production inputs increased from 114 to 117 last year. Only feed and fertilizer held steady, and feed holding steady was the result of steady to downward prices on feed at the farm level. The higher non-farm wages and profits were reflected in the index for the cost of motor vehicles, a major item on every farm, increasing from 117 to 122, up 5 points. Machinery, the major item necessary in a technogically advancing agriculture, was up from 124 to 130, or 6 points.

Interest went up from 232 to 259 on the basis of the interest paid per acre of farm. Taxes were up to 178 from the previous level of 166. Wage rates rose from 135 to 146, all based on a 1958 figure of 100.

The increase in the index of assets of 11.7 was largely accounted for by the increase in real estate of 9.5. This is a classical pattern of investment and hedging when there is a possibility of inflation. Another way of saying the same thing is that in the consumer indices, durables were up 1.6 and non-durables 3.4, and the services up 6.1.

With the increased interdependence of farmers on the rest of the economy, the increase in the services as well as in automobiles and machinery were a prime reason for the decline in net earnings. Although no breakdown is given for the increased costs of medical services in rural areas, for city wages and clerical workers, medical services were up 11.7 points in the index. For the rural people, this simply means that the medical service is not available in many rural areas, the doctors requiring the patient to go to the city and their costs, therefore, are greater than their city cousins because of the cost and added expense of transportation, whether it is the patient going to the city, or occasionally, when a physician is found who is willing to make house calls, an increased charge for house calls in the country. Thus, the area which is at the bottom of the list in terms of medical services available is at the top of the list in terms of the costs of these same services. The President has properly pointed this out as one of the areas of major concern.

In terms of the relationship of the farm dollar to the rest of the economy, only the dairy industry showed an improvement in their parity ratio last year, it being up from 114 to 119. Poultry and eggs were down from 102 to 84, food grains down from 87 to 84, feed down from 112 to 108, while tobacco was up to 114—its highest level. The result was that cash receipts were down 17 points and net farm income was down $283 million for the farmers while the output was up from 113 to 117, with output per man hour up 6 points to 167. The most dramatic increase in output, explaining some of the drop in prices, was the 22 points increase in the output per man hour for crops and the 6 point increase in output of livestock. This also helps to explain the decline in farm population of 595 thousand people last year, down to 11 million.

Thus, we see the familiar pattern of lower farm population, increased inputs into machinery to replace hand labor, followed by migration into the cities with many of these people having no saleable skills and contributing to the unrest in our cities.

Had it not been for the dramatic increase in exports, with a total increase of $4.126 billion, of which agriculture apparently contributed more than $2.5 billion, the picture would have been even worse. This not only prevented a further decline in agricultural prices, but it made a major contribution to our balance of payments. The Administration, especially the U.S. Department of Agriculture, deserves a big vote of appreciation for its export program.

We did note with approval the deletion of the refernce to farm income last year which proposed no interference with the laws of supply and demand as the determinant for the allocation of resources in agriculture. We hope that the statement previously referred to that federal economic policy no longer relies primarily on the "automatic stabilizers" built into our system or waits for a recession or serious inflation to occur before measures are taken, includes agriculture with the rest of the economy. Indeed, as we look at the action taken by the Department of Agriculture this year to shore up farm prices—32 separate actions in all—we are confident that the previous policy has been reversed and we are pleased to note this change. To leave agriculture subject to the vagaries of the market and the inelasticity of the demand for food over against a number

of variables in production from weather to price, and to impose over it a controlled economy in the field of wages and profits and government policy, is to sentence agriculture to bankruptcy and then see the decline in the major market for American industrial products due to the decline in purchasing power seriously and adversely affect our total economic structure.

Only an expanding economy can hope to absorb the growing number of people who are coming into the employment age. This is particularly pertinent when we have estimates of an increase in our population of 50 percent in 23 to 32 years. New wine can no longer be poured into old goatskins in terms of our economic life, and the answers of 50 years ago, when we had a more stable population and economy, simply do not fit the expanding population picture which we have today.

THE INTERNATIONAL PICTURE

If we may return to the expanded profits and wages to which we previously referred, we would like to discuss it in a different context. This is its effect upon our international trade and the rise of protectionism in the United States. With labor contracts expiring in the steel industry this summer, and with already announced goals of increases of 8 percent or more being sought, it is pertinent to relate this to the attempts to impose import quotas on foreign steel.

This would simply lock-in our inefficiencies in the competitive steel business and charge these inefficiencies to the consumer. While agriculture has been at the head of the technological revolution, producing its products to sell on world markets at competitive prices, making the greatest contribution to our net balance of payments of any industry, the steel industry by and large is still engaged in producing by the Bessemer process of the last century.

I spent two weeks in Germany in November of last year surveying the results of the use of Marshall Plan money for rebuilding the German economy. I was particularly interested in the pragmatic economic decisions being made by the Germans. These include reducing their yearly coal output from 143 million tons to 80 million tons, increased dependence on U.S. coal which is cheaper to import into Bremen than German coal is from the Ruhr, and the development of technically advanced steel production as a means of maintaining their share of the world market and increasing their growth, if possible. At the time we were there, the German Federal Republic laborers in the steel industry and the owners of the steel mills were pounding out an agreement under which they would freeze wages and profits at the present level in order not to undermine their competitive advantage overseas. They have been bringing into production new steel mills with the most advanced production techniques in the world. The same is true of Japan. As a result, these two countries are able to deliver their steel to automobile plants which are within two hundred miles of our basic steel complex at a cheaper price than U.S. steel can be delivered.

One of the main reasons is that most of the U.S. companies have been more interested in expanded profits, as previously noted, than in modernization of their plants. Although integrated steel production is relatively well advanced in both Japan and Germany, in the United States there is only one facility which has incorporated into a single large-scale operation the basic oxygen furnace, vacuum degassing and continuous casting—the latest and most important advances in steel making technology.

The National Steel Corporation will soon open its new $100 million facility in West Virginia, following hard upon the first basic oxygen furnace and the first 80 inch computerized hotstrip mill in the Nation. The last two gave National a three year jump on its competitors and the new facility is suppose to trim production costs by $10–$12 a ton.

This is the proper way to meet the competition from Japanese and German steel, not by restrictive tariff laws which serve to reduce our international trade and, at the same time, reduce the possibility of maintaining an expanding economy to serve the needs of a rapidly growing population.

We interject this into our testimony by way of stating our support for the treaty which the Senate must consider establishing tariff cuts during the Kennedy Round of Negotiations in the GATT.

Without discussing textiles which are basically in the same situation as steel, we would recommend the November 1967 issue of "Textile World" for information relative to textiles.

We use the example of the German steel industry to suggest to our friends in the rest of the U.S. economy that, at this time of intense competition, some statesmanship is in order. This includes both the willingness to accept lower

earnings and lower targets for salaries for a temporary period while our industrial plants adopt the modernized methods of integrated production in the case of steel, and the modern technologies in other industries which are going to be necessary to preserve the competitive advantage which we have previously enjoyed, or to maintain a competitive balance with our trading partners around the world.

The abandonment of the previous wage-price guidelines do not make any contribution to a satisfactory solution to this problem. We would, therefore, urge this committee and the Council of Economic Advisers, to most seriously consider the ways in which we may place some type of controls over the tendencies toward inflation which the President and the Council both have noted in their message to this committee—not only so that the consumers may be benefited by products at reasonable costs, but simply because the long-term basic interest of our industries are intimately bound up in the solution to this problem.

The Budget and Taxes

At a time when our economy was threatened with a mild recession, the Administration and the Congress properly passed legislation resulting in rigid tax cuts in 1964 and 1965, equivalent to about $23 billion in today's economy. This resulted in bringing federal revenues into balance with federal spending. We would comment that it was precisely this approach which was recommended by Andrew Mellon to President Hoover in the depression of 40 years ago. Where this so-called "new economics" gets into trouble is when it is necessary to reverse the process in order to restrict inflationary pressures and to balance a budget which has gone out of balance partly as a result of inflation.

We do not agree with those who believe that it is too late for a tax boost to be valuable in the present situation. Although it might not be able to bring the necessary restraint upon the tendencies of inflation, it certainly has one basic validity, and that is the restoring to the money markets of the world confidence in the dollar.

The success of the policy just noted would be more certain if we could superimpose it upon an economy which did not have the extremely heavy drain which we are having today because of the effort in Vietnam. However, it is precisely just this effort that is still making an increase in federal income necessary.

At the same time, it should be noted that at the time the gold pool nations took their action under the International Monetary System to support the price of gold, and at the time the Special Drawing Rights Plan was agreed on in Rio de Janeiro in September, we were warned by our friendly allies, especially by the members of the international gold pool, that this program could be effective only if the U.S. began to balance its budget. In almost every instance where our friends from overseas have discussed the problem of maintaining the American dollar, which certainly is to their interest as well as our own, they have advised us that we should increase our taxes.

We were very free to advise the French to do the same thing some years back when they were in difficulty, and we have advised a number of the nations who are recipients of our unilateral aid to do the same. The time has now come for us to take a dose of our own medicine, and substitute statesmanship and responsibility for political considerations which might be arrived at with great expense to the long-term economic welfare of our country.

The President has submitted a "hard-nosed" budget. Some of the items left out raise a question as to the good judgment used. The failure to enact an adequate tax structure will mean that other items, no longer in the field of the luxuries which an expanding economy should be able to afford, but in the area of the absolute necessities for a strong economic and political and social system must be laid by the board.

The advice of the Chairman of the CEA, Mr. Ackley, should have been heeded a year ago. Despite the fact that we are late in coming to grips with this problem, we are still well advised to pursue this policy, if not to halt inflation at least to restore some confidence in the dollar which has been shaken by the events of the past few months.

This committee, the Congress and the Nation should also be extremely wary of accepting the suggestions that we should not have any tax increase, even in the midst of a war, but rather a further reduction of expenditures. These, most of the time, represent those who would dismantle our Federal System and this is an excuse to do through the back door exactly what could not be accomplished through the front door. It seems to us that it is beyond the realm of

rational thought to expect a nation of 200 million people to get along with the same service level of its people as it did when it had only 100 million people. With the prospect of a growth to 300 million by the 1990's, it is obvious that the responsibilities of the Federal Government, instead of decreasing, will probably be increased. The major reason for this increase, in our judgment, will be the stresses put on our institutions at the state and local level—stresses which will result in a continuing demand for increased assistance from the Federal Government.

Grange members do not like to pay taxes any more than anyone else. However, if it becomes a choice between the irresponsible evasion of present duties which will result in simply postponing the "day of judgment", or accepting our responsibilities like mature citizens of a great country, then we stand at the side of those who propose a responsible course, and we are prepared to support the actions to accomplish the objectives of a responsible national policy.

In conclusion, the 1968 Report of the Council of Economic Advisers and the statistical information accompanying it, indicate a strong and vigorous economy. The Report indicates the points of weakness in our economy as well. If we have enough wisdom and vision to base our judgments upon sound economic conditions, instead of on irrelevant political concepts and irresponsible partisanship, then the future of this Republic is indeed bright. If we are going to bog down because of our reluctance to make the necessary difficult economic decisions, if we are afraid to take the political consequence of an economically responsible attitude, then this weakness and vacillation shall inevitably be reflected in the kind of life we live and the levels of prosperity we fail to attain.

Chairman PROXMIRE. Thank you very much, Mr. Graham. You set a fine example of brevity and conciseness, and we appreciate it a great deal.

Our next witness is Mr. Angus McDonald, director of research for the National Farmers Union.

Mr. McDonald.

STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH, NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman, we, too, appreciate the invitation to appear here and express our views on the President's Economic Report and, particularly, on the views of the President's Council.

In past years we have been very critical of some of the reports of the Council of Economic Advisers and, unfortunately—perhaps it is unfortunate—we continue to be very critical of this Report because we think it is entirely inadequate. It does not get to the roots of the farm problem, and it neglects certain areas such as high interest and the lack of bargaining power of the farmers.

It also does not seem to be aware of the managerial revolution that is going on at the present time in regard to agriculture.

The Council in the very few pages which it devotes to agriculture concentrates on supply and demand and on the poverty situation. There is little that the commercial farmer can find which would indicate that the Council has any awareness of his problems.

The Council is under the illusion, I believe, that we have a free market in agriculture. This is an inference, but it is lacking, it is lacking in the problem, for example, of economic concentration which, I believe, is responsible for many of the problems which the farmers face today and have faced for many years.

The Federal Trade Commission reports once more that there are about a thousand mergers, acquisitions, which have been made in the last year or so.

It reports that conglomerate corporations, the corporations which have two or more unrelated functions, are expanding by leaps and bounds into agriculture.

It reports, and the Department of Justice has given some attention to this problem, the fixing of prices by various groups. The price-fixing or price leadership, whatever you want to call it, is not restricted, of course, to the durable goods industries. We have been aware of that situation for many, many years, but it now extends to the food industry, and the result of that situation is that the farmer must take what he is offered in the marketplace, and the consumer and the farmer both suffer.

In regard to the invasion of agricutlure by corporations and wealthy individuals, the Farmers Union has made some brief studies based on Internal Revenue Service statistics published by the Treasury Department and I would just like to run through, Mr. Chairman, a few of these statistics which indicate why so many wealthy individuals and corporations are going into the farming business.

On page 16 of this 1965 report of the IRS on income of individuals, it reports that individuals with $1 million or more income, there were 119 engaged in farming, reported farm investment. It reported that of that 119, only 16 reported a profit.

In the category of income between $500,000 to $1 million, it reported 202 were engaged in farming, and only 32 showed a profit; 170 a loss.

In the $100,000 to $500,000 category, it reported 3,914 involved in farming; 1,040 showed a profit; and so on.

I have in my statement a complete list, almost complete—I did not give all the statistics down to the $1,000 category—but we find that these statistics are very revealing because as you go down into the lower income groups, you find a much higher percentage reporting a profit to IRS.

Now, it seems to us, and in regard—let me interrupt myself just a moment—in regard to corporations, IRS in another document reported in the year ending July 1, 1964, there were 16,277 corporate farms reporting to the IRS in regard to their farm activities, and only 7,861 of these farm corporations reported a net profit.

Now, these facts, and particularly the facts regarding individuals, indicate to us that these people are going into farming not to make a profit—perhaps they are inefficient, too—but they are going into farming to escape taxation, in order to get into a lower tax bracket in regard to transfer of their farm losses to other income. That seems fairly obvious.

Now, in regard to the farmer himself, what is his economic situation today? We all know that income is supposed to go down $1 billion this year, and, last year it went down, and the year before was fairly good.

Today, according to the President's Council, the per capita income of those on farms, I believe that is in table 79 in this book, the per capita income was, if you go to their figures, amounted to $1,200 per capita. That is in 1967.

There were about, the Council estimates, 11 million people on farms. Despite the drastic decrease in farm population, over half, everyone knows that, it is reiterated again and again, per capita income on farms continues to fall and per capital income of those off farms or

the total average per capita income of all the people continues to rise for reasons which Mr. Graham has just set forth.

It amounted last year to $2,787.

The farmer is—as Mr. Chairman, you pointed out, I believe on several occasions during the hearings before this committee—the farmer constitutes the No. 1 economic shame of America. The farmer is a second-class citizen.

Giving another example, the Department of Agriculture periodically puts out some very interesting statistics on the market basket, and we look back to 1947 to see how the farmer was doing that year on the market basket, that is, about as much food as a family of four would consume in a year, and it amounted to $870, and the farmer's share was $441 of that.

Now, according to USDA in September 1967, the market basket cost the consumer $1,089. The farmer only got $417 of this or $24 less than he got in 1947.

When it is considered that the farmer's dollar or, I suppose, anyone's dollar in 1965, was worth only 71 cents, these figures become doubly significant.

One of the problems which the Farmers Union has been concerned with has been the problem of bargaining power.

The Food Marketing Commission spent a great deal of time, we thought, and on the whole did an excellent job of studying farm food marketing over a period of a year and a half or so. Apparently the President's Council never heard of this report or at least it has not taken cognizance of it in its explanation of agriculture.

The Food Marketing Commission was very much concerned with the lack of bargaining power. We have recently seen a bill introduced—Senator Mondale, my office tells me, introduced the bill yesterday, and it is reported, Mr. Chairman, that you are one of the sponsors of this legislation. I have not checked that one out. Someone just told me they thought you were on the bill, and we appreciate that very much. We have not had time to study the bill, but on the face of it something should be done about farm bargaining power. Whether this is the bill which Congress should enact, I am not prepared to say.

Our National President has indicated in a press release that, in general, he favors this proposal to let the producers decide when prices are too low and bargaining power is needed; to let producers decide through commoditywide referendum when they want a bargaining committee for a particular commodity; to let producers decide in a referendum who will represent them on bargaining committees; to provide expanded authority for producers to strengthen prices under the provisions of the Agricultural Marketing Agreements Act of 1937; and, finally and very importantly, to provide penalties to be imposed upon those who conspire to intimidate, discriminate against or otherwise coerce producers or any producers association in their efforts to increase prices and strengthen bargaining power.

During the last 2 years I spent a great deal of time on what was originally S. 109 introduced in two separate Congresses and sponsored by both Republicans and Democrats. Unfortunately, this bill has not developed in the way that we thought that it should be developed, but this point which I mention is very important, particularly because farmers in the marketplace need protection and they need to organize

and the right to bargain for their products in the same way that labor bargains for its labor.

I mention finally, Mr. Metcalf, in regard to the tax situation on farms. Senator Metcalf has introduced S. 2613, which would close one of these tax loopholes by prohibiting those who gain most of their income off farms from taking tax losses. The farmer himself would not be affected. The farmer who is a working farmer or who derives his income from agriculture, from the farm, would be exempt under this bill.

But it would, we hope, check this vast invasion of agriculture which is going on at the present time, due to other segments of the economy apparently have so much money they do not know what to do about it.

The profits, as Mr. Graham pointed out, are at an all-time high, and I think it was around $25 billion instead of $20 billion, as you said, which industrial corporations had left over after they paid their taxes, distributed their dividends, and so forth.

My point is that agriculture should be allowed to deal with those to whom it sells its products in the same way that other organizations and unions, and others, in the same way that the gigantic food chains get together and work together at getting the prices down.

If the farmer had some kind of countervailing power backed up by legislation, such as the NLRB Act—and I am not comparing this proposal with the Labor Relations Act, it has certain similarities, but there are certain other parts of it which are quite, quite different, as agriculture is different.

One final point, Mr. Chairman, with regard to Mr. Graham's statement. We are completely in accord with the importance of farm exports. I believe, in cash, there were over $5 billion last year, $7 billion if you count the soft currency and the giveaways and so forth.

The gold situation about which everyone seems to be worried, would be worsened if the protectionists were able to keep out other products.

We are not in favor, of course, of the substitute products for cheese and various gimmicks that have been used to let down the bars and let vast quantities of all kinds of dairy products and other products come into this country, and we were instrumental in, at least we presented our views to the Tariff Commission and to the President in regard to that, and we stand firmly behind the President, in reducing to some extent the amount of these products which were coming in.

But we believe that the last round, the Kennedy Round, was greatly successful. Our National President was in Geneva, and he reports great progress was made, which would benefit not only the American farmer but the American people as a whole.

I think, Mr. Chairman, I have just about used up my time.

(The prepared statement of Mr. McDonald follows:)

PREPARED STATEMENT OF ANGUS McDONALD

Mr. Chairman and Members of the Committee, we appreciate very much the opportunity to present our views on the Economic Report of the President and the Annual Report of the Council of Economic Advisers. We have appeared here over a long period of years along with representatives of other farm organizations. Our organization is particularly interested in the functioning of the Employment Act of 1946.

Our interest was manifested in the period 1944–1946 when our then National President, James G. Patton, participated actively in the formulation of legislation. One of the by-products of this activity was a book by Stephen Kemp

Bailey entitled, "Congress Makes a Law," published by the Columbia University Press in 1950. The activity of the Farmers Union in bringing about the enactment of the Full Employment Act is outlined in this volume.

Over the years the Farmers Union has generally been critical of the Council since we believe it failed to fulfill the policy set forth in the statute. For example, in Section II the Council is, in effect, directed to consult with agriculture and other groups in the formulation of its policies and its recommendations to the Congress. For a few years after passage of the Act representatives of the Farmers Union were invited to confer with Council members along with other farm organizations. However, this practice has been discontinued over a long period of years. As I recall, the last time that we were invited to confer with the Council was during the period when Harry S. Truman was President and Leon Keyserling was Chairman of the Council.

This witness has pointed out to this Committee and to other Congressional Committees the failure of the Council to fulfill the function which the Congress undoubtedly intended both in conferring with interested organizations and in legislative recommendations to the Congress. We have appreicated very much over the years the reports of the Joint Committee on the President's Economic Report which repeatedly pointed out that the Council was failing in its duty and that it also was neglecting certain economic situations in its discussions without which it was impossible to make valid recommendations or to even explain certain economic trends.

In 1965 this witness appeared before the Joint Committee and pointed out that under the Chairmanship of Gardiner Ackley vital economic areas had been neglected and that emphasis was on matters which did not go to the root of economic maladjustments, particularly in regard to agriculture. We pointed out in our 1965 discussion that agriculture was treated as a sick industry rather than an industry which had out-produced other segments of the economy and had become so efficient that it had flooded the market with commodities resulting in unduly low prices. There was no attempt in Mr. Ackley's 1965 report to get at the roots of the agricultural problems.

In the 1966 report, the Council ceased to speak of agriculture as a sick industry, but rather by inference concluded that it was only reacting to certain economic laws which inevitably pushed off the farm producers who were inefficient. There was, as I recall, a brief discussion about the dairy industry which was in a very depressed condition because of low milk prices. Dairy farmers were leaving the industry by thousands and economists predicted that if this trend was not checked, milk would have to be rationed in the not too distant future. The Secretary of Agriculture wisely increased the support price of milk so that farmers would be enabled to stay in production. The comment of the Council was that dairy farmers had moved to towns and cities because of excellent employment opportunities.

In past years the eminent Chairman of this Committee has rebuked the Chairman of the Council on at least two occasions because of the Council's neglect of agriculture which he called the number one shame of America. He also spread upon the record certain figures indicating that farmers were economically second class citizens who did not obtain from their investment, management and labor a sufficient income to enable them to continue production. This is the crucial problem which agriculture has faced for a long time and is facing today.

Certain questions were also raised by this Committee in regard to the lack of attention to economic concentration and to the monetary activities of the Federal Reserve Board.

The 1968 report, it seems to us, almost completely ignores, or gives only a passing glance to agriculture. On pages 116 and 117 only about one-half page is allocated to discussion of farm and food prices. It is apparent from this brief discussion that the Council is primarily interested in the laws of supply and demand and consumer prices and not at all interested in the economic problems of the farmer.

Although several pages of the report are devoted to monetary policy during the 1966–67 period, no real attempt is made to grapple with fundamental economic problems as affected by the mistaken policies of the Federal Reserve Board. For example, the Council merely notes that in 1965 the Federal Reserve Board raised the discount rate one-half of one percent and that the ceiling rate on certificates of deposit was also raised. It does not sufficiently expose this mistaken policy and connect it with the housing debacle which it caused in 1967. Farmers paid heavily for the 37½ percent increase in the time deposit rate since interest rates skyrocketed not only in housing, but in all kinds of real estate

and short term loans. The country has paid dearly for the ill-advised policies of the Federal Reserve Board.

The Farmers Union has repeatedly condemned these policies and was instrumental in bringing about a national Tight Money Conference in Washington, D.C., in January 1967, sponsored by may organizations. We attempted in this conference and in other ways to bring the facts to our members and to all those who were consumers of credit.

We are aware that the policies of the Federal Reserve Board are controlled by no one unless it be the bankers who seem to have a decisive voice in the formulation of its policies. Several members of this Committee have pointed out this fact over a long period of years and have suggested remedies to be put into effect by the Executive Branch and the Congress, but nothing has been done. It seems to us that the President's Council should act in the interest of all the people and, as the President said on page 27 of the report, "This Administration will never forget that the purpose of our economy and of our economic policies is to serve the American people—not the reverse." It would appear that monetary policies during the past few years have not served the American people, but have served primarily one vested interest group. Interest rates at the present time are higher than they have been at any time since 1873. We suggest that the Council should have challenged the policy of the Federal Reserve Board and attempted to bring the best information policy on monetary matters to the attention of the President who has a multitude of problems and who finds it impossible to acquaint himself with the details of monetary policy.

I would like to take this opportunity to bring to the attention of the Committee certain studies that the Farmers Union has made during the last several months in regard to tax evasion by weathy individuals and corporations and the efficiency of the family farm. Our study on the relationship of non-farm individuals and the use of farm investment as a tax haven was published in our *Washington Newsletter* of September 15, 1967, and is primarily based on a report of the Internal Revenue Service of the U.S. Treasury Department, entitled "Statistics of Income 1965." The results of our study based on this document are as follows and is the record from individual income tax returns, broken down by income groups, on "farm" operations:

Millionaires.—Of the 119 engaged in farming, only 16 reported a profit on their income tax returns.

$500,000 to $1,000,000.—Of the 202 in farming, 32 showed a net profit and 170 showed a loss.

$100,000 to $500,000.—Of 3,914 involved in farming, 1,040 showed a profit and 2,874 reported a loss.

$50,000 to $100,000.—Of 12,398 involved in farming, 4,974 showed a profit and 7,424 reported a loss.

$20,000 to $50,000.—Of 69,132 involved in farming, 38,752 showed a profit and 30,380 reported a loss.

$15,000 to $20,000.—Of 66,003 involved in farming, 42,160 showed a profit and 23,843 reported a loss.

$10,000 to $15,000.—Of 211,673 involved in farming, 132,109 reported a profit and 79,564 reported a loss.

$5,000 to $10,000.—Of the 793,689 involved in farming, 473,948 reported a profit and 319,741 reported a loss.

We also made another brief study based on Statistics of Income for the period July 1964–June 1965, entitled "U.S. Tax Returns—Sole Proprietorships, Partnerships, Corporations," also published by the Internal Revenue Service. The partial results of our study of this document were published in the December 1, 1967, *Washington Newsletter*. This study showed that only 7,861 of the 16,227 corporation farms filing 1963 returns showed a net profit. The profit added up to $235.5 million, about $49 million more than the losses reported by the other 8,366.

These facts indicate a widespread situation in which thousands of wealthy individuals and corporations made use of certain loopholes in our tax laws to escape taxation. The wealthy individual, under existing law, may subtract his farm losses from off-the-farm income and thereby get into a lower tax bracket and pay less taxes than he otherwise would have paid. Senator Metcalf has introduced a bill (S. 2613) which would remedy this situation and would, we hope, discourage the invasion of agriculture by off-farm interests.

We have various reports in our files which indicate that corporations and individuals are buying up millions of acres of farm land as a hedge against inflation and for tax loss purposes. The South Dakota Farmers Union has con-

ducted a survey of corporate ownership in that State and has found that more than 30 corporations have acquired over 1,600,000 acres in South Dakota. Our members tell us that the same process is going on in other states.
conglomerate corporations. A conglomerate corporation, economists tell us, is a
During the last few years we have seen an increase in the number of so-called corporation which has two or more economic activities functionally unrelated to each other. One of the most notorious of these corporations is Textron which was originally in the textile business. At the present time, Textron is engaged in the manufacture and distribution of over 10 diverse products. Its holdings include a huge broiler and poultry feeding operation in the State of Maryland.

The incentive for the corporation buying up defunct and shaky businesses is perhaps the same as the incentive of the wealthy individual who invests in a farm to escape taxation. According to the *Wall Street Journal*, Textron, during a period of years, was exempted from paying $75 million in taxes to the Federal Government because of the "tax carry-forward" provision in our tax laws.

According to the Federal Trade Commission, merger activity which includes the acquisitions of both conglomerate and other kinds of corporations, continues at a high level. Almost 1,000 mergers were reported by Moody's Investor Service, Inc., and Standard and Poors Corporation for the year 1966.

Our interest in merger and corporate activity is not academic. We strongly feel that economic concentration is a primary cause of the excessively high costs of various items necessary to farm production. Significantly, although farm income, according to the Department of Agriculture, is due to remain at a very low level this year, farm receipts may increase by $1 billion. This decline in farm income can only be explained by an increase in farm costs. Farm prices have declined drastically during the last year. The parity index a month or two ago had dropped to 73—the lowest point since the '30's. *Agricultural Prices* in its last issue, reports that it has increased by one point. This simply means, of course, that farm prices in relation to the purchasing power of the farmer's dollar were lower than they had been in more than 30 years.

Low farm prices and low farm income represent a contradiction in our economy. National income is at an all time high. We have made various calculations based on figures taken from tables in the back of the *Economic Report, Economic Indicators* (published by the Council of Economic Advisers) and the November 9th issue of *Marketing and Transportation Situation.*

It is estimated that 11 million people are now living on American farms; that their farm income in 1967 amounted to $13.2 billion. This is equivalent to a per capita income of $1,200. According to the President's Council, per capita income of the total population amounted to $2.787 annually during the period October–December 1967. It is seen that even with the drastic decline of farm population that per capita income from farm activities lags far behind income derived from other activities.

According to *Marketing and Transportation Situation*, the typical market basket of farm foods cost $1,089 in September 1967. The farm value of this food was $417. This indicates a spread of $672.

The year 1947 was considered a fairly prosperous one for farmers. In that year the market basket cost consumers $890; the farmer got $441 of this amount. In other words, the consumer in September 1967 paid $199 more for food purchased by a typical family of four and the farmer got $24 less.

The significance of these figures is seen when it is realized that in 1965 the farmer's dollar was only worth 71 cents. We do not have at hand a calculation for the 1947 purchasing power of a dollar for a later date.

There has been a great deal of propaganda to the effect that the family farm or medium-sized farm is inefficient. This allegation has been disproved many times. However, the myth of family farm inefficiency persists despite the fact that the family farm produces most of the commodities which are consumed in this country and which are exported.

A recent study made by Farmers Union which is based on a study of the Department of Agriculture which in turn is based on 138 other studies, indicates that a family farm is relatively efficient over wide areas of the United States and in the production of many different commodities. (See Exhibit A, attached.)

Farmers Union periodically attempts to assemble as much information as possible in regard to actual income and expenses of farm operations, both in regard to current statistics and in regard to prices which farmers paid in a relatively prosperous period. We have in our file a list of actual farm operating costs as reported on Schedule F tax forms. Here are statistics taken from actual Minnesota farm reports:

SELECTED FARM EXPENSES ON ACTUAL MINNESOTA FARMS (BASED ON 1966 FEDERAL INCOME TAX RETURNS

Acres farmed	Gas and fuel	Feed purchased	Fertilizer and chemicals	Real estate taxes	Interest payments
200	$111		$98	$672	$1,378
322	907	$1,798	3,508	1,795	2,304
148	540	3,500	1,150	600	1,100
320	1,000	1,100	1,800	2,425	2,050
350	2,500		1,647	2,127	1,609
400	825	1,350	950	1,250	3,400

We have also compiled figures of relative costs of farm implements. Farm machinery prices of 1967 are compared with farm machinery prices of 1947 (see Exhibit B attached).

In conclusion, we would hope that the Committee would find it possible to inaugurate a study of the corporate farm invasion and wealthy individual invasion of agriculture. We consider this one of the most inimical trends which farmers now face.

We would hope that the Committee would continue to emphasize the importance of a monetary policy which pays some attention to the wishes of this expert Committee and to other Members of Congress. We hope you will continue to advise the President in regard to the necessity for a healthy agriculture. What happens to agriculture will in a great measure be dependent on action taken by the Congress.

We also hope the Committee will use its great prestige and influence to bring about the enactment of the Metcalf bill which will discourage the trend toward non-farm control and ownership of agriculture, as well as bringing in additional taxes to the Treasury of the United States which heretofore have been avoided.

Exhibit A

The Family Farm Is the Most Efficient Unit of Agriculture Production

(Prepared by Angus McDonald, Feb. 5, 1968)

Over the years there has been a vast propaganda campaign designed to convince the American people that the gigantic factories-in-the-field which exist in California and several other states should be models for all farm units. This campaign to discredit the Farmers Union idea that the family-type farm is the most desirable unit of agricultural production has been aided and abetted by economists in land grant colleges and in agriculture departments of universities. Editors of magazines, newspapers and no doubt many millions of people have been brainwashed and have consequently accepted without question the idea that the family farm is inefficient and that super-farms, owned and operated by millionaires and conglomerate corporations, represent the wave of the future.

Swept under the rug, ignored and suppressed are many studies which have been made which prove without any reasonable doubt that the small or medium-sized unit is more efficient than the large corporate unit. A number of economists apparently have been quietly working, gathering information in many parts of the United States. A recent publication of the Department of Agriculture represents summaries of these studies made in various areas of different types of farming under a variety of conditions. The overwhelming conclusion of this study, a composite of 138 studies which have been made in the last few years, leads to the inescapable conclusion that big farming is inefficient.

These studies, based on solid facts, are not wishful thinking. They are the result of hundreds of analyses of the costs and the gross profits which go into many types of farming including fruit, grain, livestock, cotton, vegetables, alfalfa, and dairy. These studies put the finger on the point of diminishing returns which is soon reached when the farm is unduly expanded or too large for efficient operation. Here are a few examples:

1. Fruit Farms in California

On the non-mechanized peach farms in Yuba City in the Maryville area of California, average production cost per ton of peaches declined up to a productive unit of about 60 acres (average production was 715 tons of peaches). Beyond that size slight reductions in harvesting costs and machinery investment per acre were realized, but these were offset by increases in costs of hired supervision.

On the mechanized peach farm the average cost declined up to a farm size of

between 90 and 110 acres. After that point there was no reduction in cost on larger units.

2. IOWA CASH GRAIN AND CROP-LIVESTOCK FARMS

(a) Southern Iowa

The hilly farm in Southern Iowa showed lowest costs for a unit of about 320 to 360 acres. This represented a 2-man operation and a 3-plow tractor. The cost revenue ratio was 0.95. This figure means that the livestock-grain farmer had to spend 95 cents for every dollar of gross income.

On upland farms in Southern Iowa the cost revenue ratio was much lower. A 1-man, 3-plow tractor farm of 160-acres produced $1.00 of gross income for every 62 cents in costs. Two-man farms showed a little better ratio—a 320-acre farm with two 3-plow tractors only had to spend 57 cents for every dollar of gross income. However, cost advantages in larger units were less than the 320-acre farm.

(b) Western and Northeast Iowa

A 280-acre farm with a continuous corn program came out with a cost revenue ratio of 0.42. Under a 5-year rotation the lowest cost on a farm of 320-acres was 0.46. Under current cropping practices a 400-acre farm also resulted in a cost revenue ratio of 0.46. For Western Iowa costs were considerably higher. This study showed little difference in costs (only 2 cents per $1.00 of income) in Northeast Iowa between 400 and 800 acres.

3. IRRIGATED COTTON FARMS IN TEXAS AND CALIFORNIA

(a) Texas High Plains

This particular study concluded that a 1-man farm with adequate capital could be as efficient as any of the larger farms. A 1-man farm of 440-acres, with 102 acres of cotton and 6-row machinery resulted in an expenditure of 71 cents for every dollar of gross income. None of the larger farms could go below this. Here is a summary of the Texas High Plains farm statistics:

	Cost revenue ratios
1 man, 120 to 240 acres	0.732
1 man, 240 to 680 acres	.708
2 man, 560 to 920 acres	.73
3 man, 880 to 1,280 acres	.709
4 man, 1,200 to 1,520 acres	.711
5 man, 1,480 to 1,800 acres	.712

(b) Fresno County, California

On heavy soils in Fresno County, California, costs of producing cotton proved to be lowest on a 4-man farm of 1,134 acres. The cost revenue ratio was 0.85. On a 1-man farm of 270 acres, the cost revenue ratio was 0.91.

However, on light soils in Fresno County a 710-acre, 4-man farm proved to be most efficient. A 1-man, 193-acre farm had a cost revenue ratio of 0.83, the 4-man farm had a cost revenue ratio of 0.76. There was no increase in efficiency after this point. The study included farms up to an 8-man operation.

4. CALIFORNIA CASH CROP FARMS

This study, based on farms in Yolo County, included sugar beets, tomatoes, milo, barley and safflower. Cost per dollar of revenue on these farms declined sharply up to about $100,000 of revenue. The cost revenue figure on these farms was 0.70. On farms of 1,400 acres which produced on the average about $240,000 worth of products, the cost revenue declined to 0.65. After that point the cost revenue statistic increased to 0.72 at $440,000. There was no decrease after that on larger units.

Conclusion of the author of this study was that there was no economic incentive to operate extremely large farms—600 to 800 acres could compete with larger farms. The difference in cost was slight and risks pertaining to management on larger farms were considered greater.

5. IMPERIAL VALLEY VEGETABLE CROP FARMS

This particular study concluded that with contract services longrun costs are constant from very small farms up to 2400 acres. Another conclusion was that the Imperial Valley farmer achieves no advantage in owning equipment and actually has advantages over larger farms which own equipment used at less than full capacity. This assumes that contract facilities are available for the small

and medium-sized farms. The general conclusion is that there are no significant economies based on size.

6. KERN COUNTY CASH CROP FARMS

In this area the 640-acre unit was most efficient. After that point costs per revenue dollar began to climb. The following table indicates the economies based on size:

CASH CROP FARMS, KERN COUNTY, CALIF.—TOTAL COST PER DOLLAR OF CROP REVENUE FOR 3 CROPPING PROGRAMS

Farm size (acres)	Cost-revenue ratio for—		
	Cotton-alfalfa farms	Cotton-alfalfa-potato farms	Cotton-alfalfa-barley-milo farms
80	1.06	1.06	1.00
160	.96	.94	.93
320	.92	.91	.91
640	.91	.89	.89
1,280	.94	.93	.91
3,200	.96	.93	.92

Source: Calculated from data in Faris and Armstrong study. California Experiment Station; Giannini Foundation Research Report No. 269.

7. WHEAT FARMS IN THE COLUMBIA BASIN OF OREGON

In Oregon, 1-man wheat farms achieve lower average costs than the two or three man farms. However, on farms smaller than 1,000 acres the costs were slightly higher. The following table indicates that increases in size beyond 1,000 acres resulted in increased costs.

COLUMBIA BASIN WHEAT FARMS: AVERAGE COST AND OPERATOR EARNINGS FOR SELECTED FARM PLANS USING THE MOLDBOARD FALLOW OPERATION

Farm size	Basic resources		Full-utilization farm plan		
	Men	Tractors	Acres	Operator income	Cost-revenue ratio
Small	1	1 30 to 40 horsepower	1,000	$3,669	0.85
Medium	1	1 50 to 60 horsepower	1,600	5,629	.86
Medium-large	2	2 50 to 60 horsepower	2,500	5,429	.91
Large	3	2 50 to 60 horsepower, 1 25 to 35 horsepower	3,600	5,252	.94

8. DAIRY FARMS

(*a*) *New England*

The most efficient unit on dairy farms in New England was a 2-man operation with 70 cows and costs estimated at $2,000 a year for labor and management. However, if no charge is made for labor, the 1-man operated farm with 35 cows achieved lower costs.

(*b*) *Iowa Dairy Cash Grain Farms*

On farms in Iowa in this category there was only a slight reduction in costs as herds were expanded from 34 to 58 cows. The cost revenue ratio was relatively higher—90 cents expended for $1.00 of gross income.

(*c*) *Arizona Dairies*

Average costs declined sharply up to a herd of 150 head. However, management difficulties typically occurred when the herd reached a size of 150 to 175 cows. This problem resulted from (1) feed waste increases with herd size; (2) difficulty in varying the level of grain feeding relative to each cow's production because of variation among cows, and (3) management, supervision and coordination duties became more difficult with resultant decline in efficiency of operation.

(*d*) *Minnesota Dairies*

A study based on dairying in Minnesota indicates that the 2-man dairy with 87 cows and a farm of 490 acres achieved a cost revenue ratio of 0.82. A 1-man, 48-cow, 290-acre operation was slightly less efficient. The cost revenue ratio was 0.84 on this farm size.

9. FEEDLOTS

Several studies have been made to determine the maximum efficiency of feedlots based on size. According to one Colorado study, feedlots with between 1,700 and 4,000 head on feed at a time with a 15-ton feed mill were most efficient. The feedlot with 4,000 to 9,000 head on feed at a time with a 50-ton mill was most efficient. This study indicates that economies of size obtained by feedlots feeding over 1,500 head are too small to have any appreciable effect on the average cost of producing beef.

A USDA study concludes that economies of size are attainable in a size range of 1,500 to 5,000 head. Beyond this point the cost curve declined slightly, but the savings were insignificant. All of these studies indicate that there is no economy resulting from the gigantic feedlots such as those operated by the National Tea food chain and the Gates Rubber Company. These feedlots are apt to be much less efficient because they are not operated at full capacity. Consequently the percentage of fixed costs are greater than in the small feedlot.

Exhibit B

Price Increases of Farm Machinery and Equipment

Price increases of farm machinery since 1947

The wholesale price of a 3 moldboard plow increased from $254 to $580.
The wholesale price of a drawn corn planter increased from $200 to $455.
A larger type drawn corn planter increased from $493 to $1,120.
The wholesale price of a grain drill increased from $391 to $901.
A larger type grain drill increased from $725 to $1,670.
The wholesale price of a manure spreader increased from $509 to $928.
The wholesale price of a 4-row cultivator increased from $363 to $811.

Percent price increase since 1947

Item	Percent
Farm and garden tractors:	
Row Crop or general purpose, 30–49 HP	79.70
Tricycle, row-crop, 40 or over max. HP	57.70
4-Wheel, Diesel, 75–92 max. HP	74.20
Tracklaying Type, under 60 D. HP	161.30
Motor Tiller, 3–4 HP	22.80
Agricultural machinery:	
Excluding Tractors	95.40
Plow, Moldboard, Drawn, 4 Bottom	146.60
Plow, Moldboard, Mounted, 3 Bottom	128.10
Harrow, Drawn	102.90
Corn Planter, Drawn	127.10
Grain Drill, Fertilizer Type	130.20
Manure Spreader, PTO Driven	82.30
Hydraulic Loader	29.10
Cultivator, Mounted, 4 Row	123.30
Rotary Hoe, Pull Type	26.50
Hand Sprayer	98.98
Cotton Picker, 2 Row Self Propelled	31.70
Combine, Self Prop., Under 15 ft. cut	83.00
Corn Picking Attachment for Combines	114.55
Corn Picker, Mounted	57.60
Forage Harvester, Drawn	104.60
Mower, mounted	126.40
Rake, Drawn	117.20
Hay Baler, Drawn	56.60
Farm Elevator, Portable	76.00
Wagon, Chassis Only	47.40
Agricultural Equipment	44.40
Stock Tank	100.70
Brooder, Gas	67.70
Barn Cleaner	24.10
Water System, Shallow Well, Jet	77.70
Motor trucks	49.10
Composite for agricultural machinery and equipment	81.40

Chairman PROXMIRE. Thank you very much, Mr. McDonald.
Our next witness is Mr. Charles B. Shuman, president of the American Farm Bureau Federation.
Mr. Shuman.

STATEMENT OF CHARLES B. SHUMAN, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. SHUMAN. Thank you, Mr. Chairman and members of the committee.

I appreciate this opportunity to comment on the President's Economic Report for 1968.

I will read parts, and I do appreciate if this entire statement will be incorporated in the record.

Our comments will be based on policy resolutions adopted by voting delegates of the member State Farm Bureaus at the annual meeting of the American Farm Bureau Federation in December 1967. The delegates represented more than 1,750,000 families who are members of Farm Bureau in 49 States and Puerto Rico. We shall confine our comments to a few major national issues and to those aspects of the President's Economic Report which are of particular interest to farm and ranch families.

At the outset, let us make it clear that the overall fiscal policy which this Nation chooses to follow is of major importance to farmers. Government policies which have caused large budget deficits have led to an inflationary spiral which has compounded the cost-price squeeze on farmers. The resulting tightening of credit has become a serious concern to farmers attempting to meet sharp increases in capital requirements.

The fundamentals of the inflation problem are well described in the following extract from a newspaper report of a recent speech by W. Allen Wallis, a distinguished economist who is now president of the University of Rochester, and I quote from Dr. Wallis:

> Inflation can be generated only by the Government. Business firms, labor unions, or consumers with excessive market power can do many objectionable things that are contrary to the public interest; but one objectionable thing they cannot do is to cause inflation—or, for that matter, prevent it.

The overriding economic issue confronting the United States today is whether we are going to be fiscally responsible. Our domestic fiscal policy determines our ability to avoid an inflationary binge which would work a serious hardship on many people and lead to a painful readjustment at some future time. It is also the key to the balance-of-payments problem which threatens the stability of the dollar as the most widely used international currency.

It should be noted that the President's proposal for the elimination of the gold reserve requirement now applicable to Federal Reserve notes is merely an accommodation to the necessities of our balance-of-payments problem and not a solution for this problem. Unless we can correct the imbalance in our international accounts, we will dissipate the gold now used to back our currency—just as we have depleted the gold previously released by removing the requirement for a gold reserve against Federal Reserve deposit liabilities.

U.S. exports—industrial and agricultural—can and must be expanded. American farmers are already making a major contribution to U.S. export earnings. Last year U.S. agricultural exports reached a new high, totaling $6.8 billion. This accounted for 22 percent of total U.S. exports. But, as the world's largest exporter and most efficient producer of farm products, American farmers can play a larger role. We have set our sights on annual agricultural exports of $10 billion. This goal is attainable if we are permitted to price competitively and market efficiently. This requires vigorous trade negotiations designed to reduce restrictions on world trade with nations which are prepared to offer reciprocal benefits to U.S. exports. Such negotiations not only must include—they must emphasize—trade in agricultural products. At the same time, Government supply management features of domestic farm programs should be abandoned.

The proposed International Wheat Trade Convention, which has been sent to the U.S. Senate for ratification, is contrary to these objectives. This convention fails to liberalize world wheat trade; in fact, it tends to legitimize trade restrictions. It would restrict export opportunities for U.S. wheat farmers and significantly limit their ability to contribute further to solving the balance-of-payments deficit.

We agree with the President that the present situation calls for action to "* * * accomplish a sharp reduction in the Federal deficit * * *"; however, we believe that the reduction must be achieved by placing major emphasis on reductions in Federal spending before consideration is given to increases in Federal taxes.

Our policy on this point reads in part as follows:

> The current fiscal situation calls for action to eliminate strong inflationary pressures. At this time we oppose any increase in taxes which is not matched by a prior and equivalent reduction in government expenditures for the duration of the tax increase. Increases in federal receipts as a result of any tax increase should be used in future years to reduce or eliminate annual deficits rather than to justify higher expenditures.
>
> We urge the Executive Branch to make significant reductions in current expenditures and in future budget requests for both defense and nondefense programs.
>
> At the same time, Congress should take steps to make changes in basic legislation enabling effective evaluation and control of government spending within annual appropriations.

In practice, this means that before we would support a tax increase of $5 billion, for example, and we say in that resolution that we oppose a tax increase unless a comparable and prior reduction in spending was made. In practice, this means that before we would support a tax increase of $5 billion, for example, a spending cut of at least $5 billion must be achieved. This would result in a net reduction of $10 billion in the budget deficit. We reject outright the contention that no sizable reduction can be made in nondefense spending. Nondefense spending has been swollen in recent years by a tremendous expansion of new Federal programs. Regardless of any differences of opinion that may exist with respect to the merits of individual programs, it should be crystal clear that the Federal Government has been trying to do too much at once.

We must not overlook the fact that we are engaged in a major war in Southeast Asia. To assume that sacrifices in nondefense spending are unnecessary is folly. It is obvious that the Nation's security must have priority, and domestic spending must be adjusted accordingly. Con-

tinued expansion of expenditures at a rate greater than tax revenues cannot be tolerated.

We understand that Gardner Ackley, former Chairman of the Council of Economic Advisers, has ridiculed the idea of matching tax increases with budget cuts by calling it a "strange proposal" and by suggesting it could lead to fiscal "overkill."

Recognizing as we do the built-in pressures for more and more Government spending, we do not think there is any danger of an "overkill." All we are proposing is that Congress determine the amount by which the deficit should be reduced and then divide this amount equally between reductions in expenditures and increases in taxes.

We in the Farm Bureau are determined to do our part in getting at the root cause of inflation—excessive Government spending. Consequently, Farm Bureau will submit specific recommendations for budget cuts to appropriate committees of Congress—and these will include proposed cuts in Government expenditures of special interest to farmers and ranchers.

We shall make specific proposals to remove the drain on the Federal Treasury resulting from passage of the Food and Agriculture Act of 1965, which caused the Commodity Credit Corporation in 1967 to make expenditures of nearly $3 billion to compensate, in part, for Government-depressed market prices. When other price support functions of CCC are added to these direct payments, net losses of the Corporation have risen to nearly $4 billion annually. In spite of this, net farm income has continued to decline during 1967.

Much of the recent growth in nondefense Federal spending is the result of Federal assumption of responsibilities that properly should be discharged by State and local governments.

With this in mind, our delegates at our recent convention adopted a policy favoring the use of Federal income tax credits.

With this in mind, delegates to the AFBF annual meeting in December 1967, adopted the following policy:

In order to increase local control of tax resources and responsibility for educational and welfare programs, we recommend that the federal government return the responsibility for these programs to the states through the use of federal income tax credits.

We urge passage of legislation which would provide that individual taxpayers be given dollar-for-dollar credits toward federal income tax liabilities for individual income, corporate income and general sales taxes paid to states. With the return of this tax base to the states should go the authority and responsibility for costs and administration of welfare and elementary and secondary educational programs now carried on by the federal government.

A Federal credit for income and sales taxes paid to States would permit the States to increase their taxes sufficiently to raise revenue necessary to replace the Federal grants they are now receiving for welfare and for education at the primary and secondary school levels.

We believe this proposal to replace existing "grant-in-aid programs" with tax credits is far superior to the various proposals made in recent years for a sharing of Federal revenues with the States.

The tax-sharing approach requires that tax money be sent to Washington for redistribution to the States. This could increase—rather than reduce—the dependence of the States on Federal appropriations. Such handouts could be reduced, eliminated, or made subject to new Federal requirements at any time.

The tax-credit approach does not separate the responsibility for spending tax receipts from the responsibility for levying taxes as the tax-sharing approach would do. Instead, it gives each State a prior claim on the tax resources of its own taxpayers and thus provides a greatly expanded opportunity to develop a revenue system based on local needs.

We recognize it will take some time to work out in detail a procedure to substitute Federal tax credits for existing grant programs; however, we urge Congress to give this approach careful study as a means of achieving two worthwhile objectives: (1) reducing fiscal demands on the Federal Government and (2) increasing the revenue available to State and local governments without which it is impossible to have effective local control.

Agriculture, as such, received only a brief mention in the President's Economic Report and only a little more attention in the state of the Union message.

In recounting 1967 developments in the Economic Report, the President noted that "* * * farm proprietors' net income dipped, but by yearend had returned to the level of a year earlier * * *." It should be noted that this dip in net farm income was at least partly due to Government efforts to increase grain production. The fact is that the Government over-reacted to hysterical evaluations of the world food situation and encouraged farmers to expand grain production in advance of effective demand. Food aid shipments under Public Law 480 actually were reduced during the fiscal year 1966–67, particularly in the case of wheat and flour. The inevitable result of this combination of factors was lower grain prices.

We agree with the President's recommendation that Congress extend Public Law 480; however, we favor changes which will make certain that needed supplies are produced in response to market prices and are purchased in the market. It should be made clear that this program is a part of our foreign aid commitment, not a subsidy to domestic producers.

In the state of the Union message, the President said that he will recommend actions to establish "a security commodity reserve" and "programs to help farmers bargain more effectively for fair prices."

Practically everyone agrees that some reserves of agricultural products are desirable to meet unforseen variations in production. In our opinion, however, Government-held or controlled reserves are unnecessary for the protection of domestic consumers, bad from the standpoint of producers, expensive from the viewpoint of taxpayers, and not necessary for exports or foreign relief.

Then I go into some detail here in the statement on the reasons why we believe that these are bad for consumers, are not desirable for consumers, are bad for producers, and bad for taxpayers.

We also point out that these reserves come back as any Government-held stockpile to fall on the market and are disruptive to a market system since there is a constant danger that the Government will break the market by releasing its stocks.

We point out that the heaviest Commodity Credit sales of stocks have been made in order to first force farmers into so-called voluntary programs by penalizing noncooperators and, second, to attempt to counteract the effect of Government inflationary policies on food prices.

Farmers are seriously and increasingly interested in finding ways to develop greater market power through strengthening their bargaining power.

There are two ways to organize farmers to obtain greater bargaining power—voluntary and involuntary—only two ways. Farm Bureau believes the voluntary method of organization offers greater opportunity for success. Truly effective power comes through the willing cooperation of informed, conscious, loyal, and active members; and this type of power far exceeds that which flows from compulsory grouping.

The only power which can compel farmers to bargain together nationally is the Federal Government, and its authority must come from an act of Congress. The Congress, as well as the executive branch of our Government, must be concerned with justice and equity for all citizens—not farmers alone. Since 94 percent of the voters are consumers, not farmers, Congress and the administration necessarily must be more interested in low food prices than high farm income. Any Federal Government direction or enforcement of farmer bargaining most certainly would include rules or devices to "protect consumers" or the authority to issue cease-and-desist orders any time prices threaten to go higher than some Washington bureaucrat thinks they should. Obviously, farmers do not want Government as a "partner" in their bargaining efforts.

Farmers are painfully trying to crawl out of the cheap food trap created by existing Government-supply-management programs. It would be a tragedy if their current interest in bargaining were to lead them into a similar Government-price-management trap. Government supervised marketing is not the way to get better income for farmers.

There is, however, a proper role for Government in improving the marketing of farm products. Legislation currently before Congress would prohibit unfair trade practices designed to discourage farmer participation in voluntary marketing programs. Congress can play its proper role in this matter by guaranteeing farmers the right to voluntarily join a marketing association without fear of reprisal.

Thank you very much, Mr. Chairman.

(The balance of Mr. Shuman's prepared statement follows:)

* * * * * * *

Let us examine these considerations point by point.

(1) The idea that the maintenance of a government-held stockpile is a good idea for consumers developed, at least in part, out of a desire to justify the existence of the large stocks already accumulated under price support programs.

Now that surpluses of some commodities have been reduced by increased exports and domestic utilization, the alleged need for government-held stocks is being used to justify the continuation of government intervention in the production and pricing of farm products.

In the absence of government reserves, the willingness of farmers and agricultural industries to carry stocks constitutes a reliable defense against shortages of consumer goods. In addition, our agricultural economy contains many other built-in safeguards against shortages.

The consumers' real assurance of adequate supplies of farm products is in the productive capacity of American agriculture, the geographic dispersal of major areas of farm production, the fact that we have a livestock economy, and the capabilities of our processing and transportation industries.

The United States has never experienced a famine—even in the years before the government began carrying large inventories as a by-product of efforts to support farm prices.

It is difficult to understand why we have so much public discussion about consumers' need for government-held stockpiles of commodities produced in great

abundance here in the United States when there is so little about the need for government reserves of commodities which are imported in substantial quantities.

(2) Government-held reserves are bad from the standpoint of producers for a number of reasons.

A policy of encouraging production in excess of consumption for the purpose of accumulating government reserve stocks thwarts, or at best delays, efforts to bring production into line with consumption. Difficult adjustment problems are created—which may lead to burdensome controls when stocks reach the point where the government decides that further accumulations are undesirable.

The release of reserve stocks inevitably depresses the price for current production. This compounds the effects of a short crop on farm income. When production falls below normal, farmers need to receive increased prices for what they have produced in order to maintain their incomes. Also, a price increase is necessary to spur greater production the following year.

A government-held stockpile is highly disruptive to a market system since there is a constant danger that the government will break the market by releasing its stocks.

On the basis of the record, it is clear that the exercise of administrative discretion with respect to the release of stocks always will be heavily affected by political considerations.

For example, heavy sales of CCC stocks have been made (1) to force farmers into so-called voluntary programs by penalizing noncooperators and (2) to attempt to counteract the effect of inflationary government fiscal policies on food prices.

From the standpoint of producers, government reserves of agricultural commodities constitute a device to manipulate markets politically, to coerce participation in government supply-management programs, and to impose price ceilings on farm products.

(3) Strategic reserves would be costly. It has been estimated that acquisition of the reserve could cost as much as $1 billion. This would only be the beginning cost. Storage of farm products is expensive. In a relatively few years storage and interest costs can easily exceed the original cost of government stocks. Thus, in conjunction with the relatively remote possibility of a real need for such stocks, makes government stockpiles a bad bargain for taxpayers. If a policy of accumulating stocks leads to the need for expensive control programs, the injury to taxpayers is compounded.

(4) It has been argued that government-held reserves are needed to assure that the United States will be able to relieve famine conditions anywhere in the world. In answer to this, we say that the characteristics of our agricultural economy which make reserves unnecessary for domestic consumers, also provide us a very great capacity to extend food aid to other countries—without the necessity of maintaining government reserves for this purpose.

Free world consumers abroad—whether customers or aid recipients—have a vital stake in our having a dynamic, progressive, market-directed agricultural economy rather than a stagnant, government dominated agriculture.

Farmers do not want to compete with CCC in the market place. They very much oppose any program—strategic reserve or otherwise—that will tend to rebuild stocks of farm commodities under government ownership or control.

Farmers are seriously and increasingly interested in finding ways to develop greater market power through strengthening their bargaining power.

There are two ways to organize farmers to obtain greater bargaining power—voluntary and involuntary. Farm Bureau believes the voluntary method of organization offers greater opportunity for success. Truly effective power comes through the willing cooperation of informed, conscious, loyal, and active members; and this type of power far exceeds that which flows from compulsory grouping.

The only power which can compel farmers to bargain together nationally is the federal government, and its authority must come from an Act of Congress. The Congress, as well as the Executive Branch of our government, must be concerned with justice and equity for all citizens—not farmers alone. Since 94 percent of the voters are consumers, not farmers, Congress and the Administration necessarily must be more interested in low food prices than high farm income. Any federal government direction or enforcement of farmer bargaining most certainly would include rules or devices to "protect consumers" or the authority to issue cease and desist orders any time prices threaten to go higher than some Washington bureaucrat thinks they should. Obviously, farmers do not want government as a "partner" in their bargaining efforts.

Farmers are painfully trying to crawl out of the cheap food trap created by existing government supply-management programs. It would be a tragedy if their current interest in bargaining were to lead them into a similar government price-management trap. Government supervised marketing is not the way to get better income for farmers.

There is, however, a proper role for government in improving the marketing of farm products. Legislation currently before Congress would prohibit unfair trade practices designed to discourage farmer participation in voluntary marketing programs. Congress can play its proper role in this matter by guaranteeing farmers the right to voluntarily join a marketing association without fear of reprisal.

Chairman PROXMIRE. Thank you, Mr. Shuman.

Our last witness is Mr. Gordon Shafer, chief negotiator, National Farmers Organization.

Mr. Shafer.

STATEMENT OF GORDON SHAFER, CHIEF NEGOTIATOR, NATIONAL FARMERS ORGANIZATION

Mr. SHAFER. Thank you, Mr. Chairman and members of the committee. I would like to take this opportunity to thank you on behalf of the organization, the National Farmers Organization, which I represent here today for inviting us to participate in this discussion.

As a preface to my remarks, I would like to remind this committee that agriculture is still the Nation's biggest single industry. Farming employs about 5.2 million workers, more than the combined employment in transportation, public utilties, the steel industry, and the automobile industry.

Agriculture's assets total some $273 billion or an amount of money equal to about two-thirds of the value of the current assets of all corporations in the United States or about three-fifths of the market value of all corporation stocks on the New York Stock Exchange.

The value of agriculture's assets represents about $36,000 for each farm employee. Agriculture, of course, with this much invested is a good customer. The farmer spends over $33 billion a year for goods and services to produce crops and livestock; spends another $12 billion a year for the same things that city people buy—food, clothing, drugs, furniture, and other products.

Each year the farmers' purchases include over $4.6 billion in farm tractors, other motor vehicles, machinery, and equipment.

About $1.4 billion was spent in 1963 in the primary metals industry for equipment in new plant—it has increased somewhat since then.

About $3.4 billion is spent for fuel, lubricants, maintenance of machinery, motor vehicles. Farming uses more petroleum than any other single industry; uses about 320 million pounds of rubber; 28 to 30 billion kilowatt-hours of electricity or, in other words, more than the cities of Baltimore, Chicago, Boston, Detroit, Houston, and Washington, D.C., combined.

We use about 5 million tons of steel in the form of farm machinery, cars, trucks, fencing, and so forth.

In addition to this, farmers are the suppliers of the world's food supply. The United States is the largest exporter of agricultural products. We have already heard some testimony here today, something about the extent of our exports, but in 1966 we exported nearly

$7 billion worth of farm products. Actually we are pretty much the world market.

In 1966, the United States exported, as I said, some $6.7 billion of farm commodities, making up about 23 percent of the total of the U.S. exports.

The United States is now supplying approximately 90 percent of the world's, of the free world's supply of soybeans, about 57 percent of the free world's supply of corn, about 50 percent of all the feed grains in world trade.

Of the U.S. exports, approximately 75 percent of the exports, are sold for cash, and the other 25 percent, roughly, are sold for soft currency.

Now, this, I believe, will give us some sort of an idea about the importance of agriculture, and, when we remember a few of these figures, we see that farming is a business, and its productive assets must yield a return, as must the capital of any other business.

A farmer's productive assets are his real estate, livestock, crops stored on and off the farm, machinery, vehicles, equipment, furnishings, and other financial assets.

The Federal reporting of the farm income seems to make no allowance for return on the capital invested.

The per capita income—we have already heard some testimony on this, too—the per capita income of farmers from all sources, and this includes work off the farm as well as the farm income, for 1966, the last year that complete figures are available—was $1,717 a year as compared to the per capita income of the nonfarmers at $2,636 per year.

Of course, this is a year, 1966, when agriculture was supposed to be comparatively prosperous in relation to other years.

So this gives us an idea of the serious situation in which farmers find themselves.

In 1950 the net farm income was only $13.5 billion, and the average net farm income from 1951 to 1966 was only $13.1 billion. Actually the average was less than the 1950 net income, and by contrast the national, annual national, income 1951 through 1966 averaged 167½ percent of the 1950 national income.

In 1966 each farm family's weekly recompense for the management and labor which they expended in their farming operations was less than $50 a week per family.

Now, when we stop to think about this in relation to expenses as we find in our economy today, and compare this to the average wage of the balance of the economy, we begin to see just how serious this farm situation really is.

For 1950 each farmer's share of the national total farm debt was $2,798, and by 1966 it had risen to $20,286.

Putting this on a per-acre-harvested basis, thinking now of the farm debt, the per-harvested-acre in 1950, $36.65 was the debt, and in 1966 per-harvested-acre, the debt had risen to $143.58, an increase of 291.8 percent.

We hear much today about the poverty situation, and this is of much concern to everyone in the Nation. But I think most of us are, perhaps, mistaken about where our chief problem in this poverty area exists. It may surprise most Americans to know that there

is more poverty in rural America, proportionately, than there is in our cities.

In the metropolitan areas, one person in eight is poor by our standards. In the suburbs the ratio is 1 to 15. But in the rural areas one in every four persons qualifies under the same standard for the poverty program.

Some 30 percent of our total population live in rural areas, but 40 percent of the Nation's poor live there.

We can no longer permit the public policy to ignore our rural poor, or, if we do, we shall see a continuing movement of rural people to our central cities.

As the summer of 1967 illustrated, the slums and ghettos of the city breed hatred and violence, which is no solution to the problems of either city or country and, of course, when the farm people are forced off the farm, as they are being, rapidly, then, of course, there is no place for them to go but to the cities where they swell the slum areas and become unemployed.

We could carry this a bit further, and we could say, I think, that world poverty is primarily brought about because of underpayment to agriculture, and the loss in trade in the world in terms of the gross farm dollar.

Now, this leads me to one other conclusion, and that is that our Nation is in serious jeopardy from an economic standpoint unless something is done to raise farm prices.

Then the next logical question, of course, is: Well, now, if this is the case, what do you propose as a solution to the problem—and we think that the problem has to have a dual solution? We think that Government has to have a share in the responsibility for creating a climate, at least, where our economic situation can be improved. We believe that our present Government program should be extended. We believe that the general public has a responsibility to farmers as well as to themselves, to assist in working through the problem which we have.

In addition to this, we believe that farmers themselves must take a major share of the responsibility for the condition in which they find themselves, and we believe that it is only through organizing and bargaining collectively that the farmer can change his economic status.

Now this, of course, is the purpose of the National Farmers Organization. We are a relatively new farm group so far as the general farm organizations are concerned. But we believe that what must be done, we think that farmers must band themselves together in sufficient numbers under the protection of the Capper-Volstead Act so that they can bargain and sell together for a cost of production plus a reasonable profit price on their commodities.

We do not think you can limit this to just the minor commodities. Some bargaining has been done, mostly in local areas, in the minor commodities. But we believe that this is not the real problem in trying to bargain for agriculture. We think that you must bargain for the major commodities and, of course, there is only one way that you can effectively bargain, and that is to bring together enough of the total production over the entire Nation of not just one commodity but of any and all commodities so that the purchasers of our production cannot bypass the organization of farmers and supply their needs.

With this in mind, the National Farmers Organization is organizing; we are now organizing, in some 35 States, with a little organization beginning in about five or six more. We have not completed the job, but we think that farmers owe it to themselves and to the Nation to band themselves together and bargain and sell together.

I think the alternative to solving our problem could very well lead to serious disaster for this Nation as a whole—not only for farmers but for this Nation as a whole.

We are now at about the lowest parity ratio that we have been in the United States since the middle 1930's and, of course, some of you gentlemen, I am sure all of you know, and many of you remember, the days of the 1930's so far as farming was concerned, and you know what happened to the rest of the Nation.

In other words, what I am trying to say is that depressions in this Nation have always been farm-bred and farm-led.

With the depressed state of agriculture as it is now in this country, I believe that we could very well be heading for the same type of problem, and I hesitate to predict, but I wonder if it would not be worse than anything we have ever seen before, unless something is done to right this situation, because with the extra assets of the Nation, the extra debt, I sometimes wonder if the Nation, as we know it today, can actually survive another serious depression.

So I believe that this is a concern of the Nation as well as a concern of the farmers, and we believe that the responsibility for correcting this situation will have to be shared by the farmers and by the people, and, of course, by that I mean Government action.

With this, I believe that I will terminate my remarks, and if there are any questions I will try to answer them.

Chairman PROXMIRE. Thank you very much, Mr. Shafer. I would like to ask each of you gentlemen to get out your pencils and maybe jot a note or two and remember these questions. I would like to have each of you in turn comment on them.

The point has been made by several of you this afternoon, and I do believe wholeheartedly, that farm income is too low. In fact, the statistics given by Mr. Shafer at the end, I think, would be most impressive. Farm per capita income in 1966, the good farm year, $1,700 or something like that; average nonfarm per capita income in 1966, was $2,600. My questions are these: Do you support or oppose each of the following measures to improve farm income?

1. The Mondale approach, and let me very quickly say what that is. It has two parts. The first part would provide for a national agricultural relations board to administer bargaining between farm committees and processors.

The second part of it would extend the marketing agreement system to all commodities.

2. A land retirement program; do you support or oppose such a program?

3. Additional credit facilities for farmers provided by additional Federal credit action.

4. The next is expansion of the food-for-peace program.

5. Finally, the kind of proposal which was described—I think, by Mr. McDonald—Senator Metcalf has introduced, that would sub-

stantially limit or eliminate using farm losses to offset income from other sources in computing income taxes.

Mr. Graham?

Mr. GRAHAM. Mr. Chairman, in regard to the Mondale bill, we would support the second part in preference to the first.

I should tell you that there have been a number of meetings between most of the farm organizations, and there is pretty general agreement among them on this point. This group includes the Grange, the Farmers Union, the NFO, the Missouri Mid-Conference Farmers Association, and the National Council of Farmer Cooperatives.

The approach generally of the second section of the Mondale bill—as I understand it has been introduced—is something that we would all support.

Chairman PROXMIRE. Your position, Mr. Graham, is that you would not support the first part; you would support the second part?

Mr. GRAHAM. Basically; yes. I think this is basically the position of most of us.

The second one on land retirement programs, if we were to believe what we hear or what we read, that we have a continued capacity for overproduction that is substantial, and according to Iowa State studies that it is going to continue for the foreseeable future, we cannot see any alternative except to continue some type of land retirement program.

If we would bring out 7 or 9 million acres out of a CAP program during the next couple of years, and they are going to come out unless something is done about it, and throw that on top of the surplus lands we have at the present time in terms of effective demand for the products, we are going to be in real trouble. I do not see any way around that one.

For additional credit, I think, generally, we have enough credit facilities if we just have enough cash to go into them. But, they are bidding against everybody else, including the Government, for a limited amount of available cash, and, so, the problem is not necessarily the amount so much as it is the cost at the present time. This is one of the reasons why we think there ought to be a tax increase that would take the money for the Federal Government out of taxes rather than bidding in the marketplace against all the private needs.

On expansion of Public Law 480, we favor very definitely an expansion of that. The Metcalf bill which you have asked about, and which Angus talked about is well within our policy, and we will support that also.

Chairman PROXMIRE. Mr. McDonald?

Mr. McDONALD. Mr. Chairman, we will support title II, the marketing order part, as I understand it. I have not had time to read the bill as introduced. We are in favor, in other words, of keeping the working programs and building on them. This is an extension.

Chairman PROXMIRE. It means you will not support title I, that is the National Agricultural Relations Board.

Mr. McDONALD. We will support title I also.

Chairman PROXMIRE. You will support both?

Mr. McDONALD. Yes, sir. We will support both titles of the bill. I would not say in every detail, but in principle, we will support the

bill as indicated by our President's press release which came out just a few minutes before I got here.

Chairman PROXMIRE. Thank you.

Mr. McDONALD. On land retirement, we have supported land retirement, but not retirement of whole farms which Ezra Taft Benson brought about, as I remember, where you had the abandonment of rural communities, and the taking of whole farms out. Parts of farms, yes, for land retirement.

Adequate credit facilities, and I cut off part of what I have got in my statement with regard to the Federal Reserve Board credit and high interest, and so forth, certainly an expansion of credit we are in support of it.

Senator Moss' bill, S. 1971, which would give credit to small cooperatives not available to them under the Farmers Home Administration, and not available to them under the Farm Credit Administration, these little cooperatives were left out in the cold.

We also would favor utilizing parts of the Federal Reserve Act which are not yet used. Section 13, part 3, I suppose, section 13-3, provides that in an emergency the Federal Reserve banks may make available under the Home Owners Loan Act of 1933—they could have done it in 1966 when we had a crisis, they did not use that authority, which was reaffirmed in this bill which was passed by the Congress in 1966. So we especially want more credit and not high interest, credit at a reasonable rate for farmers and others.

Of course, expansion of the food-for-peace program under Public Law 480, we favor that, and we favor the Metcalf bill.

Chairman PROXMIRE. Thank you.

Mr. Shuman?

Mr. SHUMAN. Thank you. On the Mondale bill it is our understanding that these two titles, the National Agricultural Relations Board and marketing agreements, both would involve Government supervised bargaining and marketing, and we are unalterably opposed.

We think that it would result in having a marketing board appointed on which would be, of course—you could not deny it—consumer and labor union representation, and we would be right back in the same trap we are in now, where we have had the Government farm programs used to hold farm prices down. We are for better farm prices and not for any device that keeps farmers from negotiating for the best price possible. So we are opposed to the Mondale bill, and will fight it in every way we can.

Second, the land retirement proposals, many of them, some of them have been useful in the past, perhaps.

We do not believe, and I was pleased to hear Secretary Freeman, yesterday, in Des Moines, indicate that there is some question in his mind as to whether or not you can adjust production through acreage controls. He said that this is open to question, and we challenge that you can.

In fact, the signing up in the wheat program was for an 8-percent cut in production for the year of 1968, and the latest USDA figure says that if it is cut any it won't be over 1 percent. This illustrates the futility of trying to adjust production through land retirement.

However, we believe that a land retirement type of program in connection, and only in connection, with the ending of these present

unworkable and unsuccessful control and payment programs might be a helpful thing. It could provide a transition program while farmers were adjusting to the market system again for these crops that are under controls.

I was glad to see Mr. Shafer point out that the parity ratio is the lowest it has been since 1937, and I emphasize that what we need are less Government programs.

Every time we have had a Government program in the last 30 years, the cost of farming has gone up, and the net income of farmers has gone down as a result of these programs.

During this last period of time, in the last several years, we have had the most expensive and the most extensive Government controls and subsidies in agriculture's history in effect, and we have an administration in charge of them that is pledged to make them work, and yet we are now near the depression level as far as farming is concerned. So we do not favor a land retirement program except in connection with ending the program we now have.

As far as additional credit facilities are concerned, we have got facilities running out of our ears. One of our biggest problems in agriculture is that farmers' indebtedness is going up. The total farm indebtedness in the last few years, particularly in the last 5 or 6 years, has skyrocketed, and so I do not, we do not, believe that we need new facilities.

We need to check inflation, which Mr. McDonald mentions as increasing interest rates. Well, the cause of increased interest rates is primarily inflation, and that is caused by the policies of this administration, which have been to spend more than we take in; and there is only one way to correct that, and that is to balance the budget and do it as quickly as we can.

So we do not favor additional Federal action in the credit field.

As far as expansion of the food-for-peace program, the Farm Bureau originated the Public Law 480 idea. We think it served a purpose, but we think it has largely served that purpose, and that it ought to be phased out as rapidly as possible. We want to sell for dollars and not to be in the business of export dumping, and so that is why we suggest that the needs for food for peace be met by purchases in the market.

I am not too familiar with the Metcalf bill, but we would not favor any bill which would cause farmers to lose any of their tax rights. We are not opposed to looking for loopholes which may be used by some to take unfair advantage of losses on farm operations. But we are very suspicious that any attempt to close these loopholes would take away some rightful privileges which farmers have under the tax laws.

That pretty well covers it.

Chairman PROXMIRE. Thank you very much, Mr. Shuman.

Mr. Shafer?

Mr. SHAFER. In regard to your first question on the Mondale proposal, which I have not seen as yet, but I think Mr. Graham pretty well stated the position that we would support on this proposal. We are in favor of any additional legislation which would enhance our bargaining position.

Question No. 2, land retirement, it is beyond me how anyone can figure that taking all of our land out of our retirement programs, phasing this program out, and expecting to put all of this land back into production, how in the world we can think this is going to cause higher prices, I cannot figure that out.

This last year is a good example of what increased production can do to farm prices; and without some way of keeping the added production from coming on to the market, I fear that prices would be much, much lower than they are today.

As far as additional credit is concerned, with the cost-price squeeze that has been on the farmers now for several years, and continues to get worse every year, the more money we can make available to the farmer—and the cheaper the rate of interest—the better position he is going to be in. Certainly this would help.

Sure, we are in favor of Public Law 480. We think it ought to be expanded to take up some more of the additional surplus, particularly in wheat, some of the feed grains, and so on, that this country is able to produce. Why not feed it to a hungry world? It seems to me that this is the logical approach.

No. 5, I am not acquainted with the Metcalf bill, but from what I have heard here today, we would be in favor of this approach, yes, to eliminate the tax writeoff of some of our other segments of our economy that come into farming.

Chairman PROXMIRE. Thank you. My time is up. I want to come back to that question.

Before I do, if Senator Jordan will permit, I would just like to ask Mr. Shafer—I missed because I was getting something from a member of the staff—did you say you are in support of both titles of the Mondale bill?

Mr. SHAFER. I said that I was not familiar with the Mondale bill, the proposal, yet. I believe that our position would be similar to the position expressed by Mr. Graham. I think that——

Chairman PROXMIRE. In favor of two but not one.

Mr. SHAFER. From what I understand. I would not say we would not support No. 1, but we are strongly in favor of No. 2, let us put it that way, from what I understand of the bill.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

I, too, have several questions, if you will use your scratch pads again, please, and I will not have to ask them of each one separately.

First of all, would you please supply for the record a list of your membership; that is, total membership in the United States and by States, if you will, please, for the record. You do not have to reply to that now.

Do you believe that Federal spending should be cut, and if so, where and how much?

Do you believe that we need a surtax and, if so, how much?

Do you believe we should remove the gold cover?

Most of you spoke briefly about land retirement, but you did not get into what incentives should be offered for further land retirement, if further land should be retired, and how should this be implemented.

These are my questions, Mr. Graham.

Mr. GRAHAM. Yes; we will furnish the first for the record.

(In answer to Senator Jordan's first question, Mr. Graham later supplied the following table:)

WHERE THEY ARE—GEOGRAPHIC ANALYSIS OF GRANGE MEMBERSHIP (DUES PAID)

	Members	Granges
New England:		
Maine	37,238	426
Vermont	12,105	191
New Hampshire	18,504	259
Massachusetts	28,245	302
Connecticut	27,158	186
Rhode Island	5,071	55
Total	128,321	1,419
Middle Atlantic:		
New York	78,866	1,110
New Jersey	11,823	131
Pennsylvania (except western)	46,184	618
Delaware	1,816	29
Maryland	2,008	47
District of Columbia	200	1
Total	140,897	1,936
East Central:		
Michigan	11,262	310
Ohio	106,414	1,126
West Virginia	1,322	27
Indiana	3,447	68
Western Pennsylvania	23,092	309
Total	145,537	1,840
West Central:		
Illinois	6,674	160
Wisconsin	1,663	34
Minnesota	1,720	56
Iowa	1,993	48
Missouri	2,188	36
West Central—Continued		
South Dakota	360	21
Nebraska	1,701	37
Kansas	26,213	220
Montana	1,486	29
Wyoming	1,064	31
Colorado	7,487	144
Total	52,549	816
Southeast:		
North Carolina	11,031	194
South Carolina	4,056	79
Florida	1,461	35
Tennessee	435	25
Virginia	1,139	30
Total	18,122	363
Southwest:		
Arkansas	641	20
Oklahoma	1,096	38
Texas	1,883	28
Total	3,620	86
Pacific:		
Washington	55,941	522
Idaho	9,409	168
Nevada	87	1
Oregon	26,062	360
California	40,122	363
Total	131,621	724
Grand total	620,668	7,184

Note: In addition, the Grange has an unknown number of members who are classified as honorary members, mostly those who have a long membership record, from whom no dues are requested. These probably number in 6 figures.

Mr. GRAHAM. In terms of Federal spending, we have some concept of the budget in terms of agriculture. But, as we testified before the House Ways and Means Committee, we do not set ourselves up as experts in the total budget of the U.S. Government. I do not think there are many people who are. We have areas in which we do have some expertise.

Frankly, we think that the cuts in agriculture at the present time have gone to the bone, and taken out some of the bone. There are substantial problems that we cannot answer at this budget level. One of them has to do with the proper funding of the Packers and Stockyards Act which, at least, guarantees some honesty in the marketplace. This, we think, ought to be increased, so at this point we do not see where you can cut more.

Frankly, I think that we have got some problems in doing any substantial cutting anywhere else. This has been a pretty rugged budget cutting session in the last 2 or 3 years.

If we are not going to eliminate military cuts, I do not conceive of how it is possible to equate cuts with tax increases.

If we would start from a year ago we might do that, or 2 years ago. But if we were to cut half of $23 to $29 billion we would practically dismantle a substantial amount of the Federal Government, if we do it outside of Defense.

We prefer, rather, a surtax. We have been in favor of this for a year. It puts the tax burden where it properly belongs—on those who have benefited from the inflation. We think it should have been passed at the time it was asked for. Our criticism before the House Ways and Means Committee was that we did not think it was enough. There is enough money in the United States today, and without substantially hurting anybody, because we are living in a pretty affluent society, after all. There is enough money to take care of most of this need which we have, at least to the point that we do not have to do quite so much deficit financing.

We would support the removal of the gold cover.

In terms of incentives for the land retirement, I am not sure what they need to be. I am not sure anybody has made a study which indicates what these incentives should be. But what we would say is that the incentive should be adequate to get the land retired, and it may be that the present incentives are sufficient. I have my doubts that they are, because of the added costs, taxes, and the like. Even idle land has taxes, and there has been a substantial increase in taxes of about 70 percent or so, and this would indicate to me that it would take a little more incentive than we have at the present time.

Senator JORDAN. Thank you.

Mr. McDonald?

Mr. McDONALD. We will furnish, Senator Jordan, for the record, our membership of our States.

(The following list was subsequently received from the National Farmers Union:)

National Farmers Union—Paid family membership, 1967

State	Members	State	Members
Arkansas	11,092	Ohio	3,138
Illinois	1,921	Oklahoma	50,010
Indiana	1,996	Oregon-Washington	1,150
Idaho	406	Pennsylvania	803
Iowa	3,491	Rocky Mountain	9,662
Kansas	7,142	South Dakota	14,612
Kentucky	426	Tennessee	118
Michigan	841	Texas	6,482
Minnesota	27,018	Utah	1,656
Montana	12,695	Virginia	638
Nebraska	7,085	Wisconsin	7,958
New Jersey	571	Miscellaneous	302
New York	441		
North Dakota	40,734	Total	212,388

Mr. McDONALD. In regard to spending and where to cut, frankly, I am not an expert on these matters and I do not know if we have resolutions to cover this or not.

But, in regard to some of these adventures, such as going to the moon, would it not be possible to cut off a few billion there? It is $5 billion, as I remember.

It would appear that the war effort and some of these things we have been talking about today are more important.

I agree with Mr. Graham. I do not know where you would cut agriculture even more than it has been cut. There is a super airplane which is supposed to carry thousands of people they have been working on, for I do not know how many years, and I am not sure it will fly yet, and hundreds of millions, I believe, Mr. Chairman, have been squandered on that project.

As far as I am concerned, the airplanes go too fast now.

We have supported, in principle, a taxing program. The farmers want to pay their taxes. But our Board, last September, passed a resolution that if we are going to have taxes which the middleclass is paying—parenthetically, this is the first war since I have been in Washington, and I have been here since 1935, where the middleclass is paying for the war. General Motors and these other people with billions of excess profits, with their war contracts are profiting from this war, and I do not see why the phrase "excess profits" has not been used a little bit up here around the Capitol.

I do not see why Representative Ullman's plan of 2 or 3 years ago to put a tax on those people whose profits were excessive since the war started, that I think would be a sensible tax program.

I believe that covers the questions.

Senator JORDAN. I asked you, Would you remove the gold cover; and do you have a plan for land retirement?

Mr. McDONALD. For land retirement, well, I thought I answered that a few minutes ago. We would be for a modified system of land retirement. We think it was a mistake—of course, the Secretary could not know—to add 30 million acres to increase wheat production.

Chairman PROXMIRE. Would the Senator yield? As I recall, you said you preferred not to take whole farms out of production.

Mr. McDONALD. That is correct.

Chairman PROXMIRE. But you would save the land retirement short of that.

Mr. McDONALD. That is correct; to make ghost towns out of rural communities.

Senator JORDAN. How about the gold cover? Would you remove the gold cover from the Federal Reserve notes, the 25-percent gold cover?

Mr. McDONALD. Yes, sir; I believe I would.

It reminds me of a story. Someone got into Fort Knox one time and stole all the gold, and they did not find out about it for 20 years.

Senator JORDAN. Mr. Shuman?

Mr. SHUMAN. Thank you.

On the first question, A list of the members by States and total for the United States? We will be glad to furnish that for the committee.

(The membership list promised by Mr. Shuman was subsequently supplied as follows:)

FARM BUREAU MEMBERSHIP

Member families by States as of November 30, 1967 (audited report for the end of the American Farm Bureau Federation's 1967 fiscal year).

State	*Total*	*State*	*Total*
Alabama	100,024	Nevada	1,630
Arizona	4,051	New Hampshire	3,487
Arkansas	54,024	New Jersey	3,199
California	60,380	New Mexico	9,557
Colorado	13,478	New York	14,591
Connecticut	2,492	North Carolina	59,814
Delaware	1,500	North Dakota	15,736
Florida	35,069	Ohio	50,875
Georgia	51,733	Oklahoma	52,785
Hawaii	875	Oregon	8,367
Idaho	11,406	Pennsylvania	12,624
Illinois	190,477	Puerto Rico	5,960
Indiana	153,162	Rhode Island	227
Iowa	110,019	South Carolina	28,760
Kansas	83,697	South Dakota	3,943
Kentucky	87,839	Tennessee	87,956
Louisiana	26,657	Texas	105,653
Maine	2,003	Utah	8,636
Maryland	9,412	Vermont	5,255
Massachusetts	4,052	Virginia	20,360
Michigan	52,144	Washington	4,064
Minnesota	29,407	West Virginia	4,088
Mississippi	66,462	Wisconsin	25,311
Missouri	41,365	Wyoming	7,928
Montana	4,486		
Nebraska	15,693	National total	[1] 1,753,532

[1] Farm Bureau memberships are reported by families. The number of individuals is not reported; however, if it is assumed that the average member family includes three persons 14 years of age and over, the total number of individuals would be in excess of 5,250,000.

Mr. SHUMAN. The second one was: Should spending be cut, Federal spending be cut, and how much? We definitely favor a very heavy cut in Federal spending, and we believe it can be made.

It is absolutely ridiculous to take the attitude that you cannot cut spending because Congress keeps adding to it. They can take it off the way they have been putting it on.

Some of the things that could be cut, we are ready, willing, and have suggested cuts in Federal farm program spending of $1 billion or more. We believe that the poverty program, much of the poverty program, is money down the rathole. It has been wasted and squandered throughout the country, and it is not effective in the objectives which could be attained in different ways. Much of the poverty program expenses could be eliminated.

We think the foreign aid programs have had a lot of water in them, and a lot of waste, and that they can be cut down very drastically.

We agree with Mr. McDonald that the moonshot and some of these things could wait to a time when we were not in as drastic a situation as far as the fiscal survival of this Nation is concerned.

There is no question but what the rivers and harbors appropriations can be drastically cut. This is the pork barrel type of thing, a kind of make-work project for the Army Engineers, in which billions of dollars have been spent on these projects throughout the United States that ought to be curtailed, postponed, or eliminated.

As I said previously, we would oppose an increase in taxes until such time as the Congress is ready to make an equivalent cut in spending.

We think this cut can be at least $5 billion. With a $5 billion tax increase there would be a $10 billion reduction in the deficit, and it could be much more, without any question.

As far as that goes, we believe the military expenses should be scrutinized, and probably some of them can be cut without endangering the defense effort.

As far as removing the gold cover: No; we are not in favor of removing the gold cover. We think that if the Congress and the administration recognize the gravity of the situation, and take appropriate action to reduce expenditures, it will not be necessary.

If appropriate action is not taken, very likely, before the year is up, we will be forced to do the same thing that Great Britain was forced to do. The situation is desperate, but it is not a time to start taking actions to remove the gold cover. It is time to meet and to treat the problem, not the symptoms.

As far as incentives for land retirement: We favor land retirement on a competitive bid basis and, as I said before, its use only as a means of transition while we are dismantling the control and direct subsidy programs.

Senator JORDAN. Thank you.

Mr. Shafer?

Mr. SHAFER. In answer to your first question, it has been our policy not to release our membership. We are a farm organization organized primarily for bargaining purposes, and it has been the belief of our membership, at least, that we should not release to those that we are trying to deal with the areas in which we are strong and the areas in which we may be weak or just exactly what our total membership is. In other words, we believe that this is a part of bargaining; because of this, our membership asks, that we do not release our membership totals.

Regarding the next question: Should Federal spending be cut? Again, let me say that we are a farm organization, and we try not to get involved too much in things that do not pertain to agriculture.

So far as agriculture is concerned, we do not see any way that you could successfully have the agricultural expenditures and still expect to accomplish as good a job as we are doing now.

We have taken no stand on the gold cover, as far as our organization is concerned, or on the need for more taxes.

My personal opinion, so far as taxes are concerned, I cannot see how we can continue forever to go into debt to take care of all of our problems. So, it appears to me, personally, that probably we do have a need for more taxes.

The land retirement question: We believe that whatever incentives are necessary to get whatever land is needed out of production should be used. I am hopeful that the present feed grain program will siphon off sufficient production to be of great help.

I would agree with Mr. McDonald in his statement that we do not favor the retirement of whole farms where communities could be drastically affected.

So far as our land retirement program is concerned, we think it should be done more generally from individual farms rather than trying to close down entire communities.

Senator JORDAN. Thank you.

Thank you, gentlemen. I am sorry, Mr. Chairman, that I took so much time. I got some good answers.

Chairman PROXMIRE. Do you want to make a comment, Mr. Graham?

Mr. GRAHAM. Yes, indeed.

Chairman PROXMIRE. Please go ahead.

Mr. GRAHAM. I think just from the standpoint of accuracy we ought to catch a couple of things here.

The statement was made that net farm income has continued to decline, and in table 77 of the CEA report it shows that farm income did decline from 1952 to 1960 from $15.1 billion to $11.5 billion.

But, beginning in 1960, it went up, and with the exception, there have been only two times when it went down under the previous year, but the increase has been from $12 billion to $14.9 billion this year, even after the drop of income.

In terms of net income per farm, by 1967 dollars there was a drop from 1950 to 1960 of $42; but from 1960 to 1967 there was an increase of $1,314.

There is another statement that was made that the release of farm stocks inevitably depresses prices.

Chairman PROXMIRE. Let me just ask you at that point, Mr. Graham, because I agree with your figures, you are right; but, No. 1, the most recent figure shows that farm income has gone down in 1967 as compared to 1966, and gone down——

Mr. GRAHAM. $283 million.

Chairman PROXMIRE. And drastically.

Mr. GRAHAM. Right.

Chairman PROXMIRE. In the second place, we know the value of the dollar has diminished somewhat during this period. We also know that what has really happened is a statistical trick. What has happened is that many, many farmers—literally millions of farmers—have dropped out of farming.

Mr. GRAHAM. Of course.

Chairman PROXMIRE. These are the farmers with low incomes, by and large—not entirely—but by and large. The farms that remain are bigger, have a larger investment. Whereas they do have a higher per capita income, the reason they have a higher per capita income is, as I say, because the farmers with lower incomes have disappeared, are no longer in farming.

Mr. GRAHAM. That is correct; no question about it. But the net farm inventory, I mean the net, including inventory changes, has gone up even with the loss of farmers. I mean, this is total. This does not break it down to per farmer base.

It has gone up historically, and it has not gone steadily down as the statement was made. This was the only point I was making. It went down this last year by $283 million, but this does not indicate a steady decline.

Chairman PROXMIRE. Yes. We raised this point the day before yesterday when Secretary Freeman appeared before us, and I think the conclusion that the Secretary of Agriculture made was that

whereas he argued that per capita farm income has gone up over the past few years, he agreed that it was still less than two-thirds of the income of those off the farm.

Mr. GRAHAM. I will agree with that.

Chairman PROXMIRE. Whether it has gone up or down, the point is that it is still too low on the basis of comparison with nonfarm income, particularly when you recognize the investment the farmer makes—which most people off the farm do not make—the enormous increases in efficiency, and the great risk involved in farming. When you put these elements together, together with the hours the farmer works, it would seem that the injustice is most conspicuous.

Mr. GRAHAM. I am not arguing about this relative——

Chairman PROXMIRE. I am sure you are not. But I wanted to put it in as much context as possible.

Mr. GRAHAM. The relative position is obviously not good, and we made that point in our testimony. The point I am making is that you cannot honestly say it has steadily gone down.

Another statement was that the release of CCC stocks inevitably depresses the price. Well, the fact is that the price went up steadily during the time we were dropping the supplies of wheat from 1 billion 400 million down to about 400 million, and we were dropping corn stocks from 85 million tons to 45 million tons. During that time the price did go up, and it is a strange thing that the price ceased to go up and started declining after the stocks had disappeared. This is a matter of historical record.

Chairman PROXMIRE. As the stocks diminished.

Mr. GRAHAM. I mean as the surplus stocks diminished. The overpowering surpluses were gone by the time prices began to go down. And furthermore, farm prices are at a low level of parity, but when the certitficates and program payments are added, the parity level is up except for nonsupported crops.

Chairman PROXMIRE. Mr. Shuman.

Mr. SHUMAN. Mr. Chairman, I just want to challenge that last statement, that it is not a matter of historical record, and we will submit figures to show it. I do not have them right here.

(Information later supplied, follows:)

CCC SALES OF FEED GRAIN IN RELATION TO UTILIZATION

Marketing year	Total utilization	CCC sales	CCC sales as a percent of utilization	Season average price
Corn:	Millions of bushels	Millions of bushels	Percent	Per bushel
1961	3,962.0	975.0	24.6	$1.10
1962	3,895.0	736.0	18.9	1.12
1963	3,848.0	170.0	4.4	1.11
1964	3,875.0	391.0	10.1	1.17
1965	4,392.0	398.0	9.1	1.16
1966	4,244.0	[1] 22.0	-------------------	1.29
Sorghum grain:				Per hundredweight
1961	521.0	221.0	42.4	$1.80
1962	516.0	241.0	46.7	1.82
1963	591.0	122.0	20.6	1.74
1964	573.0	144.0	25.1	1.88
1965	848.0	240.0	28.3	1.79
1966	911.0	[1] 37.0	-------------------	1.86
Oats:				Per bushel
1961	1,059.0	7.0	.7	$0.642
1962	1,019.0	6.0	.6	.624
1963	931.0	3.0	.3	.622
1964	891.0	13.0	1.5	.631
1965	891.0	18.0	2.0	.622
1966	869.0	14.0	1.6	.669
Barley:				
1961	441.0	40.0	9.1	.979
1962	410.0	11.0	2.7	.915
1963	420.0	30.0	7.1	.897
1964	430.0	15.0	3.5	.947
1965	395.0	12.0	3.0	1.02
1966	383.0	3.0	.8	1.06

CCC SALES OF WHEAT IN RELATION TO UTILIZATION

	Millions of bushels	Millions of bushels	Percent	Per bushel
1961	1,329.8	254.6	19.1	$1.83
1962	1,226.0	207.8	16.9	2.04
1963	1,439.7	341.7	23.7	1.85
1964	1,375.3	310.8	22.6	1.37
1965	1,598.6	379.1	23.7	1.35
1966	1,438.0	147.2	10.2	1.63

[1] Oct. 1, 1966, through July 14, 1967.

Mr. SHUMAN. I also want to point out that I would hate to try to tell any farmer today that his income situation is better today than it was before 1960. This just is not true. The income situation of the average farmer is best depicted by the parity ratio, and it is at the lowest point it has been since 1937.

The income situation, net income, and the points you brought out about the total, the fact that the improvement in individual farm income is up, is due largely to the tremendously large migration out of agriculture that has happened not only in the last 6, 7 years, but before that, and it has been about the same rate for the last 20 years. It does not matter which administration is in power, farmers are still being forced out of agriculture.

Chairman PROXMIRE. I would like to ask you, Mr. Shuman—and the other gentlemen, if you would like to comment on it—that I think some of you have already indicated your position, but Wednesday afternoon Secretary of Agriculture Freeman, when I asked him what would be the consequences of a $1 to $2 billion cut in the agricultural budget, said that in his view he would have no alternative except to virtually dismantle much of the farm support program.

On the basis of studies that he had seen, this would result in a very sharp drop in farm income. At the same time, there are many in Congress—and many outside of Congress—who feel if there are fewer

farmers, with greater reductions we have had over the years, at least in surpluses, that it is hard for them to understand how our agricultural budget is still so very big. What is your response to this, Mr. Shuman?

Mr. SHUMAN. Well, I would respond by saying that any study as to what would happen by the dismantling of the present very expensive and ineffective farm program would depend upon who made the study, No. 1, and there have been studies made by people who did not want to see these programs dismantled; and, No. 2, by the assumptions that you make in such a study.

I think, without question, if you just simply jerked out the controls and the almost $3 billion subsidy, this would reduce farm income, if you did not do anything else.

We have made proposals and suggestions that, if implemented in connection with this dismantling process, I am sure would result in increased, not reduced, income as we got rid of these programs.

The purpose of the program, particularly the feed grain program, was to reduce farm production, and yet the average production of feed grains during the years since the feed grain program has been in effect has been considerably higher than it was in the 5 previous years. The program did not get any reduction in production. It assured farmers of a certain price, and they increased their production.

The proposals that we have made include such things as an expansion of the land retirement, a prohibition against the sales of surpluses by the Government to depress prices; expansion in our purchases for—purchases rather than direct aid—purchases of the commodities on the market for the aid programs. Other ideas could be implemented and a transition could be made very quickly without any great disruption.

Chairman PROXMIRE. I take it, then, you would directly disagree with the Secretary?

Mr. SHUMAN. Yes, sir.

Chairman PROXMIRE. And argue that you could reduce the farm program by a substantial amount, $1 billion or $2 billion without a disastrous effect on the farmer's income?

Mr. SHUMAN. Yes, sir. I believe that this could be done very rapidly, with some protections adopted by the Congress.

Chairman PROXMIRE. Would all of you gentlemen disagree? I do not want to put words in your mouth.

Yes, Mr. Graham.

Mr. GRAHAM. I do not see how anybody can say that you can take $3 billion away from farm income without any assurance that there is going to be a substantial increase in farm prices, which simply is not there, and say the farm income would not be hurt. It would be hurt obviously by $3 billion to start with.

If the feed grain program at the present time was taken out, we would obviously produce more feed grain. What would we have produced without it? This is the real problem.

If all of this land went back into production, whether it be feed grain or wheat, obviously we would have a continuous pressure upon us in terms of prices. Look what we had last year in terms of wheat. Mr. Shuman points out in his testimony that this increase in wheat acreage caused a price problem that resulted from the evaluation of the world food situation. So, if that increase caused the price break

this last year as stated by Mr. Shuman, and incidentally, the Government did not demand that or insist on increases, but those farmers who could produce this extra wheat efficiently were permitted this extra increase, and they did produce enough in the light of the existing world situation so that the price of wheat was depressed; not the slightest question about it.

If it did increase acreage when the controls were loosened, what reason is there to believe that it would not happen again? If the acreage increased, would not the price decline again?

I just do not follow this business that the Government can increase acreage and cause prices to go down. But if they took off the controls and the acreage increased then prices would go up. I see no validity in that kind of an argument at all.

Chairman PROXMIRE. Mr. McDonald?

Mr. MCDONALD. Mr. Chairman, we have always been puzzled in a friendly way by the reasoning of our friendly rival organization, and I am still very puzzled.

If you take controls off, we know that farmers like to work, they like to produce. History proves that if the farmer has an opportunity to make an extra dollar by putting in an extra acre, he is going to put it in. If his income is low he will put in a few more acres. He will clear off some land he had not been using so as to make up for his less income.

If you take off controls, Mr. Shuman, you will have the worst debacle. It will be much worse than the depression, it will be much worse than it was under Ezra Taft Benson. It would be a catastrophe. It would be a catastrophe not only for agriculture but for the whole country, and the little fellows who could not get credit at the bank would go out. The big guys, the insurance companies and these off-farm interests, would buy up the bankrupt farmers, and you would eventually have consumer prices controlled by a few giant corporations.

Chairman PROXMIRE. Mr. Shafer?

Mr. SHAFER. I just wanted to say that Mr. Shuman points out that the amount of production has continued to increase even though the number of acres is being decreased through the Government programs. I cannot see any reason to believe that farmers are going to quit using the fertilizer and they are going to quit using the increased technology which they have gained in producing to cause yields per acre to go down, and if you increase the number of acres it appears to me you have got to increase the amount of production.

Again Mr. Shuman told us that our problem last year was increased production. This is what caused the lower prices, and I agree with him. This is what caused the lower prices.

So, following the same line of reasoning, it appears only logical to me that if you decrease the number of acres that are in retirement, increase the amount of crop, I cannot see anything but lower prices for farmers.

Actually, the total gross income would probably be less, much less, than before when you consider what it costs to produce these extra acres, why the net has gone down. I cannot see it any other way.

Chairman PROXMIRE. I would like to ask Mr. Shafer—when we get back to Mr. Shuman we want a rebuttal—but I would like to ask you, in connection with this, your organization has an appeal to many nonfarmers as well as farmers on the ground that it would provide a collec-

tive bargaining substitute for some of the costs of the farm program. In other words, if the farmers could negotiate for a better price, the feeling of many people is that they would not have to rely on some of the many expensive programs we have now.

I take it from your remarks at least for a transition period you would want both. You would want both the present farm programs pretty much as they are, maybe expanded somewhat on the basis of what you said a little earlier, plus the opportunity to bargain under title II of the Mondale bill, for example.

Mr. SHAFER. Mr. Chairman, this is correct.

We are organizing farmers to bargain and sell collectively for cost of production plus reasonable profit prices, but we are not there yet, and until such time as farmers are organized so that they can accomplish this by themselves, I think that it would be disastrous to——

Charmain PROXMIRE. At that point, however, you feel we could begin to cut back the farm program?

Mr. SHAFER. At that point I think we may be able to cut back on farm programs; yes.

But I think that we possibly will still need all the help we can get in the way of enabling legislation to assure us the necessary protection to bargain. We have the Capper-Volstead Act which gives us the authority, the farmer in the United States, to join together into one organization and price his commodities. But some other legislation which, as I understand it, will be offered, if the Mondale proposal is adopted, could be very helpful.

Chairman PROXMIRE. Mr. Shuman wanted to say something.

Mr. SHUMAN. Mr. Chairman, just a minute of rebuttal. The best proof that there would be no disaster in the way of overproduction and price collapse is the fact, the experience that we have had in these 35 years, and that is that these control programs never reduced production and, therefore, removing them would not be expected to increase production.

There have been made many studies of this, and it is quite evident that the real cause of the surplus problem has not been the acreage either, whether it was what normally farmers put in or what they take out. The real cause of the surplus problem in the last few years has been the manipulation of prices and the assurance before the planting time that the price was going to be a certain level. It might have been a lower price than it would have been under the market, but it increased production because they knew ahead of time and they got the payments. Half the payments are made in the spring in time to buy fertilizer.

Now, proof that there would be no disaster? The best proof is that two-thirds of agriculture has been operating without Government subsidies, without any control programs, and under the handicap of having these programs transfer production and other disruptive effects into their production and markets as a result of the programs.

Chairman PROXMIRE. Was not a significant part of the purpose of supporting the 30 or 40 percent of the farm production which is under the program, to help support the other part of agriculture?

For example, as I understand it, beef and poultry, and so forth, are not directly controlled; they are not under the program. But, at the same time, the feed grain program would have a very direct in-

fluence on the price of beef, on the price of pork, on the price of poultry, and so forth.

Mr. SHUMAN. This has been the popular argument. But it has been a negative influence because if you take a look at the facts, the feed grain program caused a greater average production than was produced in the 5 previous years without any feed grain program. Of course, the additional feed you have produced, which was stimulated by the feed grain program, very seriously disrupts the livestock markets.

The soybean situation is another story. The cotton program has forced the transfer of resources from cotton into soybeans. The same is true, to some extent, with wheat in the feed grain programs.

So, I say the success of two-thirds of agriculture which has never had any programs, never had any subsidies, never had any price supports, despite the fact that these programs have channeled all these resources over to them, proves beyond any question of doubt that the cause of our serious trouble with agriculture today can logically be laid to the farm programs. The way to improve prosperity in agriculture is not to continue to do the thing that has got us into trouble.

After all, we have been trying to do that in the last 35 years, and particularly in the last 7 years we have gone all out for farm programs, and look where we are—73 percent of parity. It is time for a change.

Chairman PROXMIRE. My time is up. I will yield to Senator Jordan.

Before I do, Mr. Shafer wanted to make a comment, if that is all right with you.

Senator JORDAN. Yes.

Mr. SHAFER. I want to give an actual illustration from an actual farmer's standpoint as to why I think doing away with the programs would increase production.

The farm that I presently farm, my father farmed before me, and 30 years ago the average corn production on this farm was in the neighborhood of 35 bushels to the acre. Now, this did not happen overnight, but by using the increase in technology between then and now, my farm presently produces about 90 bushels of corn to the acre, on the average. Just the fact that we do away—let us say, I am producing 100 acres of corn. I have 100 acres that I can produce corn on. If I put 50 percent of that into the feed grain program, I am going to grow 50 acres of corn.

If I have no feed grain program I am very likely going to grow maybe not 100 acres but way up toward 100 acres of corn, and I do not think it is going to make 1 bushel per acre difference in the production on my farm if I do not have a feed grain program, or if I do, per acre.

So, it appears to me that on my farm there is going to be almost twice as much production of corn without a program as there is with a program. I just wanted to make this point as a farmer actually farming on a farm.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you.

I would like to find something that you would all subscribe to here. You have all stated, I think, the precarious position of agriculture in today's economy and implied that the farmer is the forgotten man in an affluent society.

This is a question I put to you: Do you know of any time in the entire history of the United States when so small a percentage of consumer disposable income is required to buy food for that consumer's family?

Chairman PROXMIRE. Mr. Graham?

Mr. GRAHAM. Not only in the history of the United States but in the history of the world. The production miracle of all time is here in the United States. It is the result of our technology. We have literally made cheap food available. It is not a cheap food policy, necessarily. It is a cheap production policy on the part of farmers and, thank God, they can do it.

The only problem is whether they should get paid on what they produce. The consumer never had such a break in all the history of the world. They have the highest quality of food, in the greatest variety, and at the cheapest prices that they have ever had and, frankly, I do not think the average consumer would raise very many objections to farmers getting a decent price, either.

Senator JORDAN. Mr. McDonald?

Mr. McDONALD. Well, I am completely—I am just trying to think of what to add to Harry's statement. I am in enthusiastic approval of what he has said.

I might add that food could be even cheaper if the middleman was not taking such a huge slice, and if you did not have, as you have in every market area in the United States, just about, the control of wholesale food prices by food chains.

Here in Washington, six chains control 90 percent of the food that is sold, and I am told that the direct buying now is taking the place of competitive terminal markets all over the United States. So that if the farmer had some kind of bargaining power, the consumer need not suffer.

The farmer could get a better price for his product, and slice off a little of this unnecessary middleman profit.

Chairman PROXMIRE. Mr. Shuman?

Mr. SHUMAN. I think you did hit on something we could all agree on and brag about, and that is the fact that in terms of the purchasing power of the consumer, in other words, measured on the basis of factory wages, average factory workers' weekly wages, the consumer spends less of his take-home income on food today than any time in the history of the country. I think it is around 17 or 18 percent. It has been dropping steadily.

I would want to point out that this is due primarily to the increased research and efficiency, due to the fact we have stayed competitive. There is no question but what the law of supply and demand still operates despite attempts to nullify it or do something else.

In fact, when programs are used to try to establish prices arbitrarily, whether by bargaining or by Government, you destroy markets, and the consumer will determine the price.

We might think as farmers that the housewife ought not to worry about a little increase in price of butter or milk or cotton goods, but when those prices do increase she looks for substitutes, and if we are going to continue to produce for consumers, we are going to have to meet competition. You cannot arbitrarily fix a price.

The cotton industry has lost about a third of its market because it decided to price cotton through Government edict without regard to

competition. Within 10 years there will be no cotton industry in this country if we do not get rid of the cotton program.

Chairman PROXMIRE. Mr. Shafer?

Mr. SHAFER. I would agree that statistics show that food is cheaper in this country than it has been any time in the history of this country, and not only in the history of this country, but it is also cheaper in terms of time spent earning it here in our Nation than it is anywhere in the world or in the history of the world.

So far as I am concerned, I think that this is another place that the farmers have been partly asleep. I see no reason why we should let the nonessential industries of the country take over the spending power of the consumer. Actually it appears to me that the serious situation in agriculure and, as I have tried to outline earlier in my remarks, the seriousness that I believe is involved for the entire Nation, I believe that the entire Nation could well afford to move this percentage of their consumers' time that is spent for food back up a little to keep the family-type farming operation alive in this country.

I realize that the substitutes, and so forth, are somewhat of a problem. But I would like to state that food is food, and if you move from one commodity to another you may have a problem. But when you are dealing with all food items, the elasticity of the human consumption in this country is pretty constant.

In other words, we do not have much up and down in the amount of food that we as people eat. There is some change in which food items we might eat, according to price. But this gets back to our philosophy of bringing all prices up more or less in balance.

If this can be accomplished, I think we can reclaim some of the dollar market that we farmers have lost.

Senator JORDAN. Thank you.

Chairman PROXMIRE. That was a very good question, and I think the answers were excellent, and I am delighted to see this kind of consensus.

I would like to follow this up with a very closely related question, because it is one that I think is very troublesome for this Joint Economic Committee in recommending policy for the country.

Many of the witnesses who have come before us, administration and otherwise, have said the principal problem facing this country is inflation—rising prices. We know that one reason why prices did not increase more rapidly last year than they did was because farm prices were depressed. The farmer, in a sense, was kind of a hero in keeping prices down, but an unwilling hero and an unjustified one.

Mr. GRAHAM. Reluctant.

Chairman PROXMIRE. We do not want him to continue in that hero's mold.

My question is, To what extent in your view would more just prices for the farmer increase the cost of living for the American consumer?

Mr. GRAHAM. Well, that is taking a shot in the dark, I think. Would you mind if I would interject here something to say to Senator Jordan, that there is another area of agreement, and that is in opposition to increased protectionism. I think we are all in agreement on that one.

Chairman PROXMIRE. Yes, indeed. I went over that much too fast, but I think that is an excellent point. All four of you are agreed that

we should have the freest possible trade, and you are opposed to restriction.

Mr. GRAHAM. Yes.

It depends on how much markup there is on the farm products. If we could get a markup on the basis of the actual increase in cost, there would be some increase in the cost of living, there is no question on this. But what is happening is that when we increase the price of milk by 3 cents, we increase the price of milk to the consumer by 5 cents, because the markup is on a percentage of the total instead of on the basis of the increase in cost. This is a traditional markup system on the part of most industries. Everybody uses it but agriculture, and we cannot do it very well.

The question really becomes more acute when we ask the question as to whether the rest of the increases in wages and profits are going to be based on any productivity standard whatsoever.

If we could have this kind of a relationship like the Council tried to have before where wage increases were tied somewhere to productivity, then this would not necessarily be extremely bad.

But, where we get into trouble is, each segment of the economy wants not to have equality but wants to have an advantage, and as long as this happens, then we are in trouble. If we go up to get any kind of equality, and labor and industry both are increasing their wages and their profits, then we just go around and around in a spiral. How we can do this is the great question in the world.

I listened in the FAO to the 120 nations reporting, and if there was one single thing they said over and over again it was that the major question was how do the farmers in their countries gain an equitable income in countries with expanding economies. Over and over the same thing is said.

Chairman PROXMIRE. Do you find, Mr. Graham, an inconsistent situation in which labor is organized, militant, effective, experienced and able to negotiate for a good wage; business, with some exceptions, is organized, effective, powerful politically, is able to get a price; the farmers are not organized at all, and one of the things—the impression that I got and, perhaps Senator Jordan did to some extent—while you gentlemen do agree on two points, you disagree on just about everything else, and we find this is so common among farmers. It is hard to get agreement, and if you do not get agreement it is hard to get organization, and if you do not have organization it is hard to have effective power, and if you do not have that it is hard to get a price.

Mr. GRAHAM. We have more agreement than this, really, with one exception, and all of us are out of step but Mr. Shuman.

Mr. SHUMAN. And we have got more members than all the rest of you combined.

Mr. GRAHAM. They may have better insurance salesmen than we have.

Mr. SHUMAN. That is part of it.

Mr. GRAHAM. But the fact is that we are in agreement. All the rest of the farm organizations, as far as I know, are in agreement with the continuation of the present farm program. We are all in agreement for a reserve, even to the point of agreeing on the exact language of the bill, and this is something when you get that kind of agreement, and agreement with the administration at the same time.

Now, this maximizes agreement. We are basically in agreement in terms of the bargaining bills, very little difference there. So, there are vast areas of agreement, except for this one point.

The problem is even if we could arrive at nirvana where we had, everybody was in agreement, and all belonging to the same organization, I do not know whether it would be Mr. Staley's or Mr. Shuman's, but someone would have to give at that point, and even if we did that, and could come effectively into a bargaining situation, I doubt that we could get public support to allow us to do the things that labor now can do, and whether we can even get legislation that would give us the power that labor has at the present time. I doubt it because I think there is enough opposition to some of the use of power that labor has at the present time that I doubt if the Congress would give us this kind of power.

So we are talking in terms of a never-never land to which I do not think we can get.

Chairman PROXMIRE. We will find out. This is the first time we have got a bill before us, to my knowledge, and it is a bill to which some of you have agreed; and Mr. Shuman, as a very significant and highly respected voice disagrees with, but I think there will be a real debate in Congress, and it is possible that some of it may be at least, in part, legislated.

Mr. McDonald?

Mr. McDONALD. Mr. Chairman, I would like to address myself to your original question about increasing prices to the farmer and how it would affect the consumer, and I am in agreement with Mr. Graham that there would be some increase, and there would be not a proportionate increase.

We have an example of that, or we had, a few years ago, 2 or 3 years ago, when dairymen were going out of business so fast that it was feared milk would have to be rationed during the next few years, due to low dairy prices and for other reasons.

So the Secretary of Agriculture increased the price on 100 pounds of milk, $1, about 2 cents a quart.

And over here in Baltimore the price of milk was increased about 6 cents a quart. The Federal Trade Commission made a survey and study showing that the price of milk—it was a situation on bread, too—the prices were just about doubled. The increases were just about doubled and tripled.

Whenever the farmer gets 2 cents, he gets incidentally 2 or 3 cents out of a bushel of wheat; whatever it is, very little, why, the bakers would go ahead and double and triple the wholesale price increase.

In regard to inflation, it seems to me that the last few years it is a profit inflation. It seems to me that the interest crisis is a war inflation. The war-affected industries have chased after dollars and goods on that side of the economy so that they have caused inflation.

Over here you have poor agriculture and housing in a state of depression, who could not benefit from this increased prosperity.

When Ralph Nader comes up here and gets safety provisions in the bill—at least he was important, I guess, in the propaganda that led to this—the automobile industry now is refusing to sell automobiles to the Government, according to Drew Pearson this morning. At least the Big Three are refusing to sell automobiles, because of the safety

features required. They have to reveal certain facts if they sell these automobiles and trucks to the Government.

So you have sort of a conspiracy in the durable goods industry. They raise their prices disproportionately.

When labor gets—this has been proved over and over—when wages increase, when labor gets their wage increase, then they are doubled, they are pyramided; and, getting back to the point I made a while ago, I think we should have these profits, the highest in history, exorbitant profits up to 25, 30 percent after payment of taxes, and I think we should have excess profits legislation. I do not think that the people sitting in this room should have to pay almost entirely for this war. I think big industry should have to bear a large part of the burden.

Chairman PROXMIRE. I just have one more question, and this is to Mr. Shuman.

Mr. Shuman, you make a very interesting proposal for dollar-for-dollar tax credit to the States for their income taxes, sales taxes, and corporation income taxes.

I compute that, on the basis of the present taxes paid by the States, this would mean a credit of $30 billion. Maybe it would be somewhat less than that, because some people would not be in a position to claim it. Total Federal grants are only $15 billion.

It seems to me if you go through with that resolution, and I presume you might agree to some refinements or limitations on it, you are pretty much asking the States just to back up their trucks to Fort Knox or the Treasury and cart off as much as they want; because what they can do is to have an income tax that would match the Federal income tax, which would be fantastically burdensome, of course. It would not increase the taxes paid by any of the residents because the residents would get a dollar-for-dollar offset through the income taxes they would not then pay to the Federal Government.

But this, of course, would tremendously diminish revenues to our Federal Government. In fact, it would wipe out corporate and personal income tax, and then some, because in addition to that, of course, you would have sales tax offsets.

I just wondered if there should not be some limitation on the enthusiastic resolution that the Farm Bureau has.

Mr. SHUMAN. Well, I think there would be in practical application. Certainly we would not advocate a tax credit without a matching amount of transferred spending responsibilities. In other words, if the Congress aprpoved a tax credit then we would, of course, expect Congress to discontinue the appropriations for welfare, education, any anything else which they thought was, could be, covered by this corresponding gain by the States.

Chairman PROXMIRE. But, as I pointed out, your tax credit right now, if it is on a dollar-for-dollar basis, would be $30 billion, and the grants—all grants—are only $15 billion.

Mr. SHUMAN. That is right.

Well, there are other grants besides education and welfare, and undoubtedly there would be limitations placed on it by the Congress as to whether or not they were going to transfer more of the Federal grants in aid or other programs besides the $15 billion of basic grants. That comes to around $15 billion, I think.

Chairman PROXMIRE. Well, perhaps the figures we have are incomplete.

(The following supplemental explanatory information on the proposal was subsequently received for the record from American Farm Bureau Federation representatives:)

REGAINING CONTROL OF FEDERAL EXPENDITURES

One of the most urgent problems facing America today is the question of how to deal with the ever increasing federal budget. For a number of years Farm Bureau has felt that the *financing* and *control* of welfare programs and public education should be returned to state and local governments. Recent expansion of welfare programs and federal aid to elementary and secondary schools underscores the need for a change in direction. With federal funds goes federal control—more federal funds, more federal control.

With this in mind, delegates to the American Farm Bureau Federation annual meeting in December, 1967, adopted a policy calling for taxpayers to receive dollar-for dollar credits against their federal income tax liabilities for state, corporate, and individual income taxes and general sales taxes paid. The policy calls for these credits to be used *by the states* to provide the tax base necessary for state and local governments to assume the *full authority and responsibility for costs* and administration of basic welfare and elementary and secondary educational programs.

Using 1966 figures, the latest available, this is how the proposal would work. In 1966 more than $14.2 billion was paid to states in the form of individual income taxes, corporate income taxes and sales taxes. Federal support for basic welfare and elementary and secondary school programs amounted to $5 billion, which is approximately 35 percent of these state taxes. For states to assume this $5 billion in costs, a 35 percent credit for state taxes paid would be needed ($5 billion is approximately 35 percent of $14.2 billion).

The following table shows the program's effect on an individual now paying $2,500 in federal and state taxes. By taking a credit of $175 against his federal liability (35 percent of $500) he would reduce his present $2,000 federal tax payment to $1,825. At the same time, his state taxes could be raised to $675 ($500+$175) to fully support basic welfare and elementary and secondary school programs at state and local levels. His total tax liability would still be $2,500.

	Present system—Taxes paid	New system—Federal credit, higher State taxes	New system—Taxes paid
Individual State income and sales taxes paid	$500	$500	$675
State tax increase to pick up 35 percent credit	None	+175	
Individual Federal income tax liability (gross)	2,000	2,000	1,825
35 percent Federal credit for State income and sales taxes	None	−175	
Total individual tax bill	2,500		2,500

FEDERAL PAYMENTS TO STATE AND LOCAL GOVERNMENTS, AND INDIVIDUALS AND PRIVATE INSTITUTIONS, BY STATE, FOR 1966, FOR ELEMENTARY AND SECONDARY EDUCATION, AND GENERAL WELFARE

State	Education [1]	Welfare [2]	Total
Alabama	$45,393,394	$98,509,446	$143,902,840
Alaska	12,491,740	3,035,141	15,526,881
Arizona	21,701,301	23,336,124	45,037,425
Arkansas	23,932,648	58,913,692	82,846,340
California	132,840,505	583,055,676	715,896,181
Colorado	22,382,239	55,375,715	77,757,954
Connecticut	12,410,346	41,458,627	53,868,973
Delaware	2,395,680	5,307,520	7,703,200
Florida	41,320,409	90,342,762	131,663,171
Georgia	47,690,499	100,366,922	148,057,421
Hawaii	11,347,729	8,982,728	20,330,457
Idaho	5,986,728	10,571,785	16,558,513
Illinois	49,173,001	164,211,175	213,384,176
Indiana	26,681,970	33,663,110	60,345,080
Iowa	20,343,929	41,180,146	61,524,075
Kansas	19,675,384	36,523,607	56,198,991
Kentucky	25,297,234	76,761,242	102,058,476
Louisiana	12,444,133	148,332,345	160,776,478
Maine	8,320,108	17,336,383	25,656,491
Maryland	29,812,986	47,013,765	76,826,751
Massachusetts	23,740,016	115,151,578	138,891,594
Michigan	37,264,863	112,490,931	149,755,794
Minnesota	14,385,315	77,448,590	91,833,905
Mississippi	22,722,553	51,438,598	74,161,151
Missouri	28,586,077	103,496,333	132,082,410
Montana	7,096,066	9,492,008	16,588,074
Nebraska	11,744,445	20,100,719	31,845,164
Nevada	5,859,751	5,165,496	11,025,247
New Hampshire	4,230,427	5,581,229	9,811,656
New Jersey	41,524,780	63,962,317	105,487,097
New Mexico	19,899,205	22,829,204	42,738,409
New York	80,582,544	376,953,071	457,535,615
North Carolina	45,831,935	84,848,088	130,680,023
North Dakota	7,195,705	12,390,373	19,586,078
Ohio	46,165,553	123,832,005	169,997,558
Oklahoma	31,264,094	114,789,897	146,053,991
Oregon	11,773,284	30,902,009	42,675,293
Pennsylvania	43,632,992	180,885,408	224,518,400
Rhode Island	8,071,820	18,528,852	26,600,672
South Carolina	24,520,645	29,545,372	54,066,017
South Dakota	8,838,389	10,958,490	19,796,879
Tennessee	41,077,781	65,307,868	106,385,649
Texas	89,832,479	192,590,261	282,422,740
Utah	11,096,056	16,476,664	27,572,720
Vermont	2,278,581	7,565,318	9,843,899
Virginia	36,744,585	33,599,219	70,343,804
Washington	21,130,945	62,140,239	83,271,184
West Virginia	20,028,510	48,065,308	68,093,818
Wisconsin	13,498,394	49,533,895	63,032,289
Wyoming	3,610,676	3,995,568	7,606,244
Adjustments or undistributed to States	229,250	−4,320,704	−4,091,454
U.S. totals [3]	1,365,279,348	3,725,644,201	5,090,923,549

[1] The figures in this column represent total Federal aid payments to State and local units of government under programs for assistance to public school construction, defense educational activities, elementary and secondary educational activities, equal educational opportunities, maintenance and operation of schools; and Federal aid payments to individuals and private institutions in the States under programs for defense educational activities.

[2] The figures in this column represent Federal aid payments to State and local units of government under programs of the Vocational Rehabilitation Administration and for public assistance from the Welfare Administration's Bureau of Family Services; and payments to individuals and private institutions in the States through the Vocational Rehabilitation Administration.

[3] Includes District of Columbia, Puerto Rico, Virgin Islands, American Samoa, Guam, Trust Territory of the Pacific, and certain foreign countries.

Source: 1966 Report of the Secretary of the Treasury, table 84, pts. A and B.

STATE REVENUES FROM SELECTED TAX SOURCES, BY SOURCE AND STATE, 1966

[In thousands of dollars]

	General sales or gross receipts [1]	Individual income	Corporation net income	Total, 3 sources
All States	7,893,187	[2] 4,302,842	[2] 2,036,550	14,212,579
Alabama	166,729	53,294	22,890	242,913
Alaska	—	19,238	4,105	23,343
Arizona	96,171	21,702	13,379	131,252
Arkansas	84,415	27,423	20,848	132,686
California	1,099,383	454,313	433,825	1,987,521
Colorado	98,735	70,287	24,759	193,781
Connecticut	136,389	—	67,959	204,348
Delaware	—	49,934	12,991	62,925
Florida	283,050	—	—	283,050
Georgia	227,205	80,291	59,288	366,784
Hawaii	93,499	47,349	9,950	150,798
Idaho	28,399	29,204	8,493	66,096
Illinois	669,508	—	—	669,508
Indiana	282,318	143,678	14,248	440,244
Iowa	114,027	86,802	7,793	208,622
Kansas	113,406	72,805	22,736	208,947
Kentucky	126,880	69,747	36,253	232,880
Louisiana	139,425	30,455	31,766	201,766
Maine	52,315	—	—	52,315
Maryland	127,277	159,910	32,729	319,916
Massachusetts	16,534	253,893	[3] 49,830	320,257
Michigan	657,708	—	—	657,708
Minnesota	—	221,276	75,298	296,574
Mississippi	121,039	9,710	15,849	146,598
Missouri	243,756	82,149	11,161	337,066
Montana	—	21,111	6,958	28,069
Nebraska	—	—	—	—
Nevada	23,419	—	—	23,419
New Hampshire	—	2,289	—	2,289
New Jersey	—	9,731	42,916	52,647
New Mexico	66,977	[2] 19,051	(2)	86,028
New York	298,437	1,285,881	392,358	1,976,676
North Carolina	188,246	165,070	90,481	443,797
North Dakota	23,561	9,222	3,054	35,837
Ohio	354,221	—	—	354,221
Oklahoma	74,129	30,344	22,323	126,796
Oregon	—	147,367	31,076	178,443
Pennsylvania	599,329	—	229,088	828,417
Rhode Island	45,719	—	14,715	60,434
South Carolina	106,119	52,928	36,483	195,530
South Dakota	26,915	—	586	27,501
Tennessee	177,717	8,216	38,032	223,965
Texas	240,823	—	—	240,823
Utah	53,774	38,031	8,008	99,813
Vermont	—	21,574	4,116	25,690
Virginia	—	165,171	47,864	213,035
Washington	384,362	—	—	384,362
West Virginia	120,564	—	23,729	144,293
Wisconsin	92,132	319,667	92,342	504,141
Wyoming	18,575	—	—	18,575

[1] Excludes motor fuel and other selective taxes.
[2] For New Mexico, combined corporation and individual income taxes are tabulated with individual income taxes.
[3] Excludes portion paid on corporate excesses.

Source: "Compendium of State Government Finances in 1965," Bureau of the Census, U.S. Department of Commerce.

Mr. SHUMAN. Could I make one comment further on the previous question which the other two gentlemn discussed?

Chairman PROXMIRE. Yes.

Mr. SHUMAN. It is not particularly different. It is true, of course, that an increase in farm prices, a fairly significant increase in farm prices, if directly transferred to consumer prices, would be rather small.

But the point, the main point, that most people miss in making this argument is that farmers in most cases do not sell directly to the consumer. We sell to manufacturers and to processors, and when we sell corn or cotton or wheat to a manufacturer, we are selling in competition with other products which many times can be substituted.

This is what happened with the cotton farmer. All over the South I saw these little demonstrations where they held up a man's shirt and said the cotton in this shirt only cost so many cents. If cotton is raised from $20 a bale to $30 a bale it will only increase the price of that shirt by 2 or 3 cents. I am sure Senator Jordan remembers those demonstrations.

It was this kind of philosophy, it is this kind of philosophy, that is destroying the cotton industry, because you do not sell cotton directly to consumers, you sell it to shirt manufacturers, and when they found the price of cotton went up compared to the synthetics, they bought the synthetics.

Chairman PROXMIRE. It is a very good point, but you are picking the nonfood segment of agriculture.

Mr. SHUMAN. You can take the food section and take milk, because today if we insist on pricing milk without regard to competition we are going to find synthetic milk made out of soybean protein or something else replacing the natural product, not because the consumer——

Chairman PROXMIRE. You touch me in a tender spot, Mr. Shuman, I must say.

Mr. SHUMAN. Well, thank you.

Chairman PROXMIRE. I want to thank you gentlemen for being a very, very stimulating panel. It has been a most interesting afternoon and a fine contribution to the Joint Economic Committee's study. We thank you very much.

The committee will stand in recess until Monday morning at 10 o'clock.

(Thereupon, at 4:10 p.m., a recess was taken in the hearing to reconvene at 10 a.m., on Monday, Feb. 19, 1968.)

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 19, 1968

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

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

Present: Senators Proxmire, Miller, Jordan, and Percy; and Representatives Boggs, Curtis, Widnall, Reuss, and Rumsfeld.

Also present: John R. Stark, executive director; and John B. Henderson, staff economist.

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

The committee devotes this morning and afternoon to hearings on the international economic position of the United States, one of the most serious and perplexing issues of the time. Our witnesses this morning are three outstanding students of the subject. They are distinguished in their achievement and distinguished from each other by the diversity of their experience. First, Fritz Machlup, Walker professor of economics and international finance, Princeton University. Professor Machlup's own writings in the notable papers written for his international finance section of the Princeton Economics Department have brought him worldwide renown. He has recently held the presidency of the American Economic Association. With his wit and wisdom, and Viennese gaiety, economics can never be a dismal science.

Next, Prof. Jack N. Behrman, professor of international business, University of North Carolina. Professor Behrman had close experience with the problem of international development when he was Deputy Assistant Secretary of Commerce for International Affairs in the early 1960's. His challenging views on the payback process arising from U.S. investments abroad are well known and most appropriate.

Third, Mr. William F. Butler, vice president and director of economic research at the Chase Manhattan Bank. Mr. Butler enjoys a well-deserved reputation as one of the wisest of commentators in economic affairs in the banking community. His range is far wider than today's topic. Most recently he has given his views on the role of gold in world monetary affairs in a brilliantly written article in "Foreign Affairs."

We will begin with Professor Machlup; he has been invited by the committee to give a broad assessment of the international situation.

STATEMENT OF FRITZ MACHLUP, WALKER PROFESSOR OF ECONOMICS AND INTERNATIONAL FINANCE, PRINCETON UNIVERSITY

Mr. MACHLUP. Thank you, Chairman Proxmire.

Chairman PROXMIRE. I might interrupt by saying, Professor Machlup, I have not had a chance to see your statement. I understand you put it in the mail on Friday. But I would appreciate it if you gentlemen would confine your statements to 15 or 20 minutes, if you could. Of course, your entire statement will be filed in the record in full and made available to members of the committee and the Congress. We would like, if possible, to have as much opportunity as we could for questioning and discussion.

Mr. MACHLUP. Yes, sir; I have a prepared statement which I herewith offer for the record. I prefer not to read it to you, but to speak freely. I shall try to summarize in 15 or 20 minutes the highlights of my analysis.

Chairman PROXMIRE. Very good.

Mr. MACHLUP. We have become accustomed to discuss the problems before us under three headings: the problem of liquidity; that is, the adequacy of an annual increase in reserves; the problem of adjustment, that is chiefly the balance-of-payments problem of the United States; and the problem of confidence, which is essentially the problem of switches between dollars and gold.

The problem of liquidity, I think, has been nicely and neatly solved through the agreement in Rio de Janeiro. Unfortunately, the prospects of early activation do not seem to be too good, and for that we must blame partly our own tactics. I think it was a tactical error to give priority to the problem of liquidity and not discuss, or not include in the discussion, the problems of adjustment and of confidence.

We brought the other countries to the negotiating table by telling them: "Of course, this is only a contingency plan and we will first solve our adjustment problem." But we have never made any real efforts to do that; and this is quite easy to explain, for we cannot alone and unilaterally by politically accepted methods succeed in achieving adjustment. Yet it was a tactical error. Good strategy would have been to discuss all three problems at the same time. Perhaps, if any one problem should have gotten priority, it would have been the problem of confidence, the problem of avoiding the destruction of reserves. After all, it is illogical to try to devise a system by which reserves can be increased, but not devise a safeguard against the wholesale destruction of reserves—and the problem of confidence is exactly that.

I would like to congratulate the men who have contributed to the solution of the problem of liquidity. They did a spendid job. Unfortunately, it does not help us now in our predicament.

I propose to discuss first the problem of adjustment. To my regret, I must be highly critical of what our administration has been trying to do. As a matter of fact, we have done nothing toward solving the problem of adjustment in the strict sense of the word. There is widespread misunderstanding: The terms "adjusting something" and "tinkering with something" are being confused. We have been tinkering all along, but have done nothing that deserves to be called adjustment.

Let me explain what adjustment means. It is an economic term, and it needs explanation. Otherwise we do not understand one another.

Adjustment means that the deficit countries reduce their income and price levels relative to the surplus countries. This can be done in three ways: One, by deflation in the deficit country, which I believe no man in his senses will propose.

Secondly, by inflation in the surplus countries, which these countries do not want to do—and I doubt that they will do us this favor.

Thirdly, by an adjustment of the exchange rates, the rates by which price and income levels, expressed in different currencies, are being compared.

There are no other ways of adjustment. Everything else is tinkering, or expressed more politely, attempts to correct the balance of payments. All sorts of measures are used as correctives. We must distinguish, before all, measures that work only temporarily, and measures that work in the long run. None of the measures that we have taken or are proposing can work in the long run. They are all temporary measures. It is as if a pipe were leaking and we take our thumb and hold it over the leak. As soon as we remove the thumb, the leaking goes on.

This is not to be confused with adjustment. Perhaps we can clarify this by another example. If you see that you are bleeding from your finger and you put a bandaid over it, you stop the bleeding and there is hope that the skin will heal. And, if you remove the bandaid after awhile, maybe you won't bleed any more. But, what we have been doing to the balance of payments is not of that self-healing type. It is only of the thumb-holding type. This is why I say that no attempt at adjustment has been made or proposed.

Let me read a quotation from someone who understands a good deal of these things, about the problem of restrictions on capital movements. I read it first and shall name the source afterwards.

> Imposition of capital controls by the United States would not be a satisfactory solution. It would be contrary to all that we have been striving for in freeing trade and payments between countries. It would not be in keeping with our special responsibilities as custodian of a reserve currency, and it would be contrary to our long-run interest in ensuring that funds move to where they will be used most productively.

This statement is by Secretary Dillon, and it was made in 1962. He was right then and he still is right. I shall explain presently why restrictions on capital movement are probably ineffectual and, to the extent to which they are effectual, why they are not of the type that will bring about an adjustment. They amount to holding the thumb over a leak.

But there is also the idea of restrictions on foreign travel. On this I have more to say, though it may be a bit emotional. I have been brought up in Central Europe, and I know this type of restriction. I would never have believed that this country could sink so low as to restrict foreign travel. Whether a tax on travel expenditures will be effective or not, I cannot tell. It can be easily evaded. It will probably lead to reduced tax morality, and this can then spread to the income tax. This country has much higher tax morality than practically any other country, perhaps, with the exception of Britain. But tax morality can be undermined, and if you introduce a tax that is considered un-

ethical, or immoral, then the people's tax morality may be permanently lowered.

Moreover, if you do restrict foreign travel and the restriction is successful, it will be successful only while the restriction is in effect. As soon as you take it off, you are back where you were. This is not a method of curing a balance-of-payments deficit. This is not an adjustment measure.

You will ask me why restrictions on capital movements may be ineffective. They may be ineffective for several reasons. First, there is always the question of substitution, substituting one kind of capital movement for another. Every economist ought to know it, and I said it when we introduced the interest equalization tax, the tax on buying foreign securities. It was quite clear that capital outflow would simply take another form, and so it did. Thereafter we introduced the voluntary program restraining bank lending. Then we introduced the voluntary program restraining direct investment. There are always ways of substitution. Thus, if you really are successful in restricting the outflow of American capital, you cannot restrict the outflow of foreign capital from the United States, and this is exactly what will happen.

This is an easy way of substitution. If, for example, our own firms borrow in Europe, the rates of interest there will increase, and Europeans take back their capital from the United States. It can be done in various ways. Assume that an American firm issues securities in Europe. These securities will have to be offered at somewhat favorable prices. Otherwise you cannot sell them. Foreigners will subscribe to these issues, but sell at the same time some of their holdings of American securities in the New York stock market, and bring back the proceeds from their sales. In other words, American funds, not European funds, will have financed our sale of securities in Europe.

There are always many possibilities of substitution. But even if there is no substitution, there is always the possibility of repercussions on other items of the balance of payments. If total spending in Europe is reduced—and after all, a firm that does not receive capital will spend less—Europeans will buy less and import less. If total spending in America is increased—and, after all, a firm that does not invest in Europe will probably invest a little bit more in the United States—we shall find that this increases our imports and reduces our exports. As a result a part of the whole effectiveness will be whittled away by offsetting changes in the balance on current account. We shall find our exports reduced and our imports increased.

I do not say that this will be 100 percent of the amount saved directly by the restraint, but it may be a large part of it. With both substitution and repercussion at work, it is quite possible that you will find the results quite disappointing, apart from the fact that the whole thing is only temporary, and as soon as you lift the restrictions, you will be back where you were. In other words, this is not a program of adjustment. This is only tinkering and, unfortunately, tinkering with little hope of success.

I would like to comment on one type of corrective that has become quite customary in the United States; namely, disguised partial devaluations of the dollar. We have used this technique three or four times in the last few years. We started in 1960, when we devalued, in

effect, though not formally, the military-expenditures dollar. The Department of Defense told the military that they must buy American whenever the cost of buying here, calculated at the fixed exchange rate, is not more than 25 percent, later raised to 50 percent, higher than what they would have to pay in Europe. The effect of this is that the Armed Forces must calculate as if the exchange rate were really 25 or 50 percent different from what it actually was; that is, a disguised devaluation.

The next disguised partial devaluation was that of the foreign-aid dollar. It was done by our forcing the aid recipients to buy in America, even if the prices here were higher than elsewhere; they had to do that even if they lost up to 30 percent. So we have devalued the foreign-aid dollar.

Then we had the partial devaluation of the dollar that was used for buying foreign securities, the 15 percent tax. And now you consider introducing the partial devaluation of the tourists' dollar. I hope you won't introduce it, but will reject this plan. And there are proposals that we should have still other partial devaluations through surcharges on certain import duties, and through similar arrangements.

All this is very inefficient and partly ineffectual. It is discriminatory. It distorts the allocation of resources. It is a poor way of doing things.

If it were possible to make these devaluations general, even if it were in the form of taxes, you might say that is all right. If all imports were taxed by the same percentage, and if all exports got a subsidy by the same percentage, the same for all foreign transactions, then you would have something. But this is technically not practicable, and the only practical way of doing it is to change the exchange rates between the dollar and the currencies of the surplus countries.

Let me come to the problem of confidence. This problem seems now almost insoluble. I shall quickly mention five approaches that have been proposed or may be proposed.

The first approach is to make the dollar so scarce that people no longer want to switch from dollars into gold. This is out of the question, because the expected scarcity of gold is so much that, in order to make the dollar equally scarce we would have to adopt a deflationary program that would be a catastrophe for the United States as well as for foreign countries.

The second possibility is to raise the price of gold by 100 percent or something like that. I think it would be most dishonest if we did this, and it would also be most injurious for the whole world, because the inflationary consequences would be serious. Even if the profits made by central banks and other monetary authorities could be sterilized, you cannot sterilize the profits made by the speculators. They would sell their gold at the increased prices to the monetary authorities. There would be an avalanche of new money all over the world, with prices and incomes rising everywhere. I must warn against this approach, and I hope that our Congress will never think of doing anything of the sort.

Approach No. 3 is the so-called harmonization of reserves. This means to negotiate with monetary authorities that they agree not to convert the dollars they hold. The dollars would be locked-in by the monetary authorities agreeing to hold dollars in certain proportions or in certain minimum amounts. However, this could not work unless

you have at the same time also a really workable gold pool, which you do not have now. The present gold pool, with seven countries participating, operates at the expense of the U.S. gold holdings. I doubt that effective harmonization agreement can be negotiated now. It would have been possible 2 or 3 years ago. Unfortunately, that opportunity was missed.

Approach No. 4 is the one that I regard as the best one, from an economic point of view. The most workable plan would be to pool all gold holdings and all foreign-exchange holdings in an international pool, perhaps maintained by the International Monetary Fund. The present danger is that dollars will be exchanged into gold, and the dollars thereby wiped out. I want to safeguard against this by an agreement under which all countries deposit their gold and their dollars and pounds in a central pool, maintained by the International Monetary Fund, and replace their reserve assets with the new deposits with the fund. These deposits would then be international reserve, and the central banks would hold no gold, no dollars, and no pounds.

This plan could not be negotiable except with certain provisions reassuring to some distrustful nations. First, the gold must not be held entirely on American soil. Otherwise the plan would not be credible. You would have to deposit some of the gold on French soil and perhaps some on other countries' soil.

Secondly, there must be no increase in dollar holdings or pound sterling holdings either by the new account of the International Monetary Fund or by any central bank. That means we must give up any attempt to finance a future payments deficit by accumlations of dollars by monetary authorities.

Well, whether this plan would be negotiable or not I do not know. I believe it could be negotiable if we proceeded skillfully. But if it proves not to be negotiable, I see only one way out, and that is the fifth and last approach, to cut the link between dollar and gold.

The aim is to avoid that, in a series of gold rushes and dollar crises, too many dollars are turned in against gold. If we cut the link, it would be a meaningful way of achieving the aim. Of course, the Europeans won't like it, but we should first offer them a chance to accept a better alternative. My plan No. 4 would be much better, and it is only with genuine regrets that we should resort to No. 5. But if No. 4 is not negotiable, then No. 5 is the only way out.

The other countries would have three possible reactions that we would accept with equal pleasure. They could say, "We stick to the present exchange rates, we do not want the dollar to be devalued." In this case, they would have to purchase and hold dollars, and we should have no objection to that if the dollar is no longer convertible into gold.

The second type of reaction—some countries could devalue the dollar in terms of their own currencies. They could say, "No, we do not want to buy too many dollars. Hence, we shall pay less for the dollar. We devalue the dollar by 5 percent, 8 percent, perhaps 10 percent." This would be all right for the United States, since it would help adjust the balance of payments. We should have no objection to that.

The third possibility is for countries to say, "We do not want to buy any more dollars and we do not want to fix the new price for the dollar. We do not know what the right price would be. We shall, therefore, let the exchange rate float." Again, I think this would be a very good solu-

tion, and we certainly should not mind. Perhaps they would prefer not to let the dollar float without any limits, but they could arrange for upper and lower limits if they so desired.

These are the three attractive possibilities, but unfortunately there is a fourth possibility, which they could choose. They could say, "We shall keep the dollar rate fixed for current-account dollars. We shall devalue the dollar or leave it float if it originates from capital transactions." Such a multiple-rate system could be enforced only through foreign-exchange restrictions on their part. Such a raction would be deplorable. I wouldn't like it, but I would rather have other countries impose foreign-exchange restrictions than the United States. Hence, from our point of view, this reaction would still be preferable to our own program of restrictions.

Senator, I think I have exceeded the time that you have allotted me, and I can only hope that your questions will give me an opportunity to expatiate on some of these issues. I thank you very much for your attention.

(Professor Machlup's prepared statement follows:)

PREPARED STATEMENT OF DR. FRITZ MACHLUP

Mr. Chairman and Members of the Joint Economic Committee, you have invited me to present, in these hearings on the 1968 Economic Report, my views on the international position of the United States. I have accepted with pleasure and especially appreciate that you encouraged me to include in my testimony historical as well as analytical aspects.

THE THREE PROBLEMS

It has become customary to divide discussions of the international monetary situation into three problems: liquidity, confidence, and adjustments. All three have to do with international monetary reserves.

The problem of liquidity is concerned with the adequacy of the combined total of reserves held by all national monetary authorities and with the capacity of the international system to provide for sufficient annual increases in total reserves.

The problem of confidence is concerned with the danger that holders of monetary reserve assets alter the composition of their holdings and in the process destroy large parts of the existing reserves.

The problem of adjustment is concerned with the distribution of reserves among various countries and especially with the reversal of such imbalances of payments as would result in persistent losses of reserves in particular countries.

Experts have for years debated the relative importance of the three problems. My own view has been that they should all be taken care of at the same time. Our Government, regrettably, has insisted on giving priority to the problem of liquidity. A very neat solution has been found for it. The agreement signed in Rio de Janeiro last September provides for a novel, but well-designed mechanism for creating and distributing new reserves in the form of Special Drawing Rights. We hope that this agreement will be ratified soon and then activated without delay.

Unfortunately, there is some danger of considerable delay in its activation. Our own declarations of intentions have contributed to this danger in that we have repeatedly stated that the creation of new reserves can be postponed until we have solved our balance-of-payments problem. If this has seemed to be clever tactics in order to get other nations to negotiate on the contingent creation of additonal liquidity, it probably was poor strategy. For it is difficult and perhaps impossible to remove our payments deficit in the near future. Yet, postponing the activation of the new scheme for the creation of liquidity will make it more difficult to restore balance in international payments. We should have tried to negotiate on all aspects of international monetary arrangements so that we would not be fouled up now in this vicious circle.

The worst part of the vicious circle lies in the problem of confidence. Too many people believe that there will be a scarcity of gold and an abundance of

dollars. Of course, nothing can be scarce or abundant except at a given price ratio. If expectations concerning relative scarcities change, but a fixed price ratio is maintained, an untenable situation arises. This is a very old experience, commonly known as Gresham's Law. (Gresham died in 1579.)

If any of the three problems deserved priority, it would have been the problem of confidence. How illogical it is to design a system that provides additional reserves but makes no provisions to safeguard against the destruction of existing reserves.

I shall present my views on the position of the United States regarding all three problems. I shall follow the example of the Council of Economic Advisers and begin with the problem of adjustment.

The Adjustment Problem

The Report of the Council discusses this problem under two headings, "Adjustment Process" and "The U.S. Balance of Payments." Their analysis of the problem suffers from a failure to distinguish different kinds of approach to the problem of reducing or removing an imbalance of international payments.

They do distinguish "temporary measures" from policies that are "long term in character," but this leaves open the question whether the temporary measures have only temporary effects or long-lasting effects. If I discover a leak in a pipe and press my thumb against the hole, this is a temporary measure with only temporary effect: as soon as I remove my thumb, the leaking resumes. If I discover a bleeding cut on my finger and put a band-aid over it, this temporary measure may have lasting effects, because the wound may heal, the lesion of my skin disappear. The difference between these temporary measures is essential; to call both of them "leak-stopping policies" and be silent on the question whether they are palliatives or cures is not very helpful.

For some 250 years economists studying international finance have known the process of economic adjustment that would remove imbalance and restore balance. This adjustment involves changes in relative prices and incomes in the countries concerned, resulting in changes in the allocation of productive resources and in the international flow of goods and services. The process had originally been conceived as an automatic one, but it can be fully automatic only under monetary institutions that no longer exist. Hence, deliberate adjustment policies are now required to produce the effects which the conceivably automatic mechanism would have produced. These policies do not, however, include every type of measure, including direct controls, that may be instituted for the purpose of removing a payments deficit.

In medicine, no one would doubt for a moment that there is a difference between a surgical operation or some other painful treatment and a disappearance or removal of the need for it. There may be some alternative therapeutic techniques that could remove the need for the painful one; or perhaps the afflication may disappear all by itself. The same possibilities exist for balance-of-payments troubles: with luck, the troubles may go away or some other therapy may make it unnecessary to go through the operations which economists have called the adjustment process. I use the term "compensatory corrections" or "correctives" to indicate those things that are considered as alternatives to the adjustment process.

REDUCING THE PAYMENTS DEFICIT: ALTERNATIVE METHODS

We need even more distinctions. There are measures that do not remove deficits but facilitate financing them. For example, if an increase in interest rates attracts short-term capital from abroad, one may not want to regard this as a credit item in the balance of payments that removes a deficit, but may prefer to regard as a temporary stopgap, a way of financing an existing deficit for a while. (As soon as the attractive interest differential is terminated, the inflow of short-term capital will stop and what has been received will flow back.) In addition, we should separate measures that work on the flow of goods and services from those that work on the flow of capital funds. The adjectives "real" and "financial" can be used for this purpose.

We thus distinguish real adjustment, real correctives, financial correctives, corrective management of government transactions, and external financing.

To *finance* a deficit is to pay for it by reducing the net monetary reserves or by increasing liquid liabilities to foreigners incurred just for this purpose. (If an increase in foreign liabilities arises from an increased foreign demand for dollar balances and other dollar assets, it should be treated as an autonomous capital

inflow, as a debt incurred in order to finance a deficit. Unfortunately, we usually lack the information required for this distinction.)

To reduce or remove a deficit by *real adjustment* is to induce such changes in relative prices and incomes as will alter the allocation of real resources and cause such changes in the international flows of goods and services as will improve the current account to match the balance on capital account and unilateral payments. We distinguish aggregate-demand adjustment, cost-and-price adjustment, and exchange-rate adjustment.

Real correctives influence the international flow of goods and services through selective impacts on particular goods, industries, or sectors. *Financial correctives* influence the international flows of private capital funds. *Corrective management of government transactions* may affect government expenditures, loans, and grants to other countries.

REAL ADJUSTMENTS

Economists trained in the classical or neoclassical tradition—the present writer included—have a deep-seated prejudice in favor of real adjustment: (1) It relies largely on market forces rather than selective "interventions" by the state; (2) it is more likely to operate without discrimination, avoiding differential treatment of particular industries or firms; and (3) the chance of its working, of achieving its objectives, is greater.

On the other hand, practical-political considerations militate against real adjustment: (a) Policies to check the expansion of aggregate demand are apt to reduce business activity and employment; (b) policies to check increases in wage rates and prices are resented by some of the strongest groups in society; and (c) policies to adjust foreign-exchange rates are opposed by leaders in business and finance, here and abroad, for reasons good and bad; most understandable is the opposition abroad to a successful adjustment in the flow of goods and services, since it would hurt the business of some of the industries abroad.

Aggregate-demand adjustment is not without advocates among practical men: some highly respected bankers here and abroad advise the United States to "put its house in order" and "halt inflation;" and they intimate that this can be done by means of higher interest rates, higher taxes, and economies in government programs.

Their practical advice is unexceptionable if it refers merely to avoiding inflation of incomes and prices. As a matter of fact, high interest rates, higher taxes, and budget cuts are badly needed to prevent a further deterioration of the imbalance of payments. But it would be far too optimistic to expect that containment of further expansion would restore external balance, especially since the major industrial nations of Europe are likewise pursuing anti-inflationary policies, some even more successful than the United States.

If the conservative advice goes beyond mere avoidance of inflation and suggests in effect that aggregate demand in this country be *reduced* to such a level that our imports fall and exports rise sufficiently for the export surplus to match all other outflows of dollars—then the advice is not acceptable. A deflation of such force could have well-nigh catastrophic consequences for domestic employment and world trade.

Real adjustment by means of demand deflation in the United States is out of the question; adjustment by means of demand inflation abroad is not likely to be accepted, nor would it be advisable. Now, if the adjustment of levels and structures of costs and prices cannot be expected to occur either through reductions in the United States or through increases abroad, the only remaining possibility of real adjustment lies in alignments of foreign-exchange rates. Yet, the resistance to any moves in this direction seems too strong to allow it to be contemplated. I shall, however, not be inhibited and will return to this only chance for a workable adjustment.

PARTIAL DEVALUATIONS

Among real correctives the policies most appealing to advocates of selective measures are what I have for years called "disguised partial devaluations of the dollar." Open and uniform devaluation being ruled out, measures are recommended to reduce the value of the dollar for particular purposes or in chosen sectors of the economy.

The United States has resorted to such makeshifts several times. For example, it devalued, not formally but in effect the dollar used for foreign military expenditures. This was done by trying to save foreign exchange whenever the cost of buying at home was at first not more than 25 per cent, later 50 per cent, above

the cost in foreign currencies calculated at the official exchange rate. In other words, in decisions whether to buy abroad or at home, foreign currencies were to be given a higher value than would correspond to the official parity.

Through tying foreign aid to purchases of our products, the United States reduced the value of its foreign-aid dollar. Countries receiving aid had to buy in this country even if they could have bought at lower prices elsewhere. It cost some of them about 30 per cent more, which corresponds to a devaluation of the aid-dollar by about 23 per cent.

In July 1963, the United States began taxing purchases of foreign long-term securities at a rate of 15 percent. This is the equivalent of devaluing the dollar used for buying foreign securities. This partial devaluation, designed to reduce capital outflows, is a financial, not a real, corrective.

Last month, in January 1967, the administration proposed a tax on foreign travel and tourism, which would be the equivalent of devaluing the tourist's dollar. In addition, there are nonofficial proposals for taxes or tariff-surcharges on imports—the equivalent of devaluing the dollar for imports—and for subsidies or tax-refunds on exports—the equivalent of lowering the price of the dollar to foreign buyers of our exports.

If these disguised devaluations of the dollar were uniform, affecting proportionally all imports, all exports, and all other international transactions, they might work indiscriminately and perhaps efficiently. As it is, however, they are selective, disproportionate, and inefficient. They discriminate against some sectors and in favor of others, distort the structure of prices and the allocation of productive resources, and are usually incapable of effecting their purpose.

Partial devaluations can improve particular items in the balance of payments, but may worsen others in the process, partly because of the substitution of purchases for which the dollar is not "devalued," partly because of foreign and domestic repercussions to the reduction of purchases for which the value of the dollar is reduced.

DIRECT CONTROLS

Partial devaluations have at least one advantage: they work through price incentives and disincentives, and leave the markets essentially free. The bureaucratic mind, however, prefers a more direct approach, a more direct attack on the "item" that has been found irritating or insalubrious: it prefers direct controls, which give to some governmental authority the power to prohibit, to restrict, to license, or to permit, according to its unfailing judgment of what is or is not warranted in the national interest.

Direct controls can be employed as real correctives or as financial correctives of the payments deficit. As real correctives they may involve discretionary subsidies to exporters, quotas and other nontariff restrictions on imports, licensing of foreign travel or fixing the amounts that travelers may spend abroad. As financial correctives they may restrict bank credits to foreigners, direct foreign investment, portfolio investment and foreign loans of various types.

The effectiveness of controls that are not comprehensive, not all-inclusive (as general foreign-exchange controls, comprising all foreign transactions would be) is limited by the possibilities of avoiding, evading, and circumventing the restrictions. The elasticity of substitution among different forms of capital outflow, for example, is not sufficiently appreciated; there are also those offsetting changes in other items that are classed as repercussions, though in some instances substitutions and repercussions shade into one another.

It should be easy to understand that portfolio investment, bank loans, trade credit, and direct investment may be substituted for one another. Restrict one and you will see the others expand. Yet, many overlook that there is also substitution between foreign and domestic funds. Restrict the outflow of American capital funds and you will see foreign funds withdrawn from the United States.

This is not retaliation or an unfriendly act, but the operation of normal market forces: if American funds are kept from going abroad, interest rates abroad will rise and, naturally, foreign funds will "go home." Or, if American firms are forbidden to use their own money for direct investment abroad, but are permitted to raise foreign funds in foreign markets, foreigners holding American securities may decide to sell them in New York and buy the more attractive new securities offered by the American subsidiaries abroad. Thus, a legitimate outflow of capital takes the place of a forbidden one. Call it repercussion or call it substitution, it severely limits the effectiveness of the financial correctives.

If financial correctives are effective in reducing the outflow of capital, they may induce offsetting reductions in the trade surplus. These repercussions or

feedbacks may be small or large, but will rarely be zero. They can be zero only if the reduction in the flow of capital does not affect the use of funds either in the domestic or in the foreign markets. Assume that an American, A, is prevented from lending his money to a foreigner, F; only if A then decides to sit on his money and not to spend, lend, or invest it at all, and if F manages to disburse abroad exactly the same amount of money that he would have disbursed, thanks to the receipt of A's funds, only then will imports and exports be unaffected by the financial corrective. In all probability, A will use some of his funds at home and F will have less to spend abroad, and the United States will have larger imports and smaller exports as a result.

FOREIGN PROGRAMS OF THE GOVERNMENT

In the search for "guilty items" in the balance of payments, foreign disbursements by the U.S. Government are the most popular targets. According to one's political philosophy, one will argue for cutting military expenditures abroad or for cutting foreign aid. The question whether these funds for fighting wars and fighting poverty abroad are desirable expenditures is often confused with the question whether the reduction of these funds would cure the imbalance of payments.

Both hawks and doves are inclined to exaggerate the effects which a reduction of expenditures for military operations in Viet-Nam would have on the payments deficit. If the war ends and military expenditures in Viet-Nam are reduced, there will probably be an increase in economic aid to Viet-Nam, in an effort to rebuild what has been destroyed and to show the world that our intentions all along had been to help the country maintain its freedom and develop its economy. If, nonetheless, total expenditures abroad are reduced when military operations cease, then the Vietnamese will have less money to purchase goods and to import from abroad. The reduction of their imports may not always directly reduce exports from the United States, but through triangular trade and multilateral repercussion our exports may still be affected.

In addition, there is the probability that defense expenditures in the United States will be replaced by expenditures for other purposes. Programs in our domestic war against poverty have been cut because of the rising cost of the war in the Far East. If, with the end of military operations, we escalate expenditures for domestic programs, imports from abroad are likely to increase above the volume they would have otherwise. Hence, with all these repercussions on the flow of goods and services, one must not count on an improvement of the balance of payments by anything near the full amount by which our military expenditures are reduced.

THE INEXORABLE DEFICIT

I may well be accused of undue pessimism. Is there any historical or theoretical support for my warnings about the ineffectiveness of the various corrective measures adopted or proposed? Is the deficit really impervious to all efforts to deal with it through corrective measures?

Our actual experience can really make us rather fatalistic. Year after year, at least since 1960, we have done all sorts of things to work on the balance of payments; we have picked one item after another for special treatment; yet, we have failed. I have prepared a list of quotations from statements by our Presidents and Secretaries of the Treasury expressing their assurances and confident expectations that balance was just around the corner, that the deficit would disappear within the year, or the next one. Yet, the deficit is still with us and one cannot even say that it is substantially smaller than it used to be.

I am not including this list of assurances in my testimony, because to do so would not be charitable. After all, the President and the Secretary of the Treasury were courageously battling a Hydra: they did not realize that for every head cut off two grew in its place. They did not know that you cannot decapitate a Hydra; you have to dehydrate her if you want to get rid of her. (Incidentally, the metaphoric dehydration need not be an absolute reduction of domestic liquidity. It suffices to reduce liquidity relative to foreign countries, calculated at current exchange rates.)

I am, however, offering you a tabulation of statistical figures illustrating the problem. In Table 1, some of the strategic items of our balance of payments are so arranged that we can see at a glance the remittances that can give rise to a transfer problem. The table shows side by side our military expenditures abroad, remittances and pensions, grants and net capital exports of the U.S. Govern-

ment, and net outflows of private capital of U.S. residents. Ordinarily, military expenditures abroad are reported as part of the balance of goods and services. I took them out of there, because this is one of the items that are usually regarded as autonomous or disturbing factors. I wanted to show it as part of the financial transfers which, if all goes well, induce matching flows of goods and services.

The table indicates that the financial tranfers, in the 17 years from 1950 to 1966, varied from a low of $5.6 billion in 1953 to a high of $13.9 billion in 1964. The balance of goods and services (exclusive, of course, of military expenditures) varied in the same period from a low of $2.4 billion to a high of $11.4 billion. By and large, the years of high financial transfers were also years of high export surpluses. For example, the year with the lowest financial transfers, 1953, was the year with the second lowest export surpluses. The year with the highest financial transfers, 1964, was also the year of the highest export surpluses. The difference between financial transfers and export surplus I have called "transfer gap." This transfer gap varied between $1 billion and $5 billion. In the last six years it varied only between $2.2 billion and $3.2 billion.

My table, partly to make it less clumsy, omits inflows and backflows of foreign capital, private and official. The net inflow of foreign capital, inclusive of unrecorded transactions and inclusive of the dollar accumulations by monetary authorit'es, is equal to the difference between the transfer gap and the change in our gross reserves. Another reason why I omitted figures for foreign capital was the impossibility of separating autonomous inflows and those that were merely accommodating (that is, financing the deficit).

If we succeeded in achieving full adjustment, the surplus in the balance of goods and services would match the net deficit on the other accounts. Why full adjustment has not been attained and why, therefore, a transfer gap has remained throughout the years is a controversial question. Probably several factors have accounted for the lack of adjustment.

Virtually all theoretical analyses of the transfer problem include as necessary conditions for full adjustment relative price and income deflation in the paying country and relative price and income inflation abroad. Perhaps these conditions have not been met, chiefly because we have, for very good reasons, been unwilling to allow production and employment in the United States to be sufficiently depressed to "push out" enough of our products to achieve an adequate export surplus. Likewise, foreign nations have been unwilling to allow a rate of inflation sufficient to "suck in" enough goods from the United States.

Another important factor in the incomplete working of the adjustment process may have been the policy of some countries to offset the external effects of their price and income inflations by devaluations of their currencies. France, for example, devalued the franc in 1957 and 1958 with the result that the franc became undervalued and France could within a few years accumulate a gold reserve of almost $6 billion.

THE TRANSFER PROBLEM

It is sometimes said that the theory of the adjustment mechanism—a theory explaining how the trade balance adjusts to remove imbalances of payments—was not designated for countries or periods in which large amounts of financial transfers disturbed the balance of payments. This is not so. The classical debate of this problem of adjustment started when Britain had extraordinarily large military expenditures on the Continent during the Napoleonic Wars.

The discussion of the adjustment to large financial transfers was resumed when France had to pay indemnities after the Franco-Prussian War, and again when Germany had to pay reparations after the First World War. It was in connection with the discussions of the German transfer problem that some economists raised doubts as to whether the balance of goods and services could ever be flexible enough to allow adjustment to large transfer commitments.

In Table 2, some of the dollar figures of Table 1 were transformed into percentages of gross national product. It is significant that all the figures in question are minute fractions of our GNP. Exports of goods and services, in the period of 17 years, varied from 4.7 to 6.0 per cent of GNP. Imports (excluding military expenditures) varied from 3.6 to 4.6 per cent. The export surplus is, of course, a still smaller fraction. It varied from 0.7 to 2.0 per cent, of GNP.

The financial transfers varied from 1.5 to 2.3 per cent of GNP. It may be worth pointing out that there has been no consistent increase in financial transfers relative to GNP. On the contrary, from 1964 to 1966 they declined from 2.2 to

1.5 per cent of GNP. The transfer gap varied only between 0.3 per cent of GNP (in 1951, 1957, and 1966) and 1.2 per cent (in 1950).

The smallness of these figures is most impressive. For it shows what minimal transfers of productive resources in the economy from domestic industry to export industry would suffice to achieve full adjustment. That we should have been incapable of achieving it seems to indicate that anonymous forces involving market prices and incomes can be strong enough year after year to frustrate the aspirations and expectations of this wealthy nation. I hope my observation will not be mistaken for a plea to restrict the forces of the free market. It is meant, on the contrary, as a warning that these forces should be treated with more respect.

THE NEW BALANCE-OF-PAYMENTS PROGRAM

After seven years of unsuccessful corrective measures, the Government has now embarked on a new program. It is, again, not a program to promote real adjustment in the economic sense; instead, it relies on selective correctives operating on hand-picked items of the balance of payments. The President, the Secretary of the Treasury, and the Council of Economic Advisers hope that the country will save at least $1 billion by a "mandatory program" to restrain direct investment abroad and to bring home larger parts of foreign earnings from past investments; another $500 million by a "tightened program" to restrain foreign lending by banks and other financial institutions; another $500 million by discouraging "non-essential travel outside the Western Hemisphere"; and again another $500 million by reducing the foreign-exchange cost of keeping troops in Europe.

In summary, $1.5 billion are to be saved by financial restrictions, $500 million by a corrective measure operating on the private demand for foreign travel, and $500 by corrective management of government disbursements abroad. The last of these may turn out to be the only continuing saving, if troops are brought back from Europe or if compensating payments are received from NATO allies. The other $2 billion are nothing but stop-gaps.

Even if the three stop-gap measures succeeded in improving the balance by the full $2 billion, and even if this improvement eliminated the deficit for the time the restrictions are in force, it would not restore balance; it would only suppress imbalance. As soon as the restrictions are lifted, the deficit will reappear, for their is nothing in the program that has any adjusting, remedial or curative effects. The demand for foreign travel will not be reduced over a long period by restricting for a few years the chance of satisfying it. The flow of capital funds from this country to Europe is determined by relative incomes, prices, profit rates, interest rates, and saving ratios. None of these underlying conditions is altered by the restrictions. The flow is likely to resume, perhaps even to broaden, when the restrictions and prohibitions are taken off.

But that these selective controls are only temporary, and that they have no lasting effects, is not all. An additional question arises concerning the effects that they will have even temporarily. The possibilities of substitution and of repercussions must not be disregarded. Permitted outflows may be substituted for the prohibited ones, and repercussions in the trade balance may offset some of the savings achieved in the selected items. I shall presently provide explanations for these warnings. But I must first deliver myself of an observation on the principle of restrictive measures.

As one who has lived many years in Central Europe under all sorts of prohibitions, restrictions, and controls, I have always admired and loved the supposedly indomitable spirit of freedom in this great country. It is a traumatic experience to see the lighthearted sacrifice of several freedoms with the adoption of the program of payments restrictions. I would never have thought that this wonderful country could sink so low as to impose restrictions on foreign travel.

SOME THEORETICAL EXPLANATIONS

But now I must make good on my promise to present explanations for my skepticism concerning the effectiveness of the corrective measures. The explanations are theoretical, but I hope they will not appear esoteric or specious.

I shall use as illustration the restriction of direct investment, which is intended to save $1 billion a year.

There are two extreme positions concerning the effectiveness of such a corrective measure. At one end is the opinion that a reduction of a financial transfer, say by $1 billion, will leave all other items in the payments balance unchanged

and merely reduce the financing item, that is, reduce the loss of gold or the increase in liquid foreign liabilities.

At the opposite end is the opinion that a reduction in financial transfers by $1 billion will reduce the export surplus by the same amount and hence will leave the deficit, and the need to finance it, unchanged.

I propose to regard the first theory as naive and the second as oversophisticated; both are wrong. The truth lies in the middle, and whether it comes closer to the naive or to the over-sophisticated theory will depend on circumstances. What kind of circumstances control the outcome can be briefly indicated, still with reference to the same illustration, the reduction in direct investment abroad.

If American firms that have for several years been making direct investments abroad are now barred from doing so unless they can raise new capital in foreign markets, it is possible that the increased demand in the foreign capital markets leads to a backflow of foreign capital from the United States. It may be short-term capital or it may be long-term capital that returns to Europe. To repeat the example used before, American firms issuing new securities in a European market may find foreign buyers who secure the needed funds by selling in the New York stock market some of the American shares they have been holding. The incentive for such a switch from old to new securities is clear: newly issued securities have to be offered at slightly reduced prices. To the extent that this way of financing is used, the restrictive measure by the United States will be ineffective.

Let us assume that the American firms reduce direct investment in Europe but make, within the limits stipulated by the new mandatory restrictions, some investments in Canada which they might not have made otherwise. The addition to the investible funds available in Canada may make it possible for Canadians to engage in the purchase of European securities. This would again constitute substitution of another form of capital flow from the United States to Europe.

Let us assume next that direct investment abroad is in fact reduced by the full $1 billion and that there is no replacement by any other funds going from the United States to Europe. Investment in Europe in preceding years has unquestionably contributed to effective demand and, directly or indirectly via third countries, to purchases of goods and services from the United States. The amount so used may have been relatively small; if so, the feedback from the reduction in investment, resulting in a reduction of American exports, may be small, too. But it will surely be greater than zero.

The next repercussion to be considered is connected with the use the American firms make of the funds which they, but for the restriction, would have invested in Europe. If they use any of these funds for increased investment in the United States, this will amount to an injection of additional funds into the stream of effective demand. Some fraction of any addition to effective demand is likely to show up as an increased demand for imports. The fraction may be small, but not zero.

To the extent that the domestic market, because of the increase in effective demand, becomes more attractive than foreign markets, American firms will be less eager to seek foreign outlets and will divert some of their production from export to domestic sales. It is unlikely that the amounts involved would be very large, but it is just as unlikely that they would be zero.

We have seen in the tabulation of financial and trade statistics that increases in our financial transfers to foreign countries have for many years failed to produce equal increases in our export surplus. The same conditions that can explain the incomplete adjustment of the trade balance to increased financial transfers can explain also why reductions in our financial transfers are unlikely to be matched by equal reductions in our export surplus. On the other hand, just as our increased financial transfers have increased our export surplus significantly, so reductions in financial transfers can be expected to reduce our export surplus.

CONCLUSIONS REGARDING THE PAYMENTS DEFICIT

I shall not be so bold as to present my conclusion in the form of a numerical forecast. It is not possible to predict a result determined by so many unknown variables. At this point we do not even know whether the Congress will pass the proposed surcharge on the income tax. This one factor alone can make a difference of about $1 billion in the payments deficit. That is to say, if we get the surtax, and thereby reduce the spending power of individuals and corporations, imports will be smaller and exports larger than if no tax increase is imposed.

But there are too many other factors in the picture to permit anyone to come up with a reliable forecast. Nobody knows, for example, what will happen concerning movements of foreign capital. This item can change either way and in very substantial amounts.

None the less, I believe that conclusions of a qualitative sort can and should be drawn. The two conclusions on which I feel pretty sure are the negative and regrettable ones concerning the effects of the restrictive program. There will not be an improvement of the payments balance by $2.5 billion, as the Administration seems to hope. And whatever improvement will be achieved by the program, it will be only temporary and will not contribute to the adjustment process, will not bring us closer to a solution of our problems.

The widely believed excuse that our military expenditures abroad, chiefly those connected with the war in Viet-Nam, are too large to permit balance in our payments to be achieved, is not justified. Our total financial transfers, inclusive of military expenditures, have been between 2.3 and 1.5 per cent of our GNP. This is a modest drain on our resources. There is no reason why a nation should be unable to accomplish a real transfer of such magnitude.

Adjustment of the balance of goods and services to make the real transfer match a financial transfer of around two per cent of GNP is not an impossible task, provided the adjustment process is allowed to work. I agree that we must not try to do it by depressing domestic incomes and prices. I am afraid that we must not expect our major trading partners to help us sufficiently by means of inflations of their income and price levels. But I see no reason other than superstition and timidity why we should not try to achieve the required relative reduction of our income and price level through adjustments of foreign-exchange rates. The rate adjustment that would achieve the needed adjustment of the trade balance is quite modest and should be negotiable.

I must safeguard myself against misinterpretation. If I speak of adjustment of exchange rates, this does not mean devaluation of the dollar in terms of gold. I do not believe either the desirability or the inevitability of an increase in the price of gold, and I shall explain this position presently. So let no one confuse exchange rate and gold price.

I shall not make the mistake of discussing the problem of adjustment independently of the problem of confidence. This, I am sorry to say, is hardly discussed in the *Economic Report*. Let us turn to it.

The Confidence Problem

I have stated what is meant by the confidence problem: it lies in the danger of massive switches from holdings of dollars to holdings of gold, with a destruction of monetary reserves in the process.

The first distinction required for analysis of this problem is that between private and official holders.

HOLDERS AND SWITCHERS, PRIVATE AND OFFICIAL

The distinction is important chiefly because of differences in motivation. Private holders of assets make their decisions mainly in their own interest—which includes, of course, the interest of their firm or their family. Official holders make their decisions in what they conceive to be the interest of their country; by definition, they are politically motivated, which may imply that their considerations of the putative national interest are fused with consideration of their own chances for re-election, re-appointment, or popular acclaim.

The differences in motivation can mean that official holders may refrain from switching from dollars to gold while private holders decide to switch, or the other way around, even if their expectations of future events are the same. On the other hand, massive gold purchases by private dollar holders can induce monetary authorities to act similarly even if their expectations differ. For when private purchases of gold result in losses of gold and in accumulations of dollars by central banks, the authorities may convert these dollars into gold merely to restore the previous composition of their reserves. And if these conversions make a heavy dent in the gold stocks of the United States, some official holders may find it prudent to increase the metallic portion of their reserves.

The virulence of private speculation in gold became apparent in December 1967, when the United States within four weeks lost almost $1 billion of its gold; and this despite the fact that other monetary authorities gave up some of their gold and increased their dollar balances. There is nothing under present arrange-

ments that would preclude frequent recurrences of such gold rushes. One wonders how many similar scrambles for gold we are able or willing to endure.

Official switches from dollars to gold have sometimes taken place without any provocation from private speculation. The most conspicious moves were, of course, those of the two largest European owners of gold, Germany and France. In the years 1964 and 1965, Germany reduced her foreign-exchange holdings by almost one half and increased her gold stock. France did the same thing in 1965 and 1966. Not all but most of their accumulations of gold cut into the gold reserves of the United States. There has been none of such official switching in recent months, if we disregard the action by Algeria. On the contrary, the major monetary authorities have realized that they had better stabilize the boat rather than join in rocking it. Germany, especially, has cooperated with the United States as the Bundesbank accumulated large amounts of dollars. Similar accommodation has been received from Italy.

This kind of bilateral accommodation, however. is no solution to the problem of confidence. A viable situation can exist only if massive raids on official gold holdings are excluded by institutional changes.

THE PRIVATE DEMAND FOR GOLD

There exists widespread confusion concerning the increase in private demand for gold. Observers often confuse speculative purchases with long-run demand. They also fail to distinguish increases in the demand for gold that are associated with decreases in the demand for dollars from gold purchases that do not involve reductions in private dollar holdings.

When the Council of Economic Advisers observe that our "deficit may have been increased further indirectly by the flurry of private gold purchases," they probably assume that these gold purchases were financed, directly or indirectly, by capital outflows from the United States. This is only a very small part of the picture. Perhaps they mean that many foreigners would be more interested in American securities if they were not so crazy about buying gold. In this sense it is true that our balance of payments is worsened by the gold rush. On the other hand, when private foreigners use their dollar balances to pay for the gold, both our dollar stocks and our liquid liabilities are reduced, and the balance is unchanged.

I believe the Council also overestimate the industrial use of gold when they figure that it was about $750 million last year. Since even industrial processors of gold may be speculators in their inventory policies, it is possible that industrial purchases in 1967 were unusually high. But that the current use of gold for industrial purposes, including jewelry, is much less, can be gathered from the known figures for the United States. In 1965 industrial users of gold in the United States purchased $185 million worth of gold. Statistics are available for only eleven other countries; the rest has to be guessed, and the total was estimated at $300 million. I doubt that the total for the world reached $500 million in 1967—which still would have been less than one-third of the gold production in the western world.

The remainder was probably divided between traditional gold hoarders and speculative gold buyers. The difference between them is that the traditional buyer acquires gold regardless of its price and of expectations concerning increases in the price, whereas the speculator buys because he expects the price to increase. He would probably sell again after the expected increase has taken place or after he has resigned himself to the fact that his expectation had been wrong.

The stupidity of persistent gold speculators is incredible. If a speculator bought his gold in 1954, his investment by the end of 1965 would have been worth less than one-third of what he would have owned had he purchased an average portfolio of American industrial stocks. A speculator who bought his gold only in 1960, would have found at the end of 1965 that his investment was worth less than one-half of what he could have had if he had purchased a Dow Jones mixture of industrial stocks. Even if his hope of a doubling of the price of gold had come true at the end of 1965, he still would not have made as much as an investor in American stocks.

I have not carried my calculations to December 1967, but they would unquestionably put the gold speculator still further behind the average investor in the New York Stock Exchange; the gold buyer of 1954 probably has now only one-fifth of the shareholder's present worth.

If speculation on a rise in the price of gold were to stop, in the sense that no further speculative purchases would take place but that those who have bought gold for speculative reasons were (foolishly) holding on to their not so precious possession, the private demand for gold by industrial users and by traditional hoarders would fall substantially short of present gold production. Thus, the present price of $35 an ounce could be maintained only if the price support extended by the United States and other monetary authorities is continued.

It is true that this situation would change after a few years. As incomes rise and as other prices increase, private demand for gold, quite apart from speculation, increases. And since gold production is expected to decline in coming years, the time will come when private demand catches up with new production, and thereafter overtakes it.

Whether this will be the time for an increase in the price of gold will depend on what happens to the monetary stocks of gold. They are now in a magnitude of about $40 billion. Even if all gold production stopped completely and even if the industrial use and traditional hoarding of gold were to double, the present monetary gold stock would suffice to feed private demand for about 20 years.

Since the monetary gold stock serves chiefly to satisfy old superstitions, there is hardly any reason against using this enormous buffer stock for gradually supplying all that private users might demand in the foreseeable future.

MEANS OF PAYMENT FOR PRIVATE GOLD PURCHASES

The effects of private purchases of gold upon the financial position of the United States depend to some extent on what funds the buyers use to pay for the gold. It is one thing if the purchases are made out of current incomes in all sorts of currencies; it is another if they are paid for out of dollar balances no longer demanded by their holders.

The United States is to some extent involved no matter how the private gold purchases are financed. If the present gold pool—United States, United Kingdom, Germany, Italy, Belgium, Netherlands, and Switzerland—supplies the gold, the share of the United States in the loss of gold will initially be 59 per cent. Eventually, however, it is not unlikely that under present arrangements the United States will have to shell out all of the gold, because the other monetary authorities may not be willing to have the metallic part of their reserves reduced.

If the purchase of gold is at the same time as a flight out of dollar holdings, the effects upon the United States position are more serious. Paradoxically, they need not show in any change of the liquidity balance, since both the gold stock and the liquid liabilities to foreigners decline *pari passu*. (The reduction in liabilities to private foreigners leads first to an increase in liabilities to official foreign holders of dollars; their increase in dollar holdings is then cancelled when they use the dollars to pay for the gold sold by the United States.

The erosion of the United States gold stock occurs in any case. It is, therefore, necessary to change international arrangements so that not all private gold purchases, even those not connected with reductions in the demand for dollar balances, cut into the reserves of the United States.

DOLLAR OVERHANG AND DOLLAR OVERFLOW

It would not be difficult to deal with speculation against the dollar and with speculation on an increase in the price of gold if the excess supply of dollars were not constantly replenished by our continuing payments deficit. In other words, one could deal with the overhang from past accumulations of dollar balances if there were not always an overflow of dollars pouring into foreign markets. (The opposite, incidentally, is also true. It would be easier to deal with the current overflow were it not for the overhang that threatens to come down on the exchange markets in a crisis of confidence.)

In view of this predicament and in view of the impossibility of stopping the overflow in the near future, action to seal, brace, or otherwise secure the overhang of dollars is of utmost urgency. It is sufficient to confine this action to the dollar holdings of monetary authorities since only they can present their dollars in New York for conversion into gold.

Let us then consider what kinds of action might be taken with regard to official dollar holdings.

FIVE APPROACHES

In principle, five approaches can be used to solve the problem of confidence and, in particular, the problem of conversions of official dollar holdings into gold. All have been recommended in some quarters. They are

(1) To make the dollar scarcer;
(2) To increase the price of gold;
(3) To "lock in" the official dollar holdings under so-called harmonization agreements;
(4) To "take out" the dollars from official reserves by having them exchanged for deposits in an international conversion account (settlements account); and
(5) To cut the link between the dollar and gold.

I may be quite brief in disposing of the first, the most orthodox approach. It is practically impossible to make the dollar sufficiently scarce. Scarcity is always relative and, with present expectations of a future scarcity of gold, only a very drastic deflation in the United States would do the job. Such a policy is out of the question.

The second approach is the one most widely discussed. The "gold lobby" seems to be getting increasing popular support. I reject the recommendation of an increase in the price of gold, chiefly for two reasons. One is noneconomic: it would be morally indefensible to hurt those who have helped us by carrying large dollars holdings and to reward those who have hurt us by converting them into gold. The other reason is an economic one: a sharp increase in the price of gold would lead to large, highly inflationary profits. Even if the profits of official holders of gold could somehow be sterilized, those of private holders of gold would be monetized and the consequent increase in the reserves of commercial banks and in the cash balances of countless speculators would drive up prices and incomes everywhere.

The third approach calls for an international agreement on "harmonization of monetary reserves." The monetary authorities would have to commit themselves to hold certain minimum ratios or minimum amounts of their total reserves in the form of dollar assets. They would probably be more agreeable to such a plan if the limits were stated in absolute terms and if it were agreed to that there must not be any further accumulations of dollars in official reserves. The plan would provide a solution of the problem only if it were combined with firm arrangements about joint sales of gold. (The present gold pool, as we have seen, does not distribute losses of gold reserves in a way that would be tenable in the long run. Speculators, therefore, cannot expect the present arrangement to last.)

The fourth approach calls for an isolation and concentration of all official dollar holdings in one central pool. Earlier plans to this effect, such as those proposed by Keynes, Triffin, Bernstein, and Maudling, have not found official support. One of the objections has been that these plans allowed for continued accumulations of reserve currencies (dollars and pounds) either by the central reserve agency or by national authorities. There can be no solution to the problem of confidence if continued accumulation of gold-convertible dollar assets by monetary authorities is permitted.

The fifth approach is recommended chiefly by those who have given up hope for a cooperative or collective solution. To cut the link between dollar and gold, that is, to stop the practice of the United States of buying gold when it is offered and selling gold when it is demanded, would be an action vehemently opposed by most foreign governments.

The implications of this approach must be examined carefully, because it may turn out to be the only one that is really practicable. But, before I undertake such an examination, I wish to describe a plan which I regard as feasible and much more desirable. It is a plan that pursues the fourth approach in a more comprehensive fashion than has previously been proposed.

A GOLD-AND-EXCHANGE CONVERSION ACCOUNT

My proposal combines features of the plans proposed by Keynes, Triffin, and Bernstein, but it differs from these plans in various respects. Instead of discussing similarities and differences, I shall confine myself to a description of the essentials.

The United States deposits all its gold reserves in a new Conversion Account (or Settlements Account) of the International Monetary Fund and will treat

its deposit with this account as a reserve asset (its largest, under present circumstances).

Other countries, especially those in the Group of Ten, deposit all their gold reserves and all their holdings of reserve currencies (dollars and pounds), except for small working balances, in the new conversion account of the IMF and will treat their deposits with this account as part of their monetary reserves.

The monetary reserves of the participating countries will thereafter consist only of deposits in the conversion account, reserve positions in the General Account of the Fund, and special drawing rights recorded in the Special Drawing Account of the Fund. Neither gold nor national currencies will be carried as monetary reserves of the participants. Working balances in foreign countries will be strictly limited to amounts needed for transactions and intervention purposes.

The conversion of gold and reserve currencies into deposits with the conversion account is a one-time procedure (at the time of its establishment or of joining the group of participants) and is irreversible. The deposits with the the conversion account may have gold-value guarantees but will not be convertible into gold. These deposits can be held only by national monetary authorities which undertake to accept transfers of such deposits in settlement of payments balances and in payment for their own currencies (or for currencies of third countries in day-to-day transactions).

The conversion account gives no credit, it makes no loans or investments, and it acquires no currencies beyond the amounts deposited by countries at the time they open their accounts.

The conversion account will keep its gold stock in vaults on the soil of different countries, so that participants need not be apprehensive concerning emergencies in time of war.

The future of gold need not be determined at the outset. In principle, it would be possible to leave the gold market entirely free, the Fund neither selling nor buying gold, regardless of the price gold might fetch in the free market. (Any gold-value guarantee of deposits would be in terms of the official accounting price of gold maintained by the Fund.) Alternatively, the Fund might be authorized to stabilize the price of gold by purchasing gold when it is in excess supply and by selling gold when an excess demand exists. It would also be possible to set a pair of prices for bids and offers, allowing the Fund to make a profit from the spread between selling and buying prices.

The Fund would receive income from interest on the dollar and pound assets acquired when the accounts were set up. These assets would preferably be in the form of consols. If some governments negotiating these arrangements should be unwilling to give up their anachronistic views concerning the repayment of debts that serve as a monetary base, gradual amortization may be conceded. In this case, provision must be made for replacing reserves destroyed in the process with reserves deliberately created (perhaps in the form of Special Drawing Rights).

All deposits in the conversion account carry interest. The income of the Fund from interest earned on its dollar and pound assets and from eventual profits through transactions in gold should be adequate to cover the interest paid on its deposits.

The Fund should facilitate the process of adjustment not only by advice and admonition given in connection with conditional drawing rights on its General Account under present rules and practices, but also by greater adjustability or flexibility of foreign-exchange rates. In order to prevent power politics from interfering with this function, a more mechanistic system should be considered. For example, it might be provided that any country that persistently loses monetary reserves at a conspicuous rate will have its exchange rate reduced by small monthly steps; and that any country gaining reserves persistently and at a fast rate will have its exchange rate increased. By limiting these adjustments to steps not larger than, say, one-fourth of one per cent per month—except in instances of serious inflation which would require faster adjustment—the fears of disequilibrating speculation would be allayed.

The elimination of gold convertibility would make such a system of flexibility or increased adjustability of exchange rates possible. However, certain governments might so strongly resist this recommendation, that one should not insist on its being made a necessary part of the arrangement from the beginning.

While it can hardly be denied that we have at present no effective adjustment mechanism, and that the problem of adjustment demands solution, one

may concede that the problem of confidence is more urgent. Hence, we should not block collective solution of the confidence (convertibility) problem by insisting on solving the adjustment problem at the same time.

Fortunately, if the adoption of a plan to establish a gold-and-exchange conversion account stops speculation on the rise of the price of gold, and thus stops the gold rush, the present imbalance of payments will be alleviated. This supports the argument that, if the inclusion of greater exchange-rate flexibility should not be negotiable at this time, postponing a solution of the adjustment problem may not cause excessive harm.

We learn slowly, and older people usually learn more slowly than younger ones. In most countries, the men in charge of monetary affairs are mature persons, whose ideas have hardened and have become unchangeable. It may take some time, until the old guard retires and younger men take over, before it will be recognized that greater flexibility of exchange rates is indispensable for a workable international monetary system.

CUTTING THE LINK BETWEEN DOLLAR AND GOLD

A comprehensive plan to solve the problem of confidence, or indeed any new plan requiring collective action on international monetary arrangements, may not be negotiable at the moment. To resign oneself to this fact of life, shrug one's shoulder, and do nothing—is possible, is easy, is realistic. But it is irresponsible.

There are those who believe that temporizing is the only intelligent conduct, simply because anything else is "politically impossible." What this means is, before all, that in an election year no administration likes to press for the adoption of unpopular measures. It means also that the politician prefers to wait until the need for action is more widely understood. And, in terms of the concrete case, it means that we must wait until we lose another three or four billion dollars worth of gold.

I am not a politician and I believe I have a responsibility to advise against temporizing. I recommend that we take action when action can do most good. It is useless and wasteful to wait until we have dissipated several more billions of gold. Not that we need the gold but, if we dispose of it, we ought to give it to those who have a moral claim to it. That is, not to speculators, not to hoarders, but to governments to whom we have said in effect that they would not regret it if they held dollars rather than gold.

Thus, if we cannot get the governments of the Group of Ten to negotiate an agreement for a comprehensive plan, I propose the following course of actions:

(1) We announce that within a few months—say, three or four months—we shall stop selling gold to anybody, including foreign official holders of dollars.

(2) We announce to all official holders of dollars that, if they want to purchase some or all of our gold, they are welcome to it, but they must take it within the period indicated. Just as a caution, we shall limit the offer to any one country to the amount of dollars it held on a certain day prior to the announcement.

(3) We announce that we shall not purchase any gold now or in the future, or repurchase any gold that we sell, either at the present price or at any other price. In short, we are through with gold as a monetary base.

(4) We announce that we shall have no objection to any country (a) continuing to maintain the present, fixed exchange rate between its currency and the dollar, (b) reducing the exchange value of the dollar at which the country is pegging its currency, or (c) allowing the exchange rate to float.

In other words, we shall not undertake to influence other countries regarding their policy vis-a-vis the dollar. We shall leave it to them to decide what they think is best for them.

If any country decides to keep the exchange rate unchanged, this will imply that its monetary authority stands ready to sell and buy dollars at the present exchange rate. If, because of our payments position, the dollar remains in excess supply, the foreign monetary authority will have to increase its holdings of dollars.

Any country that decides to adjust the exchange rate so that at a reduced price of the dollar its monetary authorities have to acquire only smaller amounts of dollars, or none at all, will thereby avoid extending "involuntary loans" to the United States; its decision will contribute to the adjustment required for restoring balance in international payments.

If a country decides to let the exchange rate float, it evidently has concluded that it will neither accumulate dollar balances nor dispose of any that it owns, and that it will let the price of the dollar be determined in the free market. This excludes the possibility of further deficits and surpluses in its transactions with the United States (if the balance of payments is calculated on the basis of "reserve transactions"). It does not exclude the use of fixed exchange rates vis-a-vis the currencies of other countries (some of which may be more significant in the trade relations of the country concerned).

The three possibilities do not exhaust the range of options open to a country. Another option involves the use of multiple exchange rates. A country may decide to maintain the present fixed exchange rate for current-account dollars, that is, for dollars arising from, or used for, trade in goods and services, but to let dollars arising from inflows of capital depreciate. The execution of this decision to split the market would probably require foreign-exchange controls of the most stringent sort, because capital transactions can be disguised as payments for goods and services. The introduction of such controls would be regrettable, but from the American point of view one may say that controls abroad are less objectionable than controls at home. Still, this outcome would be deplorable and one can only hope that most foreign governments would realize how much harm can be caused by such measures.

The chief purpose of the link-cutting action would be achieved no matter what other countries decide to do. For, convertibility of dollars in gold having been abolished, the confidence problem as a threat of reserve destruction would no longer exist.

The use of the dollar as an international transactions currency would not be impaired by the action. Banks and trading firms hold dollar balances because they need them in their business and because the reservoir of goods which the dollar can buy at relatively stable prices is larger than that of any other currency. With the fear of "convertibility crises" removed, the usefulness of the dollar in international trade may even increase.

Some traditionalists fear that the abolition of gold reserves and of a firm link between dollar and gold would invite inflationary policies; they believe some monetary discipline is exercised by the link to gold. In fact, gold-reserve requirements and gold-convertibility rules do not give us more discipline—we do what we would do in any case—they only create guilt feelings.

One genuine drawback of this solution of the confidence problem is that the link-cutting action is unilateral and, therefore, offends the spirit of international monetary cooperation. For this reason, this approach should be regarded as inferior to a negotiated, multinational arrangement. Some economists though, believe that, in the absence of convertibility of dollars in gold, the United States would have less need for international cooperation.

The Liquidity Problem

We now come to a much happier subject. While we still grope for solutions of the problems of adjustment and confidence, we have found and agreed on a solution of the liquidity problem. And a very neat, most satisfactory solution it is.

I have just completed a long study—over a hundred pages—of the Rio Agreement with all its details and implications. I have concluded that the scheme is superior to any of the alternatives that have been discussed in the last ten years, and that it should work well once it is activated.

New Principles

The system of Special Drawing Rights embodies novel features based on sound principles of monetary economics.

The Special Drawing Rights (SDR) are deliberately created and distributed among participants in agreed proportions. They will be owned reserves—not borrowed reserves. They can circulate only among the participating monetary authorities—hence, cannot go outside the group of participants. They cannot be extinguished or destroyed—what one holder loses another gains.

The SDR's are not created by acts of lending or investing, nor by decisions to borrow or to make use of an overdraft facility. They do not constitute anybody's debt, indeed, the Special Drawing Account owns nothing and owes nothing, but acts merely as a bookkeeper and a source of information. Finally, the age-old myth of "backing," which economists for hundreds of years have vainly tried to exorcise, has at last been punctured. There is no asset that could be said to

"back" the SDR's. Their acceptability rests entirely on the participant's commitments to accept them and on their knowledge that all other participants will actually accept them in payment for convertible currencies, their own or that of the payor or that of a third country.

If the plan is ratified and activated, it can provide for adequate annual increases in total monetary reserves. The international monetary system will no longer depend on uncertain gold production, unreliable gold supplies from the Soviet Union, or erratic private demand for gold, nor on deficits of reserve-currency countries, reserve needs of other deficit countries, or the willingness of surplus countries to accumulate reserve currencies. At last, there will be some rationality in the creation of reserves. Contrary to some misgivings that inflationist attitudes will prevail in the decisionmaking about the creation of SDR's, it seems more probable that decisions will err on the side of excessive caution.

The future of SDR's—assuming ratification and activation of the scheme—looks bright. Whether gold and reserve currencies remain ingredients of national monetary reserves or whether they will be replaced by deposits with a Conversion Account, the share of SDR's in total reserves is going to increase from year to year. It may not be long before SDR holdings will be the most important part of thee monetary reserves of the world.

ONE DOWN, TWO TO GO

The new scheme has not been developed as a boon to any particular country or group of countries. It is a truly cooperative and collective arrangement to help all. The men who have long labored on it, and have patiently and skillfully steered the negotiations to a happy end, deserve our thanks.

My only regret is about the single-mindedness with which the experts have devoted themselves to solving the problem of liquidity, leaving the other two problems, of adjustment and confidence, unsolved and almost untouchable. This single-mindedness has left the international monetary system in a terrible mess.

TABLE 1.—GROSS NATIONAL PRODUCT, FOREIGN TRADE, AND VARIOUS FOREIGN BALANCES OF THE UNITED STATES, 1950-66

[In billions of current dollars]

Year	GNP	Goods and services, excluding military expenditures			Financial transfers to foreign countries					Transfer Gap	Liquidity balance	Changes in gross reserve position
		Exports	Imports	Balance	Military expenditures abroad	Remittances and pensions	U.S. Government grants and capital	Private U.S. capital (net)	Total			
1950	284.8	13.8	11.4	2.4	0.6	0.5	3.6	1.2	5.9	3.5	−3.5	−1.8
1951	328.4	18.7	13.7	5.0	1.3	.5	3.2	1.0	6.0	1.0	−.8	0
1952	345.5	18.0	13.7	4.3	2.1	.6	2.4	1.2	6.3	2.0	−1.2	+.4
1953	364.6	17.0	14.0	3.0	2.6	.6	2.1	.3	5.6	2.6	−2.2	−1.3
1954	364.8	17.7	13.3	4.4	2.6	.6	1.6	1.6	6.4	2.0	−1.5	−.5
1955	398.0	19.8	14.8	4.9	2.9	.6	2.2	1.2	6.9	2.0	−1.2	−.2
1956	419.2	23.6	16.5	6.9	2.9	.7	2.4	3.1	9.1	2.2	−1.0	+.9
1957	441.1	26.5	17.6	8.9	3.2	.7	2.6	3.6	10.1	1.2	+.6	+1.2
1958	447.3	23.1	17.5	5.6	3.4	.7	2.6	2.9	9.6	4.0	−3.4	−2.3
1959	483.7	23.5	20.2	3.3	3.1	.8	2.0	2.4	8.3	5.0	−3.9	−1.0
1960	503.7	27.3	20.2	7.1	3.1	.7	2.8	3.9	10.5	3.4	−3.9	−2.1
1961	520.1	28.6	20.2	8.4	2.9	.7	2.8	4.2	10.6	2.2	−2.4	−.6
1962	560.3	30.3	22.2	8.1	3.1	.8	3.0	3.4	10.3	2.2	−2.2	−1.5
1963	590.5	32.4	23.5	8.7	2.9	.9	3.6	4.5	11.9	3.2	−2.7	−.4
1964	632.4	37.1	25.7	11.4	2.9	.9	3.6	6.5	13.9	2.5	−2.8	−.2
1965	683.9	39.1	29.3	9.8	2.9	1.0	3.4	5.3	12.6	2.8	−1.3	−1.2
1966	743.3	43.0	34.2	8.8	3.7	1.0	3.4	4.2	11.3	2.5	−1.4	−.6

TABLE 2.—FOREIGN TRADE AND VARIOUS FOREIGN BALANCES AS PERCENT OF GROSS NATIONAL PRODUCT OF THE UNITED STATES, 1950–66

Year	GNP	Goods and services, excluding military expenditures			Financial transfers	Transfer gap	Liquidity deficit
		Exports	Imports	Balance			
1950	100	4.8	4.0	0.8	2.1	1.2	1.2
1951	100	5.7	4.2	1.5	1.8	.3	0
1952	100	5.2	4.0	1.2	1.8	.6	.3
1953	100	4.7	3.8	.8	1.5	.7	.6
1954	100	4.9	3.6	1.2	1.8	.5	.4
1955	100	5.0	3.7	1.2	1.7	.5	.3
1956	100	5.6	3.9	1.6	2.2	.5	.2
1957	100	6.0	4.0	2.0	2.3	.3	+.1
1958	100	5.2	3.9	1.3	2.1	.9	.8
1959	100	4.9	4.2	.7	1.7	1.0	.8
1960	100	5.4	4.0	1.4	2.1	.7	.8
1961	100	5.5	3.9	1.6	2.0	.4	.5
1962	100	5.4	4.0	1.4	1.8	.4	.4
1963	100	5.5	4.0	1.5	2.0	.5	.5
1964	100	5.9	4.1	1.8	2.2	.4	.4
1965	100	5.7	4.3	1.4	1.8	.4	.2
1966	100	5.8	4.6	1.2	1.5	.3	.2

Chairman PROXMIRE. Thank you, Professor Machlup.
Mr. Butler?

STATEMENT OF WILLIAM F. BUTLER, VICE PRESIDENT AND DIRECTOR OF ECONOMIC RESEARCH, THE CHASE MANHATTAN BANK, NEW YORK

Mr. BUTLER. Dr. Machlup has made many of the points that I have made in my paper.

It seems to me that our balance-of-payments situation is an extremely serious one at the moment, that we have to move to deal with it. In my terms I think there are four ways one can move. The first way is through the rule of controls, which is the rule we have adopted. I agree with Dr. Machlup that controls do not solve balance-of-payments problems. At best they buy time to work on more fundamental problems. I think if we use this time wisely to adopt responsible monetary and fiscal policies, to check inflation at home, which I think we need to do for both domestic and balance-of-payments reasons, then the price paid through these direct controls may be justified, and the so-called temporary controls may prove truly temporary. There is an old saying that there is nothing so permanent as a temporary tax, but I hope that these balance-of-payments direct controls can be made temporary.

I think that the best course for the United States and for the world is for us to cure domestic inflation by holding down spending, raising taxes, and reducing the increase in the supply of money and credit to viable proportions, and in addition reviewing and reducing our overseas Government commitments. I think that if we pursue these policies, we would help ourselves domestically and one could see an end to our balance-of-payments difficulties, with a cessation of fighting in Vietnam.

I think this is by far the best course for the United States to pursue, and a key element of this proposition is that we should maintain the price of gold at $35 an ounce.

If we do not pursue these policies, we have some other alternatives. One is more controls, which I think would be only putting the finger

on the pipe that Dr. Machlup talked about, and would lead sort of inevitably to successive crises and perhaps even to a world financial collapse at some point. I think this would be the worst possible thing to do.

Another alternative would be to raise the price of gold. This has been suggested by various sources. I think again I would agree with Dr. Machlup that this would be a great mistake. It would flood the world with liquidity. While in theory central banks could sterilize this, it seems to me that the temptation to inflate further would be irresistible. This would apply to the United States as well as to other countries that hold a lot of gold. A rise in the price of gold would reward some people whom I do not think it is in the interests of the United States to reward, and possibly penalize in some sense some people who have supported us.

I think there is no way to be completely sure that an increase in the price of gold might not set off a set of competitive devaluations, and beggar-thy-neighbor policies. I doubt that this would happen, but one cannot rule out the possibility.

Another alternative is to suspend our commitment to buy and sell gold at $35 an ounce. While, as I have said earlier, I think the best alternative is to do what we have to do to defend and develop and perfect the present system, keep the price of gold at $35 an ounce, I think if we do not pursue these policies, the best alternative would be to suspend our commitment to buy and sell gold at $35 an ounce. I think this would put the question to other countries as to what their policy should be. If they chose to let the dollar float or to let it devalue against their currencies, they would give our exporters a very great advantage, and would hamper their own exporters. I think their decision would have to be that they would peg their currencies to the dollar, to present exchange parities. I think this would be a viable system for the world financial structure. However, I think it is a less good system and a more risky system than the one we have now. I think again about all it does is to buy us some time. It does not relieve us from the charge of getting our balance of payments back into balance at some point.

I think this is the essential thing. I think we can do this. If we do it, we can contribute incredibly to the future prosperity, growth, and high employment of the world economy. If we do not do it, whatever gimmicks we invent are going to be very harmful to the cause of high employment and prosperity throughout the world.

Thank you very much.

Chairman PROXMIRE. Thank you, Mr. Butler. Thank you for your concise statement.

(The prepared statement of Mr. Butler follows:)

PREPARED STATEMENT OF WILLIAM F. BUTLER

Mr. Chairman and members of the committee, I appreciate very much this opportunity to appear before you to discuss the balance of payments and policies with respect to gold.

Let me try to make it completely clear at the outset that I believe firmly that the existing gold-exchange standard is the most efficient, equitable and powerful international monetary system in the world's history. It has served the world well, and has made a most significant contribution to the unprecedented growth in world production, trade and investment in the postwar era. I believe our objective should be to preserve the present system, while working to improve it by

gradually supplementing it with some new source of international liquidity. The key to this proposition is that the official dollar price of gold must be held at $35 an ounce.

Holding these beliefs, I am deeply concerned by recent policy developments at home and abroad. The world is in the process of turning full-square away from the policies of liberalizing trade, investment and travel which have contributed so importantly to prosperity and growth during the postwar period. The road we and other industrial nations are now traveling can lead only to successive, and cumulative, policies of restriction which will surely jeopardize our prospects for prosperity, economic growth and high employment.

Yet I believe there is still time to turn back to the high road of liberalism. The most urgent requirement is that the United States pursue policies which will deal effectively with the fundamental causes of our balance-of-payments deficit, and make the temporary set of direct controls to which we have resorted truly temporary. At the same time, we need to seek the cooperation of other nations, particularly those in persistent balance-of-payments surplus. It will be extremely difficult, if not impossible, for the United States to eliminate the deficit if other nations cling to policies which bring them payments surpluses. And we must avoid actions on our part, such as quotas, border taxes and other devices, which provoke retaliatory actions abroad.

In the situation as it existed at the close of 1967 the United States had to come up with a program strong enough to reverse the deterioration in our external payments. To be convincing, the program probably had to include direct controls over private investment as well as restrictions on overseas travel. But controls of this character are in no way a lasting answer to our real problems. They do buy time, at a heavy cost. If this time is used wisely to mount programs which deal effectively with the basic causes of our deficit, the cost may be justified. But if the temporary improvement they are bound to produce is used as an excuse for inaction on fundamental matters, the consequences for the United States and the world economy could be extremely serious.

Our balance-of-payments problem stems from two basic sources: domestic inflation and heavy government overseas commitments. It is our failure to face up to these problems that underlies the erosion in confidence in the dollar. While there is no questioning of the vast wealth and strength of the United States, there is a growing feeling abroad that we will take the easy way out, through an increase in the price of gold, rather than making the hard choices required to get our domestic house in order and tailor our international commitments to our ability to finance them.

I believe that, for both domestic and international reasons, the United States must move to contain inflation. From the end of 1958 to the end of 1965 we had a remarkable period of price and cost stability. Our competitive position in world markets improved, and our basic trade surplus widened. In contrast, we slid back into inflationary habits in 1966 and 1967, and the inflationary spiral is accelerating this year. As a result, our trade surplus shrank from $6.7 billion in 1964 to less than $4½ billion last year. Unit labor costs in manufacturing, which on the average had been stable in the years 1959 through 1965, have gone up more than 7% since the end of 1965.

The root-cause of this inflationary upsurge lies in the enormous rise in federal defense and non-defense spending after mid-1965—an increase at annual rates of over $45 billion in cash outlays, of which defense accounts for $24 billion. In the absence of a major tax increase, the federal cash deficit soared into the $20 billion plus range. The process of financing these huge deficits without pushing interest rates even higher involved Federal Reserve policies which supported an increase in the supply of money and credit of some 15% last year.

Under the precepts of both the new and the old economics, the combination of large federal budget deficits and rapid increases in the supply of money and credit, at a time of low unemployment, will yield inflation. And the inflation will be aggravated, and made more intractable, by an upward spiral in wages and salaries. Postwar experience shows clearly that the average of wages and salaries goes up at a rate equal to the advance in productivity *plus* the increase in the cost of living. So the initial demand-pull inflation leads to an upward cost-push spiral which will keep spinning so long as it is financed.

If this process is not halted it threatens to undermine both domestic prosperity and our balance of international payments. Inflationary policies involve heavy risks of creating a boom that could lead to a severe slump. As inflationary psychology spreads, it enhances the incentives to build inventories, expand

capacity, go along with large wage increases and speculate in goods, land and securities. Such a boom would come to an end at some point, as booms always do. But with the erosion of confidence, the ensuing slump might prove quite difficult to deal with. If we fund federal deficits of $20 billion or more in a period of high employment, it seems to me that we are seriously constricting our ability to deal with any recession by applying the procedures of the new economics. The long-run costs of inflationary policies in terms of unemployment seem to me to be far more serious than any short-term effects from policies directed toward price stability.

The international costs of a failure of the United States to bring domestic inflation under control and correct the imbalance in our international payments could prove even higher. The stability of the world financial structure rests essentially on confidence in the dollar. This confidence is engendered in part by our commitment to buy and sell gold at $35 an ounce, and in longer part by the stability and strength of the dollar. Dollars are held and used widely around the world because their purchasing power has dropped less in the past decade than any other major currency. The only international asset that can compete with the dollar is gold, and gold can compete only because of the speculative possibility of an increase in its price because of a failure of the United States to put its house in order.

If confidence in the dollar should be severely shaken, and I do not believe it has been as yet, my fear is that we might run into a world-wide economic crisis. There could be a world-wide rush to liquidity which could only lead to a downward spiral of production, employment and trade. The results could be a return to the controls and restrictions which contributed so much to the stagnation of the 1930's.

It is my firm belief that we can avoid these undesirable consequences if we move to deal decisively with the problems we confront. I believe we need to act on three broad fronts:

First, we must reduce the federal deficit sharply by a combination of rigorous restraint on spending and a tax surcharge;

Second, we must restrict the rise in money and credit to a rate which is in line with the potential real growth of the economy;

Third, we must reduce our overseas military expenditures.

These are not easy steps to take. Yet I believe the costs and travail involved in taking them will prove incomparably less than will our failure to do so. Prompt and resolute pursuit of these policies can get domestic inflation under control and pave the way for an end to our balance-of-payments deficit, once there is an end to the fighting in Vietnam. I do not believe such policies need lead to an intolerable increase in the unemployment rate. Nor need they lead to any abatement in the war against poverty—with resolution, there is ample room to cut back government programs of lesser priority.

In short, of all the alternatives facing the nation, I believe the course I have just outlined is far and away the best one. Let me try to embellish that conclusion by discussing some of the alternatives.

One, which I have considered above and rejected, is to slide further down the path of direct controls and restrictions. This is, in my judgment, the clear path to worldwide stagnation.

A second alternative which is receiving wide attention is that of increasing the price of gold. It is argued that such action would bring a quick and easy solution to our current problems. The speculators would cash in their gold and retire to the wings awaiting another crisis. Confidence in the dollar would be restored as the nominal value of our gold stock increased. No one would be upset, the argument runs, since all major nations would follow our lead in marking up the price of gold.

My personal view is that there are a number of serious drawbacks to any increase in the price of gold:

(1) It would take a big increase—possibly a doubling of the price as many have suggested—to convince speculators that the new price would be held for many years.

(2) A doubling of the price of gold would add at one stroke a plethora of liquidity to nations holding large gold reserves, a category which includes the United States. While in theory central banks could sterilize this liquidity, I fear that the temptation given sovereign governments to inflate would prove irresistible. If the United States continued to follow inflationary policies, it would only be a matter of time before the dollar came under pressure again.

(3) An increase in the price of gold would reward Soviet Russia, South

Africa, the leading gold-producing nations, as well as central banks which have shifted from dollars to gold, and speculators and hoarders. It does not seem to me to be in the interests of the United States to give such nations or individuals a windfall gain. Moreover, those nations which have cooperated by holding dollars would be penalized—certainly a most unjust reward.

(4) There is no way to be completely sure that an increase in the price of gold would not set off a round of competitive devaluations and beggar-thy-neighbor trade restriction policies.

It seems to me that an increase in the price of gold is another palliative, like direct controls, rather than a solution to our basic problems.

A third alternative would be to go off the international gold standard by suspending our commitment to buy and sell gold at $35 an ounce. If we do not display the wisdom and fortitude to deal with our problem of domestic inflation and curtail our international commitments, we may be forced to contemplate this alternative.

As I have said earlier, I hope things will not come to such a pretty pass. It is my firm belief that the best course for the nation, both domestically and internationally, is to do what is required to set our balance of payments right.

If we do not pursue the responsible fiscal and monetary policies necessary to work back to a viable balance-of-payments position. I would argue that we should choose the third alternative I mentioned—suspending our commitment to buy and sell gold at $35 an ounce. Since it is not in the interest of the United States to raise the price of gold, and since no one can force us to take such action, I believe we should, and would, cut loose from gold. In that unfortunate event, we could maintain the present exchange parities with other currencies. We could use IMF credits, swap arrangements or sales of part of our remaining gold stock to finance any payments deficits. Other nations would have a powerful incentive to keep the dollar from depreciating in terms of their own currencies.

The main point I am trying to make is that the United States has alternatives other than simply raising the price of gold, a move which to me does not appear to be in the best interests of the nation or the world. Our best alternative in my view is to do what is necessary to bring our balance of payments back into balance, and I believe we can do this with policies which are also needed to ensure domestic prosperity. Lacking such responsible policies, I would maintain that it would be better to suspend gold purchases and sales and maintain the present parity of the dollar than to raise the price of gold.

Finally, it seems to me to be in the best interests of the United States and other industrial nations to cooperate in the task of preserving the present system of international finance and adapting it to the future requirements of supporting world prosperity and progress.

Chairman PROXMIRE. Our last witness this morning is Professor Behrman.

STATEMENT OF JACK N. BEHRMAN, PROFESSOR OF INTERNATIONAL BUSINESS, UNIVERSITY OF NORTH CAROLINA

Mr. BEHRMAN. I appreciate this opportunity to give to the Joint Economic Committee some of my views and particularly the control schemes which have been worked out on capital investment. While I am interested in the other aspects I will focus on this, if you will, Senator.

By way of introduction I see five contradictions which have developed in U.S. economic policies over the past several years. The first is that we have been talking about temporary solutions to problems which we have not identified the temporary causes of, and I think this is the point Mr. Machlup was making.

We have stated that the controls would be temporary, but as I indicated in 1965 when the voluntary controls came out, nobody was

identifying those temporary causes that we were going to remove and how we were to remove them. That still remains the case.

The second contradiction is that we have just gotten through an extensive and difficult negotiation on the liberalization of trade, a major element in the balance of payments, and have been moving in the past several years in exactly the opposite direction on other aspects of the balance of payments through restriction of capital and now travel.

A third contradiction I see is a shift in the U.S. posture toward the adjustment process, depending on its own situation vis-a-vis the rest of the world, and that is the responsibility which we now say the surplus countries have to correct our deficit. This was a responsibility which we foisted on them and in fact continued for the first 20 years after World War II: to say that the deficit country had the major responsibility, and that we would help them out under certain circumstances if in fact they were pursuing policies which we approved.

In fact, we gave considerable aid as you know, Senator, to the European countries including aid to France during its pursuit of the war in Vietnam. In other words, we were willing to help though we were a surplus country, if in fact we approved of the policies of the other countries.

What some of them have been saying to us in effect is: "We are unwilling to help you because you are pursuing policies which we do not approve."

The fourth contradiction I see is that as the Council report states, countries whose competitive position and domestic demand levels are satisfactory may have deficits due to excessive capital flows. This is a phrase, "excessive capital flows," which Secretary of the Treasury Fowler has used in the past. I know no way of determining what an excessive capital flow is as compared to an excessive element in any other of the balance-of-payments items. That is, the balance of payments is a mixture of economic factors which meld together in a single balance, and I do not know precisely how one can be excessive as compared to another. This is a contradiction in the treatment of the elements of the balance of payments.

Finally there is a contradiction in what we say we want to do and what we are doing. As the report of the Council of Economic Advisers states, the United States must carry out its responsibilities as the major world bank. It reiterates again that the U.S. dollar is the key international currency, and yet it has been moving repeatedly to weaken the role of the dollar as Professor Machlup indicated with successive partial devaluations and now controls.

In fact, what we are saying is that the dollar is not strong enough to bear the burdens which it must bear if it is to be an international currency.

May I make one footnote on the controls, and that is that I hope that the committee has asked for the legal justification for the controls. They were imposed under the 1917 Trading With the Enemy Act. Incidentally there should be a correction there. My copy says 1947, it is the 1917 act which permits control of U.S. persons, companies, or subsidiaries involving financial transactions with an enemy country. I know no particular way, myself, how we can declare that all the banks outside the continental United States are enemy banks,

but I am sure that the Attorney General has made such determination which is satisfactory to the administration. I hope the committee asks for that justification.

Let me turn now to the adjustment process, and how we apparently are handling it, as compared to the ways in which Professor Machlup pointed out. One of the ways of handling a deficit is to employ reserves, and by employing reserves I mean permitting them to flow out to meet the deficit.

This is a role which we have almost denied gold. We have stated that we would use the gold to meet deficits, but have acted repeatedly to indicate to the rest of the world that we feel very very badly if we use gold, if we lose it, and, therefore, have signaled to the rest of the world that we ourselves consider that gold is more valuable than the dollar.

Now, of course, Congress has before it a bill to remove gold from the dollar, and again in a sense we are contradicting ourselves. We are saying we really do not need it to back the domestic currency, but we do need somehow to hold it—not to be given up but to be held in order to strengthen the dollar internationally. Not even the Europeans accept this particular construct of the relationship between gold and the dollar; and, in fact, the reason why they have voted for gold and against the dollar is not because there is any particular relationship between the two, but because they distrust the United States handling of the dollar more than they distrust the value of the gold in the world market.

Let me turn now to some of the specific factors which the Council mentions as being the cause of the deficit and, therefore, subject to some kind of correction. They indicate some special factors, the $500 million loss for Expo 67; they mention the cost of the Middle East crisis. They do not, so far as I could find anywhere in the report, mention the copper strike and its effect of $300 million to $500 million cost of additional imports on an annual basis. It has not run to that yet. It has not been a full year but on an annual basis it would run between $300 million and $500 million of imports of copper.

They do go on to blame, however, direct investments, asserting that there has been a disappointing performance on the part of the return of earnings, in 1966–67, particularly; but so far as I could read in the report, they do not mention that the return of earnings was affected by the voluntary constraint program. In fact, the earnings themselves are dictated more by foreign factors than by anything the companies can do.

Additionally, they indicate that there are cyclical forces which contributed to an indicated total drop in U.S. direct investment outflow during 1967 of about $500 million. I have been studying direct investments now for about 15 years, and I know of no evidence which indicates that there is a cyclically affected flow of direct investment from the United States to the rest of the world.

On the contrary, our experience is too short. We have only about 15 years of experience in outflows, and this is not enough to tell us about the cyclical effects on direct investment, and we certainly know nothing about the shifts from one country of destination to another according to economic cycles, and we know very little about the cyclical effects of the U.S. economy itself on an outflow of direct investment. So, I would like to throw some doubt on that proposition.

Turning now to the controls, the Council's report states that the new mandatory controls are necessary for the purpose of injecting equity into a control scheme; that is, voluntary controls were not equitable, but mandatory controls will be equitable.

But the mandatory controls are themselves based on 2 years of experience under voluntary controls—1966 through 1967—and, therefore, compound the very inequities which are supposed to be avoided. Many companies tried to do their best to meet those control levels. In fact, they operated in such a way that there was a zero-net outflow of funds for some, who contributed to the U.S. balance of payments through a reduction of capital abroad; that is, they actually decapitalized in some cases. They, therefore, are left under the mandatory control system with a zero base, and even if you are permitted to export capital equal to 65 percent of your base, that is still zero from any companies.

In addition, there are some companies who were standing in the wings in 1964–65 planning investment who were literally cut out through the voluntary controls, because they had no base, and are still in a position of having no base. Although exceptions are permitted, these exceptions have to be given authorization by the Department of Commerce, and as you know, Mr. Chairman, if exceptions have to be granted, you begin immediately to remove equity. Therefore, I see no particular way in which the controls will operate to gain the one major thing which they say mandatory controls will gain over voluntary controls.

As to the effect of the controls themselves, I have worked out a table which I will not go through in this presentation, but will only indicate that the best that we can tell, an outflow of dollars in a normal pattern, a normal aggregate pattern of investment, will be paid back in the balance of payments within about 2½ years. Now this is an aggregate experience taken from the data of the Department of Commerce, and is not a specific investment project. But, if that is true, I think we are already now in 1968 bearing the burden of 1965 restrictions in a loss of exchange, to meet our balance-of-payments deficit.

Each year, of course, as the controls proceed, we are continuing to lose the payback from past investments which were not permitted.

Now then, the average, as I quite well admit it, is made up of a variety of specific projects, and, therefore, of varying financial outflows and inflows. I have tried to detail in the table a few examples and as many of the complex factors as one could get an even estimated grasp of. They show that even a direct acquisition might well be repaid in 2½ years, and any expansion of investment after that 2½ years might very well give rise to an immediate payback.

For example, General Motors has reported that over the past 20 years no dollars have flowed out to support its investments abroad. If that is in fact the case, all of the returns, which normally run about 60 to 65 percent of earnings have been on top of a zero base of outflow; that is, they are a net contribution to the balance of payments.

This is largely the case for an expansion of existing investments, which occurs largely without any outflow dollars. Therefore, in order for us to get the largest paybacks, what we need is to expand existing investment. That, however, means that there must have first been a base somewhere, and, therefore, we are now beginning to pay addition-

ally for the fact that we have discouraged investment literally since 1962, not since 1965, but since 1962, with the Revenue Act of 1962, which displayed, at least, an aura of disapproval by the Government of foreign investment not only for balance-of-payments reasons, but, because of tax reasons, tax inequities and so on.

We are, therefore, I think, now beginning to pay fairly seriously for our follies in the way in which we looked at foreign investment outflows.

There is another aspect which I wish to close on, and that is that our handling of the investment controls, including the portfolio on direct investment, particularly now, indicates to European and other countries that we are willing to slap them very hard for the purpose of showing them that they are in fact dependent on the United States. It is, in my view, almost a spite action, an action which says to them, "If you do not really understand how important we are, we will show you by pulling the props out from under you." That, to me, is an irresponsible action for a country as strong as we are.

Not only that, but that and the various devaluations we have gone through, the control schemes, feed even more the growing desire in the United States for a type of economic isolation, for a type of withdrawal from economic responsibilities which I see growing in magnitude, and which I regret greatly, since they may turn us back toward the thirties.

That is all, Mr. Chairman. Thank you very much.

(The prepared statement of Professor Behrman follows:)

PREPARED STATEMENT OF J. N. BEHRMAN

U.S. DIRECT INVESTMENT RESTRAINTS, 1965–68

1967 was a year of contradictions for U.S. international financial policy, and early 1968 has seen an intensification of the basic conflict between the principles of a free society and controls which are appropriate only with a wartime economy. These controls have not been justified as necessitated by war financing but as required by the economic forces. The Government has, moreover, insisted that the controls are temporary, without indicating the temporary causes which may later be altered or offset. Without an identification of the temporary factors justifying departure from free economic institutions, it is difficult to assess the ability to generate measures to terminate the controls.

A further contradiction arose in the successful negotiation of the Kennedy Round, liberalizing trade, while controls were imposed on capital flows. There is no clear justification for interference in these aspects of international payments rather than or exclusive of interference in the area of trade. One fears that the only justifications for differential policies on trade and investment is that of administrative nicety—that is, it is easier to turn on and off controls over capital than controls over goods.

These comments are directed at the present control policies which are carrying the U.S. not towards but away from those "broad economic objectives that all nations hold—such as high employment, sustained worldwide economic growth, a high degree of freedom of international trade and capital movements, and an adequate flow of capital to the less developed nations." (*Econ. Report*, p. 165.) The *Economic Report* asserts that "there was no choice but to move, in part, in ways that are restrictive and thus not fully compatible with the long-run aims of expansion and efficiency in the world economy." (p. 166.) This is the washing of hands by the deficit country in the face of an asserted lack of responsibility on the part of the surplus countries. The Report cites the OECD Report on the Adjustment Process which calls on the surplus countries to assume a special responsibility to maintain their pace of economic growth. But the OECD does not impose upon the surplus countries the responsibility for deficits in international

payments. Such a concept of causation is too simple and one which the U.S. Government has refused to accept since 1945, throughout the Marshall Plan, and during its aid to developing countries.

While the U.S. accepted the burden of relieving the pressures of reconstruction, recovery, and more rapid growth from many countries over the world, it not once agreed that the pressures were generated in part by its own economic policies—even though at times U.S. growth rates were low and nearly stagnant. For it now to claim that others should assume some responsibility for U.S. deficits is a tactical switch and highly unrealistic politically. No government is yet ready to assume *responsibility* for what is happening in another economy or to the other's international payments. The causes are too complex and the remedies difficult to accept when they involve "donations" to another country. While they may agree not to fight to maintain their surpluses, even this agreement will be contingent on the circumstances. But the U.S. Government has been asking for more—a sharing of its burden, though there are no principles of burden sharing yet accepted.

The reason why the U.S. Government assumed the earlier responsibility of assistance to relieve others' deficits was that it approved of the objectives of those countries—including the French pursuit of the Viet-Nam war in the 1950's. Had it disapproved—as it sometimes did with the developing countries—it would have (and did) withhold aid. Other countries are saying the same thing to the U.S. now: "while payments are obviously two-way, we do not approve of the purposes of your expenditures."

Consequently, we have selected an element of payments to control—capital flows—which Europe has at times complained about and concerning which there is some question within the U.S. as to its usefulness. The rationale is that even "countries whose competitive position and domestic demand levels are satisfactory may have deficits due to excessive capital outflows." But where are the criteria of "excessive"? What capital flows are referred to?—short-term? flight capital? portfolio? direct investment? No distinction is made in the argument, and all are tarred with the same brush. I know of no reasoning that shows how capital movements may be "excessive" while outflows of funds on other accounts in the international balance are all "reasonable," and no effort is made in the report to explain the culpability of capital for the deficit.

But having asserted that capital movements are an appropriate subject of restriction,* especially when other countries do not behave properly, the Report turns to the record of U.S. international payments and the impact of the deficit. In brief, the policies to treat the deficit are aimed at making the dollar sound and returning it to that position of strength which will permit "the United States to carry out its responsibilities as the major world bank . . ." This role, however, is undercut by the necessity felt by the policymakers to achieve balance. They are going to demonstrate that "The dollar is a world currency" by prohibiting it from performing the functions of such a currency. At the same time, the Government proposes creation of SDR's which will supplement the role of the dollar, internationally. There is an underlying current that somehow the U.S. dollar can both be an international key currency and yet not have to bear the burden of being one—even permitting the authorities to place controls over its use, at times, despite the fact that such action denies it an effective role as a key currency. Thus we come into a strange world of controls for the purpose of strength—a tactic we strongly opposed on the part of others—and of a "world bank" which seeks to give up that role.

ADJUSTMENT PROCESS

Among adjustments to a deficit examined by the Council, little attention is given to the use of reserves. (Its discussion of removing the gold cover is in a later section of the Report.) There is even an implication that reserves should not be used in the statement that "every nation—particularly the one that serves as the world's bank—needs an adequate margin of liquidity" (p. 167). Further, the U.S. Government has tried for 8 years to prevent others from asking for gold while saying that the entire gold stock is there to back the dollar.

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*I must raise a question concerning the legal basis of the present restrictions. They are imposed under the 1917 Trading With the Enemy Act, which grants power to control financial acts of U.S. persons, companies or subsidiaries involving "enemy" banks. I suggest that it is a strain of the word to declare *all* banks outside the continental U.S. as in enemy hands. And I hope that the Congress has asked the Attorney General for a copy of his opinion on this matter which he undoubtedly provided the President.

Historically, the role of reserves performed the function of providing an alternative to currency *and* goods. If the former was uncertain of value (lack of confidence) and goods were not desired, gold provided the alternative. Gold, then, was an acceptable import or export when goods were not and when some currencies were weak. Countries with weak currencies needed to hold gold for contingencies. Contrarily, as long as the British pound was considered sound, the level of reserves needed by England was quite small. And, if the U.S. dollar were "as good as gold" there would be little demand for gold save from private hoarders. So long as the dollar is sound and more desired than any other competing currency, the gold reserves *needed* by the U.S. are practically nil—witness the decade 1945 to 1955 when gold reserves were little called for. When the dollar is weak and there is lack of confidence, large reserves are needed—more than the U.S. can command without drastic shifts in economic policies which would be detrimental to all. Thus, the crux of the matter lies in the policies directed at maintaining the strength of the dollar, which cannot include controls, for they automatically attest to its weakness.

The *pressure* of the U.S. deficit, therefore, is intimately related to the domestic strength of the dollar, which is recognized by the Council in its stress on the necessity for firmer fiscal and monetary policies and its statement that the easing of monetary conditions in 1967 widened the deficit. If adequate domestic measures had been taken in 1966 and 1967, if the export drive had been expanded in 1965, rather than relaxed, and rather than waiting until 1968 to re-emphasize it; *and* if the gold reserves had been let go freely, rather than attempting to hoard them, the situation would be much improved today. Rather than make certain to maintain stability of the dollar and use the gold, we cried the weakness of the dollar when in fact it was strong. The U.S. Government has acted for 8 years as though the dollar would be weakened by a loss of gold, as though the gold were more precious than the dollar, and as though holding gold would somehow strengthen the dollar. It has been obvious to the rest of the world that these suppositions are not correct. The projected untying of the dollar from gold domestically is our own recognition of the fact that gold does not give strength to the dollar. Rather, the rest of the world voted for gold against the dollar, when it did, on the ground that the U.S. did not know how to manage its own economy so as to maintain the value of the dollar.

The Council attests to this point itself in noting that the worsened deficit in 1966 was a result of the foreign exchange costs of the Viet-Nam war, and "the strains placed on our domestic economy." (p. 169) These strains were exemplified in the increased import demand in 1966 and particularly in the last of 1967. It is interesting to note that among the "special factors" explaining the deficit are a $500 million loss because of Expo 67 and costs of the Mid-East crisis, but no mention is made of the $300–$500 million (annual) loss from the copper strike, which occurs from greatly expanded imports. But the Council does blame direct investment for an increase in the deficit on the grounds of only a slight increase in income from investment in 1966 and an inadequate return in 1967: "This disappointing performance reflected an actual decline in income from investments in Western Europe during the last two years, despite the further substantial buildup of assets there." (p. 170)

There is in the above statement a lack of recognition of the fact that voluntary controls existed on direct investment in 1965–67 and that companies retained earnings abroad in order to expand production rather than send dollars for new investments. This action built up assets but the return of *earnings* was determined first by factors abroad, which were not favorable, and is not the whole story on the payments accounts of direct investment. The avoidance of emphasis on the voluntary controls is evident also in the statement that direct investment outflows dropped in 1967 because of cyclical forces: "Along with other influences [not named], the cyclical forces contributed to an indicated total drop in U.S. direct investment outflow during 1967 of about $500 million." (p. 170). We have not had enough experience with large direct foreign investment outflows since World War II to know whether they are cyclically affected and whether, if so, they are affected more by the parent country cycle or that of the host country—and whether they shift among countries of destination according to the pattern of economic growth cycles. The evidence of the past decade provides little evidence of cyclical behavior, and to claim such a correlation at a time when companies were responding strongly to constraints by the Government which forced a reduction in outflow is certainly to focus on the wrong factors.

Controls

This voluntary program is now substituted by a mandatory one, despite admitted "excellent business cooperation" with the former. Besides the stated necessity to curtail outflows, a justification for the new controls is "to insure equality of burdens among all direct investors." Such an objective is hardly accomplishable. Not only have inequities already been built in, but the history of foreign investment precludes equal treatment now. Inequities have been built in by assuming a given base period as appropriate—one under which voluntary controls existed. But, some companies tried to do more than their share and even paid out dividends greater than earnings, taking funds from surplus, and making no new investment. Their base is thereby restricted to zero and 65% of zero is still zero. A company which delayed investment, as requested, in 1965–67, also reduced its base; only those that invested to the limit are not discriminated against.

Companies that were projecting their first foreign investment abroad have no base at all, while companies having invested over 20 or more years have long since stopped sending dollars overseas and need no base; having established a policy of returning 60 to 65% of earnings anyway and borrowing locally as needed, the 35% limitation on the "moratorium" countries is no constraint. Nor can the medium and small-size businesses borrow readily abroad to make their investment. Thus, there is discrimination based on who was abroad first and how long. And exceptions granted by Commerce merely intensify the possibility of inequities, for administrative judgments are seldom equal nor circumstances similar.

The effect of controls whether under the voluntary or mandatory system is always discriminatory; it is impossible to determine whether situations are equal or to treat the new-entrant equitably. Further, what is equitable among companies may not be the best policy for the economy, if it *must* reduce outflow and increase inflow. Such an objective would argue for a careful selection of projects to be approved which would require the least outflow and provide the largest and most prompt return to the U.S. of funds. The discrimination which will result from present procedures will produce a warping of the foreign investment flows and future returns which will certainly be different from that without controls, but with what precise damage we cannot now tell.

Both government and business officials have said since 1965 that the controls should not be continued for long and that the damage to company operations and the U.S. balance of payments would be large if restraints remained. We cannot know precisely the impact of the past constraints on the present payments position, but the longer they remain the better we can estimate for the impacts to begin to fit the average pattern of investment flows and returns. Thus, we may use the aggregate statistics to show the effect of continued controls over foreign investment.

As recognized in the Council report, capital outflows account for between 30 and 35% of capital outlays abroad, 20% comes from re-invested earnings, long-term borrowing abroad about 8%, with short-term borrowing and depreciation allowances constituting the remainder. Thus, on the average and including expansions of existing plant and new enterprises, expenditures for plant and equipment abroad of $1 million require no more than $350,000 of outflow. This outflow is immediately reduced by sales of capital equipment and patents owned by the parent, as well as technical assistance, to the affiliate. These will amount on the average to $50,000 each—often higher for countries outside of Europe. Thus, the net outflow will be on the order of $250,000. Exports may have been stimulated by realization in the market that a local supply would soon be available, but some exports may also be substituted by foreign production. Apart from these shifts, the affiliate will soon return income from earnings and sometimes management and R&D fees.

The accompanying table illustrates data from different investment situations. The first, relying on the aggregate data on manufacturing investment abroad, demonstrates that the payback period for outflows of U.S. dollars is about 2½ years—on the average. But this average is made up of different projects—some returning funds immediately to the U.S. and without any outflow and others draining dollars for several years before they are offset by earnings and exports through the affiliate. The extreme unfavorable situation is that of a company making a mis-calculation as to whether its exports would decline and investing abroad when it did not have to in order to maintain its market. It is unlikely that it would ever repay the lost exports.

EXAMPLES OF PAYBACK FROM U.S. DIRECT PRIVATE FOREIGN INVESTMENT

Item	Aggregate data (period)				Acquisition and expansion (period)							New facility and loss of exports[1] (period)						
	0	1	2	3	0	1	2	3	4	5	6	0	1	2	3	4	5	6
(1) Capital expenditure of which	$100				$100				$50.0			$100.0						
(2) Local borrowing or depreciation	45				65				40.0			30.0	$30.0					
(3) Retained earnings	20					$3.5	$3.5	$3.5	10.0	$7.5	$7.5							
(4) Dollar outflow of which	−35				−35							−20.0	−20.0					
(5) Equipment	5				5				2.5			2.5	2.5					
(6) Patents, technical assistance, and management	5				5								5.0					
(7) Net outflow (−)	−25				−25							−17.5	−12.5					
(8) Income (8 percent of book value)[2]		$4.5	$4.5	$4.5		3.0	3.0	3.0	4.0	5.0	5.0			$3	$3	$3	$3	$3
(9) Exports: direct												10.0	10.0	−20	−20	−20		
(10) Exports to affiliate: Products		4.0	4.0	4.0		4.0	4.0	5.0	6.0	6.0	6.0			5	5	10	10	10
(11) Components		2.0	2.0	2.0		2.0	2.0	2.0	3.0	3.0	3.0			5	5	5	5	5
(12) Exports: Other[3]		2.0	2.0	2.0		1.0	1.0	1.0	1.0	1.0	1.0			2	2	2	2	2
(13) Imports		−2.0	−2.0	−2.0											−2	−2	−2	−2
(14) Net effect in year	−25	10.5	10.5	10.5	−25	10.0	10.0	11.0	14.0	15.0	15.0	−7.5	−2.5	−5	−7	−2	18	18
(15) Cumulative payback (−) drain	−25	−14.5	−3.0	7.5	−25	−15	−5.0	1.0	20.0	35.0	50.0	−7.5	−10.0	−15	−42	−24	−6	21

[1] Assumes that exports of $50 would have continued if there had been no investment; in years 1 and 2, exports rise in anticipation of local supply.

[2] Book value equals U.S. dollar outflow plus retained earnings. In the "new facility" example, there are no earnings to retain for investment to begin with.

[3] Assumes a marginal income propensity to import by the host country of 1/10 and a U.S. share of 20 percent—or, 2 percent of marginal income; in the acquisition case, it is assumed that former sales are doubled, so that only half of sales are new income.

But, this last result is highly unlikely because U.S. businesses are basically reluctant to invest abroad unless they are losing the market or stand in grave threat thereof; or, unless a company has not entered the market as yet and fears never to be able to enter through exports. In such cases, the substitution of local production for exports merely holds a market and gains some return when export earnings would have fallen to zero or never arisen. We can feel fairly certain that exports are not completely substituted by foreign investment by the fact that exports in the areas of high investment activity have not declined. They have not risen as fast as foreign production, but some categories have risen faster than the average of all industrial export. In the main, it is the technically advanced sectors which supply both exports and investment. Thus, in the aggregate, what is occurring is either an expansion of market opportunities by investment, raising the level of former exports through the establishment of selling affiliates or manufacturing and selling units, *or* widening the types of goods sold by the company as a result of extensive promotion of the company name and line. One cannot know from existing data whether the situation could have been more favorable with less investment and more export promotion. But, given the freedom of companies to decide which is the more profitable route, it seems highly unlikely that they would take the investment route if the export channel were effectively open on an intermediate or long-term basis.

As noted above, these conclusions from the aggregate data—and we shall have much better data from the current census on foreign investment—can be contradicted on either the optimistic or pessimistic side by reference to specific cases. The other cases in the accompanying table show that the payback period for an acquisition might well be 2½ years also but that of an expansion (which involves frequently no U.S. funds at all) provides a payback immediately. And, of course, a prior investment is necessary to reap the gains of an expansion of outlays on facilities.

The case in which exports were significant but expected to decline provides more complexities but still can be estimated to pay back the outlays as well as the loss of exports within a period of 4½ years from start-up of operations and 5½ years from the first outflow of capital, assuming a 2-year construction period. The conclusion rests heavily on several assumed relationships, and any alteration of these can produce quite different results. It is necessary to keep one's estimates relevant to business practice and expectations, however, if policies are to be made on the expectations of gaining returns for the payments deficit.

Restraint of investment in the case concerning a loss of exports provides a significant gain for the payments deficit over 3 or 5 years. But, prevention of the others will damage U.S. payments within 3 years. And, if one may assume that exports are often generated by expectations of the market of a continuous supply, the payback may have actually been achieved *before* start-up of foreign production—even if earnings are not gained for some years.

Another aspect which is quite hypothetical but significant is that concerning the indirect impacts of economic growth resulting from foreign investment on export and import patterns and volumes and on interest rates and thereby again on growth rates and trade and investment flows. The outflow of capital from the U.S. will tend to slow down its own growth through a reduction in capital supply (and demand for capital goods), raising the interest rate; this in turn reduces import demand and improves the balance of payments. The converse occurs abroad; in addition, the differentials in interest rates tends to draw short-term capital to the U.S. and out of Europe and other countries—unless offset by monetary policy. These secondary and tertiary impacts are not quantifiable but must be considered in determining the effects of capital restraints.

Given the admission that some countries need the inflow of U.S. capital and the fact that even European countries have come to depend in part on repeated infusions, despite the heavy local borrowing by foreign enterprises. there is something of a "spite action" in the capital controls. It is almost as though the U.S. were saying—"We'll show you how dependent you are on us and then you'll recognize how much you need to hold dollars, even if you don't want to." This is hardly the way for the most powerful country in the world to behave; it is petty rather than responsible. It demonstrates an eagerness to toss off the burdens of leadership, which is precisely one of the causes for lack of confidence on the dollar, for that leadership requires monetary and fiscal rectitude on our part as well as maintenance of a strong economy.

Some economists argue, however, that the U.S. must look to its domestic problems first, maintaining full employment even by inflation. Yet this prescription will tend to remove the dollar from its role as the international currency, for continued U.S. inflation relative to others will bring strong pressure to devaluation. But the key currency—if the dollar so remains—cannot be the subject of devaluation; others will merely follow, and the consequent disruption from such an attempt would be a firm signal that the U.S. has abandoned its role of world leadership in economic affairs. Not only will it have abandoned that role, it will have done so through the route of controls and the abolition of trade and capital movements, pushing the world back to the 1930's.

Chairman PROXMIRE. Thank you, Mr. Behrman. Thank you, gentlemen, for your most stimulating presentations.

Mr. Behrman, I would like to start with you. Your analysis indicated that a $1 million investment abroad may, on the average, require a capital outflow of only about $250,000, as I recall it.

Mr. BEHRMAN. That is correct, on an aggregate basis; yes.

Chairman PROXMIRE. And you conclude that the payback period of U.S. investment abroad is about 2½ years in an average or normal situation?

Mr. BEHRMAN. Yes, sir.

Chairman PROXMIRE. If this is true, it is obvious that some investments must pay back in 12 months or 18 months or you have some examples of very, very big and important areas where you have no outflow at all in the payback?

Mr. BEHRMAN. Yes, sir.

Chairman PROXMIRE. In view of this would it be possible to administer a program that follows up on your interesting suggestion on page 8 when you say, "A careful selection of projects be approved which would require the least outflow and provide the largest and most prompt return to the United States of funds."

In other words, would it be possible to say that you would make investments that would pay back in 18 months or 24 months or maybe even 12 months? Is this a feasible alternative or not?

Mr. BEHRMAN. No, sir; I would not think so, for this reason: The decision of a company to pursue an investment project takes about 2 years in gestation. I am talking about a new project, an acquisition or an establishment of a new project, not an expansion of an existing one.

If the company had any idea at the end of a year and a half or 2 years with the cost of investigation being several hundred thousand dollars, that the Government would say "No," the initiative on the part of the board or any other official is going to be seriously damaged.

Chairman PROXMIRE. Are you saying that you simply cannot determine in advance?

Mr. BEHRMAN. You cannot determine quickly in advance.

Chairman PROXMIRE. You cannot determine what?

Mr. BEHRMAN. Quickly in advance, what the payback will be. In fact, some of the payback which I have indicated—that is, an expansion of exports before construction—comes only after an announcement of the fact that the investment will take place. You cannot be sure of that, that the demand for imports in the foreign country will go up until the announcement is made. You can guess it, but you could not prove it to the Department of Commerce.

Chairman PROXMIRE. Then I take it that in view of your very convincing argument—you have had an enormous amount of experience

in this since you have been studying it for 15 years, and I doubt if any competent expert or economist has made the kind of exhaustive studies you have—would you conclude that it would be wise not to approve the President's proposal. I do not know if we can do anything about it except, as you say, examine the legal authority, because the President does not come to Congress asking to restrict investment. As I understand it, he is acting under a law passed many years ago.

Mr. BEHRMAN. In 1917.

Chairman PROXMIRE. At any rate, as far as your position is concerned, do you think it is an unwise policy on the part of the President to impose this restraint? If this is true, would you go further and repeal the interest equalization tax and would you go further and repeal the Commerce Department's so-called voluntary program, and would you also repeal or rather reverse the Federal Reserve Board's restraint on banking institutions as to lending abroad?

Mr. BEHRMAN. Senator, if we were in 1965 I would have said—as I said at the time, or in 1962 or 1963, when the interest equalization tax went on—we should have done none of those things at that time.

Representative RUMSFELD. Would you repeat that? I am having trouble hearing you.

Mr. BEHRMAN. I am sorry. I say if we were in 1965 when the voluntary controls went on or if we were now in the period when the interest equalization tax was imposed—was it 1963, Fritz? I have forgotten—I did say then that we should not have done any of those things. On the contrary, what we should have done, having a strong dollar as we did at that time and a strong economy with an inflation rate much lower than anyone in Europe, instead of crying the weakness of the dollar, which we did officially all over the world, have declared the strength of the dollar and used our gold reserves to meet the deficit, and continue to maintain the dollar strength, we would not be in the position we are in now.

Chairman PROXMIRE. What would you do now?

Mr. BEHRMAN. Now? All right. Now you can save by constraints, as we are now doing on controls, an amount of money from a capital outflow, let us say $1 billion or whatever else, which is what they are after, you can save $2 billion, 1 year at a time. To me this will not solve any of the problems which Fritz Machlup laid out very nicely. What we are saying is that somehow $2 billion can do something to solve fundamental problems of confidence. I do not think it can.

On the contrary, we are building up problems for the next few years which, in my view, are equally or more serious, because we will not get back the plus flow we would normally get back in 1970–1971, and additionally we are telling the rest of the world that we are somehow not strong enough to maintain our responsibilities. My answer, Senator, is "Yes;" I would ask that these not be continued.

Chairman PROXMIRE. Not be continued?

Mr. BEHRMAN. Not be continued.

Chairman PROXMIRE. All right. You say you could not quantify it, but could you give us any ball park estimate on your very interesting observation that the outflow of U.S. capital tends to slow down our economy and speed up the economies abroad, and, therefore, seems to have something of a counterbalancing effect on our balance of pay-

ments. This would be most helpful if you, or any of the other gentlemen here, could give us some notion of those dimensions.

You have already made a very strong case. There is a payback of 2½ years in our investment abroad. If you can also make a case that this is somewhat equalizing.

Mr. BEHRMAN. I am not sure that Fritz had the paper earlier. Let me just brief a point. Fritz, you probably have been working on it much more than I, but what we are getting into now are the secondary and tertiary effects of capital flows among nations. This has not been thoroughly studied, I think, even on the theoretical basis.

Chairman PROXMIRE. Doesn't it assume a rigid monetary policy?

Mr. BEHRMAN. Yes; it assumes a given monetary policy.

Chairman PROXMIRE. Which is not realistic?

Mr. BEHRMAN. Which is not realistic.

Chairman PROXMIRE. In other words, it can be offset?

Mr. BEHRMAN. Yes, sir; it can be offset on either side.

Chairman PROXMIRE. Yes.

Mr. BEHRMAN. But as long as the United States is not itself inflating, a capital outflow is advantageous to the United States, initially. Now, what happens with it in the various flows and in the various offsets, as you say, becomes quite complex, and that is why I cannot get into the ball park, because it does yield to varying monetary policies in various places, various countries and there is also a possible flow of funds among foreign countries.

Chairman PROXMIRE. I want to ask Mr. Machlup about this, in just a minute, but I would like to ask you one more point in connection with this, and that is, what you are telling us is that on the assumption that the so-called temporary factors will last more than a couple of years, then the action taken is unwise. It is only on the assumption that the temporary factors might evaporate within a year or so that you can justify the kind of temporary action that is being taken; is that correct?

Mr. BEHRMAN. Yes, sir. That was the administration position, itself, in 1965, but what I asked then and what I ask now, Senator, is, What are the temporary factors?

Chairman PROXMIRE. You list the copper strike. North Vietnam is another one—perhaps temporary we hope—and there are others. I would like to ask Professor Machlup to comment.

Mr. MACHLUP. I would invite you to turn to table 1 of my prepared ent (p. 415). In the fourth column you find the balance of goods and services excluding military expenditures. I show military expenditures separately in the next column, as one of the financial transfers.

I have arranged all financial transfers to foreign countries under four headings: Military expenditures abroad, remittances and pensions, U.S. Government grants and capital (net), and private U.S. capital (net). If you add up these four items, you get the total which I show in the next column and which I call total of financial transfers to foreign countries. Now, we can compare this total with the fourth column previously mentioned; namely, the balance on goods and services excluding military expenditures. This balance may be called real transfer to foreign countries. I invite you, now, to compare the lows and the highs.

In 1953, the total of our financial transfers was $5.6 billion.

Chairman PROXMIRE. What year is that again?

Mr. MACHLUP. 1953. The total of the financial transfers in 1953.

Chairman PROXMIRE. Yes.

Mr. MACHLUP. $5.6 billion. Our financial transfers then increased, and the high was in 1964, of $13.9 billion. Now, if you look at the real transfers, the net transfers of goods and services, shown in the fourth column, you find that these were $3 billion in 1953, but $11.4 billion in 1964.

This indicates to me that the financial transfers created, so to speak, the real transfers. There was, to some extent, an adjustment taking place, a self-adjustment.

Most of the financial transfers were independent of the state of the balance of payments. Military expenditures were surely not increased because of an improved balance of goods and services; likewise, capital movements, governmental or private, were not induced by the trade balance. They were autonomous transactions. But these financial transfers, through economic forces, created their own offset, the improvement in the balance of goods and services. Unfortunately, these improvements were never big enough. They always left us with a transfer gap. The third column from the right shows you the transfer gap.

I want you to note, the transfer gap in 1953 was $2.6 billion, and in 1964, despite the enormous increase in financial transfers, the transfer gap was still only $2.5 billion. This indicates, at least to me, that the rise in financial transfers brings with it a rise in real transfers, and likewise, and—this is the point that Mr. Behrman has been making—a reduction in financial transfers is likely to bring with it a reduction in real transfers. So, if we transfer less to foreign countries in the form of dollars, they will also buy less from us and we will buy more from them.

Representative BOGGS. May I ask you a question about those figures?

Mr. MACHLUP. Yes.

Representative BOGGS. I notice you do not have 1967.

Mr. MACHLUP. That is right. They are not yet available in full detail.

Representative BOGGS. Obviously, one of the big items in your whole table are military expenditures abroad. How much increase was there in 1967 over 1966?

Mr. MACHLUP. I called Walter Lederer this week, and he could not yet give me the final figure. There was an increase.

Representative BOGGS. How much?

Mr. MACHLUP. I could not tell. I think the increase was less than $1 billion.

Representative BOGGS. That is probably what is wrong with your figures. They do not reflect the increase in Vietnam, which is certainly a most significant element.

Mr. MACHLUP. These figures come from the Department of Commerce, and 1967 is not yet included. The Economic Report has a figure which is only for the first three quarters of 1967. Taking the first three quarters at an annual rate, you see an increase of between $500 and $600 million for 1967 over 1966. It was from $3.7 to $4.2 billion, hence, a little over $500 million. There may have been a further increase in the fourth quarter.

Chairman PROXMIRE. My time is up.

Congressman Rumsfeld, you are next. We will come back to Congressman Boggs.

Representative RUMSFELD. Let me clarify one thing, Mr. Machlup. In your statement, page 27, where you discuss these five approaches to solve the problem.

Mr. MACHLUP. Yes.

Representative RUMSFELD. I take it from the remark you made earlier in your statement, it could almost be said that liquidity and adjustment are to be considered together?

Mr. MACHLUP. The problems, you mean?

Representative RUMSFELD. Yes, the problems.

Mr. MACHLUP. The three problems. Unfortunately they were not considered together in official negotiations. They should have been considered together.

Representative RUMSFELD. This is your position with respect to your recommendations?

Mr. MACHLUP. At this stage we must take it for granted that we have not dealt with the adjustment problem and the confidence problem, and hence, we must now ask what we can do. On page 27, I have listed the five approaches to solve the confidence problem. The confidence problem means the danger of massive changes from dollars into gold that threaten to wipe out a large amount of world monetary reserve.

Representative RUMSFELD. First, let me say, I thought all the statements were excellent and I appreciate the time you gentlemen have taken. In each case your statements have been properly on a broader subject than the one I am going to raise, but I would like to have each of you comment on the proposal for removal of the gold cover, and with specific reference to what the possible results might be in the event it is done or it is not done, once it comes before the Congress. What I am asking is, do you see any particular impact in the event that Congress considers it and decides against it?

Mr. MACHLUP. If you want me to start the ball rolling, I think the removal of the gold cover for the Federal Reserve notes is an absolute necessity, if we are all looking at the problem intelligently. We should have done it years ago. It is a complete anachronism to hold gold behind banknotes. It is something which people in the 19th century insisted upon. For that period it was a proper requirement.

In the 20th century, or at the present time, for anyone to insist on a gold cover for banknotes is ridiculous. We should send him back to school. It is absolutely silly, this whole thing, and I do pray you, sir, that you convince your colleagues that they should not prolong something that belongs, from our point of view, to the Dark Ages.

If gold is of any use, it is to send it to foreign countries when they want it. This is the main use of gold. There is, of course, also an industrial use, and I hope the time will come when the governments will be willing to hand all their gold over for industrial uses.

Chairman PROXMIRE. Mr. Butler?

Mr. BUTLER. I would say that I agree completely with that statement. To the extent we can trade gold for useful things, I think we should do it.

I do not see any great psychological repercussions abroad. I think it is assumed abroad that we will do this. And I would certainly agree that we should do it and do it with the greatest dispatch and the least argument possible.

Mr. BEHRMAN. Yes. I would only add that from the domestic standpoint we have already made the largest step, and that is the removal of gold from the credit liabilities of banks. Gold does have a role to play internationally. Unfortunately what we have been saying for the past 8 years is that it is too precious to permit it to play that role. That, I think, is the big contradiction. We should release it, and we should let it play its role.

Representative RUMSFELD. Then none of the three of you see any legitimate arguments in opposition to this proposal? Could I ask Mr. Behrman and Mr. Butler to comment on Mr. Machlup's proposal on page 27 where he, as you will recall, recommended the fourth approach, and in the event that the leverage from the threat of the fifth was insufficient to achieve the fourth, then his position that the fifth should be the course of action for this country.

Mr. BEHRMAN. Let me say that I agree in principle with the value of this fourth proposal, that is that the best way to use the gold that we do have, and to shore up its international strength, is to put it in a common fund.

The thing which has caused gold to give us so many problems in terms of the rise in price is its redirection over the past several years and its sources of new supplies—South Africa and Russia. The fact that some countries have piled it up has made it even more difficult for us to adjust the price, because it creates inequities for countries that went along with us and did not demand the gold. Therefore, to remove this type of problem, the only thing to do with it is to put it in a common fund. It is even possible in my view to divorce official gold from private gold and, as I think Fritz was implying, not to increase the supply of official gold but just to leave it as a lump behind the international liabilities.

If that were done, it were put in a common fund, it seems to me at least that these special drawing rights would not have been needed, and would not now be needed, if you adopted Professor Machlup's fourth proposition. Having it in a common fund, and having no shifts between official and private gold, it would be even possible to raise the price of gold and, therefore, to provide additional international liquidity if and when it were needed, because then you would have none of the repercussions which we now face.

I would strongly agree that we should not raise the price of gold now.

As to the fifth point, as to whether we should use that threat, I myself would prefer a different tactic which I think is feasible, and that is to try to get ourselves back in the position which we held in 1964, of a very strong economy with a rate of inflation much less than in the other industrialized countries of the world. Make it quite clear that we intend to maintain the strength of the dollar, for it is really an internal strength that provides the external strength. What Europeans are saying is, "We do not think the dollar is going to be strong internally and, therefore, how can it play a strong role internationally?"

If we demonstrate that, and then use the gold to meet the deficits from time to time, indicating that the dollar is as strong or stronger than gold, then the preference for gold begins to die out. The problem is that nobody is quite sure that our economic policies even from one administration to the next will be stable enough and strong enough to maintain that commitment. That I think is the burden of an international currency, that the country sustaining that international currency must handle its domestic policies in a way to maintain that strength. That is a burden which some economists say they do not want to bear. They would rather have creeping inflation and let the international dollar go.

In a sense that is what Professor Machlup's final proposition is. We will just untie it. We will let it go and let it flow. To me, from a business standpoint, and a financial standpoint, that is a very harsh alternative, and I would hope we would find the other one easier to follow.

Representative RUMSFELD. Thank you.

Chairman PROXMIRE. Mr. Butler?

Mr. BULTER. You will find very little disagreement on this panel on these matters. My only disagreement with Jack Behrman would be that a generation is somewhat longer than 4 years.

Mr. BEHRMAN. Yes; I would accept that.

Mr. BUTLER. You will find very little disagreement on this panel on I think Dr. Machlup has indicated, it would have to be negotiated. The chances of negotiating it, your point 4, are fairly slim at the moment. So, I think we have to pursue other alternatives, and the best one to my mind is to do what we have to do to defend the dollar, to check domestic inflation, validate the argument that the dollar is better than gold. The dollar is better than gold so long as we run our domestic affairs properly. We have less inflation than any other country in the world. Then gold is better than dollars only under the assumption that we will double its price at some point, which I do not think we should or would do.

Representative RUMSFELD. Because of your judgment that the prospects to achieve No. 4 are very slim, you, as a fifth alternative, would prefer Mr. Behrman's approach?

Mr. BUTLER. Yes.

Representative RUMSFELD. To the ones indicated in the statement?

Mr. BUTLER. I think that all of these things do nothing more than buy us time; that we have to do the things required at some point to check domestic inflation, to maintain the integrity of the dollar. That all of these gimmicks that have been recommended do really nothing more than give us a little more time, and they run the risk always, and the very great risk, of at some point leading to some sort of international collapse of possibly frightening proportions. I do not think this country or the world should run these risks. I think it is far better to do what we should do and to do it quickly, properly, with resolution.

Representative RUMSFELD. Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Boggs?

Representative BOGGS. Thank you very much, Mr. Chairman. I appreciate Mr. Rumsfeld asking the questions about gold cover, because as members of the panel might know, that bill will be con-

sidered by the House of Representatives tomorrow. The Democrats have a meeting on it.

I would like to state the question negatively. What do you think the impact would be if the Congress did not pass the bill that is now pending?

Mr. MACHLUP. Well, no one can know for sure, but there may be an impact on gold speculation. We cannot know what the gold speculators think and whether there will be another gold rush, another wave of gold buying as we had in December. As you know, in December, $900 million of gold were lost within 4 weeks. It is quite possible that another such wave would come in February and March, if Congress turned that bill down. I do not forecast. I merely say it is a possibility.

On the other hand, if Congress were voting against the bill, and refused to pass it, I believe there is a way around it. The Federal Reserve banks would simply pay the penalty and allow the banknotes not to be covered by 25 percent in gold. They would have no practical alternative. We will not refuse to sell gold under present circumstances nor will we refuse to increase the amount of Federal Reserve notes if there is a demand for banknotes in the economy.

Now, since these two things are quite clear, there simply is nothing else that they can do. Of course, you could say that we should stop selling gold. That would be an alternative, and it might be a good alternative.

Representative BOGGS. Would any of the other members of the panel care to comment on the negative aspects of failing to pass the bill that we are to vote on tomorrow?

Mr. BUTLER. Again, I would agree. I think it does run the heavy risk of leading to another gold rush. As Dr. Machlup said, you cannot be sure of this, but I think the assumption in Europe, the assumption on the part of people in Europe with whom I have talked, is that we will remove it. Now if we do not remove it, then this changes their view of the future, and I think it could very well add to speculation against the dollar.

I think it is a provision that should have been removed at least 10 years ago. But having not done it then, I think we should do it now, and we should not run the risk of losing another $1 billion of gold merely because of that anacronistic provision.

Mr. BEHRMAN. I would like to add that in a sense not acting on the bill, that is refusing to pass it, may encourage a run on the dollar as well.

Chairman PROXMIRE. Would you say that again? I did not hear it.

Mr. BEHRMAN. It may encourage a run on the dollar as well for this reason. It is widely recognized that gold is not needed for the domestic cover. What will be assumed, therefore, abroad, in my estimation, would be that Congress considered gold more valuable than the dollar; that is, we should not sell it. Not to remove the cover is saying in effect, "Congress says, 'Do not sell it' " period! "We need it more than we need dollars and it is too valuable to let you have."

Since the Federal Reserve can, in fact, go ahead and sell it anyway, it appears to me the reaction might very well be, "If it is that valuable, we want it," and, therefore, accelerate the demand for it.

The reason why there would be a run on the dollar now, if the

bill is passed, is that, relatively, the dollar is weak compared to gold. We are not taking the cover off at a time of strength, and I want to add a caution that we should have done it when the dollar was strong. We are now doing it when it is weak and, therefore, we run some risks.

Representative BOGGS. None of you can see any happy results if the Congress fails to pass the bill?

Mr. BUTLER. That is right.

Mr. BEHRMAN. Correct.

Representative BOGGS. Mr. Chairman, I want to congratulate you for having this hearing today. I came here specially because the very subject that we are discussing is now being considered before the legislative committee which has jurisdiction, the Ways and Means Committee. The committee is meeting now, so after my little time is over I am going to have to make my departure, but I would like to ask a few questions about the balance of payments, because, as I say, the legislative committee has the subject before it right at this moment.

I want to talk to my good friend Professor Behrman. I have worked very closely with him for many years and have great respect for him. I do not quite understand what you recommend.

In the testimony that I have heard so far, I have heard a great many witnesses against the regulations which have been issued relative to capital investment abroad. Already the mail is coming in in great volume on the proposal with respect to travel in the developed countries. Tariff barriers are being erected to American exports all over the world. I went into this subject very closely last summer in my subcommittee on this committee, meeting with all kinds of protests everywhere. What alternatives do you give?

If I may say so myself no person has worked any harder for freer trade between the nations of the world. Yet, I must say, I am terribly concerned by these artificial barriers that our European partners are erecting to American goods, and I am not certain that this total investment abroad, which certainly does have an impact upon domestic employment, is the answer to this question, so what I would like you to do is to tell what you are for. I think I know what you are against.

Mr. BEHRMAN. As far as where we should move from right now——

Representative BOGGS. That is where we are.

Mr. BEHRMAN. Right. I agree. Let us take it from there.

Representative BOGGS. Politics is always the possibilities of the present.

Mr. BEHRMAN. Yes. The first thing which we need to do is to lay out a program domestically.

Representative BOGGS. What program?

Mr. BEHRMAN. Including the ones which Congressman Mills has insisted on.

Representative BOGGS. That means reducing expenditures?

Mr. BEHRMAN. Yes, sir.

Representative BOGGS. Where?

Mr. BEHRMAN. In the total budget.

Representative BOGGS. I know; but what programs?

Mr. BEHRMAN. You want to know exactly which items in the total budget?

Representative BOGGS. Surely; and how much.

Mr. BEHRMAN. How much? That is a difficult thing for me to say. I would have to study that, Mr. Boggs.

Representative BOGGS. I know, but we are right up against it right now, today, so you tell me where.

Mr. BEHRMAN. All right. If you will give me a little time to study the total budget and exactly where it has been increased——

Representative BOGGS. I thought maybe you had done that before you came.

Mr. BEHRMAN. No; I did not come to talk about the domestic budget.

Representative BOGGS. How can you separate them when you say the domestic economy is the answer to these foreign problems?

Mr. BEHRMAN. Simply because the dollar strength is determined domestically, Mr. Boggs.

Representative BOGGS. OK, then give me the answer domestically.

Mr. BEHRMAN. All right; the answer domestically is to reduce the inflationary pressure, the expansion of credit and the Government expenditure and to raise taxes, all four of them. Now, it has to be done to the point where the result is a rate of inflation under that of European countries, and that point is not determinable in advance; it has to be done by several methods; the piano has to be played with several notes and continuously—not one at a time.

Representative BOGGS. Let me understand exactly what you are saying. You are saying that travel restrictions, capital restrictions, withdrawing troops abroad, reducing foreign aid commitments will have no impact?

Mr. BEHRMAN. No, sir; I did not say all of those. I am saying that the capital restraints will have a minor impact, much less than has been claimed.

Representative BOGGS. What about travel restrictions?

Mr. BEHRMAN. Travel restrictions; I do not think we will get more than $200 million or $300 million out of that and it is at very heavy cost in terms of restrictions and——

Representative BOGGS. What about——

Mr. BEHRMAN. Withdrawing troops.

Representative BOGGS. Just a minute—the growing percentage of the export-import gap?

Mr. BEHRMAN. I am sorry, I do not get the question.

Representative BOGGS. The fact that our exports relative to our imports are now showing a considerable decline, almost alarmingly so in the fourth quarter of 1967.

Mr. BEHRMAN. Well, the gap has been cut largely by a rise in imports, Mr. Congressman.

Representative BOGGS. Of course.

Mr. BEHRMAN. Right. Well, not "of course." It could have been a drop in exports as well. But exports have continued up, not as much as——

Representative BOGGS. Not proportionately.

Mr. BEHRMAN. Right, and this is exactly what Professor Machlup is pointing out.

Representative BOGGS. I did not hear his full statement.

Mr. BEHRMAN. Well, the drop in our financial outflows has been matched by a partial drop in exports.

Representative BOGGS. Let me ask you this question because my time is so limited. Assuming that Congress reduces all of these items that

you will recommend to us later, and we still do not pass the surtax, will we strengthen the economy?

Mr. BEHRMAN. No, sir; I would not think you would strengthen the economy sufficiently.

Representative BOGGS. In other words, you are saying that the cornerstone of the whole problem is passage of the surtax and reduction wherever possible of domestic expenditures?

Mr. BEHRMAN. Expenditures and financial rectitude as well; that is, a reduction of financial pressure, inflationary pressures.

Representative BOGGS. What?

Mr. BEHRMAN. Reduction of inflationary pressures from the monetary system as well. These things have to be played together. But, Mr. Congressman, you cannot strengthen the dollar by playing around internationally. You must strengthen the dollar domestically.

Representative BOGGS. I am afraid you do not help us very much, professor.

Mr. BEHRMAN. The choice is a difficult one, Mr. Congressman.

Representative BOGGS. Unfortunately, you are dealing, as so many of us are trying to do in generalities. You have to spell these things out. You have to say where you are going to make these cuts. You know, you have had a lot of time to study this. If this is your position you should have given us some recommendations on where to cut, not just say "Cut." Anybody can say "Cut." It is like being for peace. Everybodoy is for peace, but the question is how you get it. That is all, Mr. Chairman. Thank you.

(Mr. Behrman later submitted this material for the printed record:)

In response to questions by Representative Boggs, I would like to offer three alternative approaches to reducing expenditures, in order of my own preference:

(1) Congress should promptly place a ceiling on total government expenditures for FY69—say, $2 billion above FY68. It should then appropriate only the FY68 levels for each agency, giving the increase wholly to DOD.

But, to assist the administration to expand programs which it considers highly desirable and to cut the less desirable ones, authority should be granted to shift funds from one Department or agency to another, up to (say) 5% of the agency's funds—that is, any one could obtain a 5% increase or sustain a 5% decrease. If military spending were to rise more, some other agencies would have to sustain a cut.

Further, a 10% shift of funds among bureaus of any given Department should be permitted so that higher priority projects could be expanded—but only at the cost of cutting elsewhere.

Finally, I would insist on a 5% cut in personnel levels (not payroll), within each agency, to be taken at the discretion of the agency head.

The objective of this technique is to provide a quick decision so that the public, business, and foreign countries can know promptly that the Government is acting strongly to reduce inflationary pressure. Most critics care less where the cuts come than that they come promptly. The transfers authority would reduce public criticism, as would the cuts in personnel. Of course, the administration might cut programs strongly desired by Congress, but this is a risk the Congress must take if it cannot determine itself where to make the cuts.

(2) As an alternative, I would insist that the Budget Bureau have all agencies rank their programs as to priority and then that the Bureau do the same for all programs. Congress could then focus on those of lowest priority, cutting sufficiently to keep total expenditures to only $2 billion over FY68. Again, the administration might select for down-grading the projects more widely supported by Congress, but such an action would nearly force the Congress to accept the first approach above.

The problem with this approach is that it takes time to make the determinations. I would, therefore, urge the Congress to agree quickly to a range within which total expenditures will fall—say $2 to $3 billion over FY68, so that all can see that the final result will be anti-inflationary.

(3) If the Congress feels it must select the specific programs to sustain cuts in order to raise military spending, two principles should be followed: one, that no cuts be made in those programs directed toward meeting social ills—poverty, health, slum clearance, urban renewal, etc.—but the Congress should give strong guidance toward the specific goals it expects to be achieved by these; two, that the primary cuts should be in programs which can be delayed without serious damage to any vital area of the economy in the short-run: highway construction, rivers & harbors, subsidies to shipbuilding, space exploration, SST, and oceanographic research and development.

If these are insufficient to cut the proposed budget by $8–$10 billion, Congress should accept that the quasi-wartime situation demands a delay in some longer term programs of educational assistance and should insist also on a careful husbanding (if not reduction) of military support programs which are not closely related to the effort in South Viet-Nam.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Gentlemen, I want to commend you all for very constructive statements. It seems you all agree, No. 1, that the gold cover should be removed, No. 2, that the measure taken by the administration to stabilize our balance of paayments are ineffective, actually, and only borrowing time.

I refer, Mr. Butler, to a statement that you make on page 2. You are speaking about controls of the character—you say, "Controls is in no way a lasting answer to our real problem. They buy time at a heavy cost."

You go on to say that the root cause of our troubles is inflationary pressures, inflationary upsurge due to the enormous rise in Federal defense and nondefense spending after 1965, and so on.

I have the same question, of course, that all of us must face here in the Congress: What do we do to reduce these inflationary pressures? The question has been put by Mr. Boggs about the reduction in taxes. I wish the rest of you would address yourself to that. Do you believe that the Budget can be reduced, that spending can be reduced, and if so, where?

Mr. BUTLER. Well, I believe that it can be reduced. Certainly, the increase in spending can be held down. One way to do it is just to put a ceiling on the rise in expenditures and a ceiling on every Government agency. I think you have to pay for whatever rise there is in the cost of fighting in Vietnam. You probably have to pay for the rise in interest costs. But I think it is perfectly feasible to set a ceiling on other Government expenditures, and I think a rise of $2 billion in spending would cover what is now contemplated in Vietnam, and interest, and that Government agencies could live with a ceiling.

I think a more sophisticated way to do it would be to go through each Government program, item by item, looking at the cost versus the benefits. I think this a very time-consuming and difficult process, but I do not see any reason why you cannot just impose a ceiling for a year, and I think this would be extremely beneficial.

I think in addition you probably need a tax increase. We have a deficit of $20 billion plus. This is what is raising questions around the world as to the integrity and viability of the dollar. We, in my opinion, need to take action to get this deficit worked down perhaps not to zero but down to a very small figure.

The combination of tax increase plus some ceiling on spending I think would bring this about. There has been a tremendous increase in Government employment in the past 2 years. I wonder whether——

Senator JORDAN. Would you care to put a dollar figure on it? What are you talking about when you talk about cutting expenditures? What kind of dollar figure?

Mr. BUTLER. The Budget has gotten so complicated that I must confess I do not understand it any more. But, if you take in effect the old administrative budget, which comes, under one line in the new sort of budget, I would say a $2 billion increase for fiscal 1969 over fiscal 1968.

Senator JORDAN. $2 billion is your estimate of what could be——

Mr. BUTLER. I would hold the budget, the spending increase to that figure.

Senator JORDAN. Hold the spending increase to that figure over the prior year?

Mr. BUTLER. That is right. This, as I understand it, would be $8 billion less than the administration is asking.

Senator JORDAN. Yes; it would be an $8 billion cut?

Mr. BUTLER. That is right.

Senator JORDAN. Of the amount of the President's requested budget of $186 billion?

Mr. BUTLER. That is right.

Senator JORDAN. Mr. Machlup, what would be your estimate of the amount that could be cut, if any, from the Federal expenditures, and where would you cut?

Mr. MACHLUP. I must beg off on the question of where to cut. I am not really a student of the Federal budget. What I do know is that it usually takes a long time for such measures to become effective. If we need quick action, then I think the tax increase is the only remedy that can be applied on the fiscal front.

I know that our chairman has expressed himself very much in opposition to it, but I must beg his pardon if I disagree with him on this question. We do need this tax increase very quickly, if for no other reason than for the effects on the balance of payments. Calculations have been made to show that, even if the tax increase should not reduce the rate of price inflation, it would have a balance-of-payments effect of about $1 billion. This $1 billion would be very helpful. So, even without any dampening effect on the wage-price spiral, the tax increase could lead to a $1 billion relief for foreign payments.

But there is in addition the effect on the wage-price spiral. The point is that, if business corporations are weakened by higher taxes, they are strengthened in their holding out against trade union demands. In other words, a business that has to pay a higher tax will have less funds and will be less capable of making concessions in the next wage negotiations. So, we actually retard the inflationary updrift of money wages. The best wage-price guideline would be to show business that it will not have a chance to pay the higher wages. I am strongly in favor of the increase in the income tax surcharge, because that is where quick and decisive results can be achieved.

Senator JORDAN. Professor Behrman, would you care to address yourself to the business of cutting the budget?

Mr. BEHRMAN. Well, Congressman Boggs put that monkey on my back a few minutes ago. I tried when I was in Government to cut the budget or parts of it. As far as the details go, again, Mr. Jordan, that I think has to be worked out in the bargaining of Congress with the

Executive. I would only say that the objective which we have before us is to make certain that the combination of fiscal and monetary policies pulls the inflation down to about 1½ to 2 percent a year.

Now, that may mean more of a cut or more of a tax or whatever, but it is the combination that has to be worked out with the Executive and Congress for that objective. To specify any one cut is to me not necessarily the answer.

Senator JORDAN. Administration witnesses appeared before the committee last week and said that a combination of tax increase and spending cut would result in overkill. Would you care to address yourself to that?

Mr. BEHRMAN. That in my view would depend on the magnitude of each, Senator. I do not know exactly what magnitudes they were testifying to at the moment, but it is certainly conceivable to me that a small increase in the budget as Mr. Butler indicated with a tax increase is not an overkill, but if you have a larger tax increase, 14 percent or whatever, and a substantial cut in the budget, you might have overkill. But this has to be played in an orchestration.

Senator JORDAN. Would you say that your suggestion of an $8 billion cut in the President's proposed budget plus a 10-percent surtax charge would result in overkill, Mr. Butler?

Mr. BUTLER. No; I certainly do not think so. I think it is a pretty big moose that we are shooting at, and that you need a fairly large-caliber weapon to deal with it.

Chairman PROXMIRE. Did you say "moose" or "mouse"?

Mr. BEHRMAN. Moose.

(The following letter was subsequently received from Mr. Behrman:)

THE UNIVERSITY OF NORTH CAROLINA,
SCHOOL OF BUSINESS ADMINISTRATION,
Chapel Hill, N.C., February 22, 1968.

Senator WILLIAM PROXMIRE,
Chairman, Joint Economic Committee, New Senate Office Building, Washington, D.C.

DEAR SENATOR PROXMIRE: I would like to respond more fully to Senator Jordan's question as to the possibility of an overkill through too much taxation or too heavy a cut in expenditures, and to Congressman Boggs' questions on where to cut expenditures.

What is needed to meet the problem of overkill is to introduce, through the surtax, some flexibility in the fiscal techniques. This could be done by passing a surtax of, say 8 percent, imposing 2 percent each quarter. Then, if evidence developed that the tax was acting too harshly on the economy, it could be removed or reduced the second quarter, and reimposed or left in abeyance the third, etc.

It would be better, however, to provide for automatic response in the tax to the economic changes, so that the imposition, reduction or removal of the tax for each quarter did not have to be debated each time by Congress and the administration. Automatic removal or adjustment could be stipulated according, for example, to the rate of inflation; thus, removal of the surtax could be provided if the price level remained stable for a quarter; or the surtax could be cut to 1 percent in a succeeding quarter if the inflation fell to an annual rate of merely 1 percent during a quarter. The surtax would be at its maximum if inflation occurred at an annual rate of over 2 percent in the preceding quarter.

With such flexibility, it is conceivable that Congress could be persuaded to pass a larger surcharge, say 12 percent, with 3 percent added in each quarter, leaving the law on the books for a longer period than a year. This would avoid the necessity of determining now when the surcharge should be revoked, and a higher surtax would assure the doubters that the U.S. Government fully intended to make the dollar internally sound.

I hope these comments may be useful to the committee in writing its report, and I would be glad to discuss them with you or the staff if desirable.

——— ———.

Senator JORDAN. Mr. Butler, would you be concerned with the January report that industrial production showed a decline of six-tenths of 1 percent, indicating that the economy is not so buoyant as has been anticipated by some of the people who have prepared the budget?

Mr. BUTLER. I think one can never take a 1-month change in the index of industrial production, or any of these other economic statistics as making a trend. Our view is the gross national product in the first half of the year will rise, a somewhat slower rise in the second half, but nonetheless, a rise. I think that one of the basic reasons for seeking fiscal responsibility here is in addition to its repercussions on confidence abroad, which I think are very important, but also this would get the Federal Reserve out of the business of financing inflation. With the size of the deficits that we face and we have had in the past year, the Federal Reserve has had to make it possible for the Government to finance the deficit, and in doing so, the Federal Reserve has increased the supply of money and credit in a very inflationary fashion.

One of the main reasons for asking for restraint on spending plus a tax increase is to enable us to slow the rise in money and credit to tolerable and reasonable proportions.

I think there is plenty of what new economists call aggregate demand around to keep business moving ahead, even with these measure of fiscal restraint and with proper monetary policies, I think you could slow down, over time, the rate of inflation, while not, hopefully, bringing on any recession.

I think the danger in not taking these fiscal measures is that at some point you will have to jam on the monetary brakes, and run very great risks of a recession which could be more difficult and intractable than the ones we have had recently.

In particular, if you run into a recession, with a $20 billion budget deficit, I think your ability to deal with the recession through fiscal measures is severely restricted, and I do not like to see our country running these risks.

Senator JORDAN. Thank you.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman. I, too, want to express our gratitude to these three excellent witnesses for the help they are giving us. I think a lot of the public may not realize that witnesses like this are very busy men, that the papers which they prepare for us are a labor of love, and I am very grateful.

Chairman PROXMIRE. If the Congressman will yield, I join in that wholeheartedly. I know they have spent a lot of time on their excellent papers; they are most useful.

Representative REUSS. I want to state that Mr. Butler and Mr. Behrman, particularly, have indicated their belief that it is essential that we keep our domestic economy from becoming inflated, and I certainly agree. I am ready to spend less, tax more, create less money, or whatever is necessary to do it, and I gather that Mr. Machlup agrees with that, too. However, I guess I may have the same minor quarrel with Mr. Behrman and Mr. Butler that I think Mr. Machlup has. Suppose we do all these things. Let us just stipulate that from here on out, domestically, it is going to be full employment without inflation. We are just not going to have any more 3- and 4-percent increases in the

indexes. Do you gentlemen really think that we can keep on running a $4 billion external military deficit in our balance of payments, and make it all up on our composite of our conventional accounts, that we can be mercantilist enough to run that kind of a trade surplus, and that somehow American tourism patterns are going to change and Americans won't want to go abroad any more, and, hence that we are going to get our tourism in kind of a balance somehow, or that American investors won't want to invest abroad?

I just cannot see how in the long run or in the short run we are going to get our balance of payments into shape just by pursuing the sound internal spending, taxing, and money policies that we all stipulate we need to start pursuing.

In other words, aren't we overlooking the biggest thing, namely our meddlesome propensities in the world, and as long as those propensities continue at the level which they are now at, aren't we in bad trouble on our balance of payments? Mr. Butler?

Mr. BUTLER. If I could speak first to this, hopefully briefly, I think you have a real point. We put out, as I remember it, $8 billion last year in economic aid and overseas military expenditures. I think we cannot conceivably, no matter how good our domestic policies are, support at this time $8 billion of overseas Government spending.

Now, $1.5 billion of this, or something like that, was directly related to Vietnam. Some of it was offset by tying aid to exports or foreign purchases of military things here, but, nevertheless, it seems to me that, short of greater agreement on the part of other countries to aid in the support of the defense and economic development of the free world, we cannot afford $8 billion.

I think if we could get an end to the conflict in Vietnam, we would save roughly $1.5 billion. I think if we were to review our other overseas commitments, that we might find some way to reduce them by, say, a half billion dollars. In balance-of-payments terms every billion dollars counts, obviously. I think we could probably assume that we could support $6 billion of military expenditures plus economic aid at the moment. I think this could increase, over time, in a very useful way.

I think this does not necessarily mean reduced support on our part of economic development. I think it can increase the flow of private investment, and that you can improve the efficiency of the moneys we would then spend under economic aid. But I would agree that prerequisite for getting our balance of payments under control is some review and reduction in what we are trying to do overseas.

I do not think that this need means a reduction in travel or international investment. Our international investment, I think, pays off very, very handsomely. I would like to support what Jack Behrman said. We did an extensive study of the balance-of-payments impact through the operation of international oil companies which showed a very big and very quick payoff for the moneys that we put out in terms of investment in international oil. I think we can support the travel drain. I think we need to do what we can to encourage people from other countries to travel here. As their incomes rise I think this will naturally increase. I do not think we have to, as you put it, reduce our propensity to invest in travel overseas. But, I think we have to reduce, at least for the time being, some of our military and perhaps economic aid commitments.

Representative REUSS. Mr. Behrman, would you agree that, though you manage the domestic economy ever so well, nevertheless the trade, investment, and tourism accounts—the conventional accounts, so-called—are not likely to yield a sufficient surplus to enable us to live in the imperial military style to which we are currently accustomed?

Mr. BEHRMAN. Mr. Reuss, I would say that if that volume of expenditures continues to increase as it has in the short term recently, that we could get into serious trouble. I would argue, however, that we could sustain some pressure had we done what your prescription states, that is, to maintain inflationary levels in the United States less than had occurred in Europe in the past 2 years, 1966–1967, as the importance of which was stressed even by the Economic Report of the President; the inflation had a very strong impact on the balance of payments.

Representative REUSS. Although you yourself did a pretty good job of debunking that when you pointed out the effect of the copper strike and the effect of steel purchasing and so on?

Mr. BEHRMAN. Certainly, they had an effect, but there is also an inflationary impact in the sense that the export surplus declined because of imports.

Let me put it this way. My first point is that even if we are in trouble, controls won't do the trick.

On the second point, I have to agree with you, we can get ourselves in deeper trouble if we continue to accelerate Government expenditures which have no payback whatsoever.

But the third point is that, if the United States were doing what you prescribe, and I think this is an absolute necessity, the dollar would be held abroad in larger amounts than it has been in the past, the dollar would have supplied international liquidity which the SDR was to supply, we could afford assistance to less developed countries—private investment has a quicker payback there than my table indicates—and the gold outflow would have been less because the dollar would have been a stronger dollar.

Further, I would say that we would be in an even stronger position today had we not cut back the export drive in 1965–1966 which we did, and had we not been giving signals to business all along that you may export but you may not follow it with an investment. But the data show quite clearly I think that investments pull exports and that in fact the same industries are both high exporters and high investors. They are the technologically advanced industries. There is almost a cyclical development as an industry goes overseas with exports: as your new items begin to die a bit in terms of their usefulness in the United States, you begin to pick them up in investments abroad, so that there is a pull two ways. Exports will mean investments later, if exports do go up; and investments pull exports.

So expansion would put us in a better position than the controls have done and will do; even if we have the pressures you talk about from military expenditures, we would be in a better position to reverse our current policy.

But I would have to agree with you that we can put ourselves into great difficulty if we continue public expenditures abroad with fiscal irresponsibility at home.

Representative REUSS. Thank you. Now, let me turn to Mr. Machlup, who like myself does not believe that merely ridding our domestic

economy of inflation, desirable though that is, will in and of itself cure our balance-of-payments troubles, and I gather that Mr. Butler and Mr. Behrman do not hold out that hope either.

Let me ask Mr. Machlup this. Even if we went to your fourth alternative of a gold conversion account in the IMF, and thence to less rigid exchange rates, wouldn't the United States still have a problem if it persisted in its grandiose, swollen, meddlesome, costly political-military adventurism around the world? If we are going to spend $4 billion-plus in military adventures alone, do you think that we are likely to be able to recoup offsetting surpluses in our conventional balance-of-payments account?

Mr. MACHLUP. Yes, sir; I believe this is possible. Don't forget that $8 billion is only 1 percent of our gross national product. For a long time this 1 percent figure has been mentioned as the minimum foreign aid that a nation should grant. So, I definitely believe that we ought to be able to afford it. It is only a question of the relation between the income and price level here and the income and price levels abroad. That relation will be the strategic variable in allowing the adjustment of the trade balance to the financial transfers.

Representative REUSS. Aren't you advocating something awfully mercantilist though? Here you want the United States to run stupendous surpluses on trade.

Mr. MACHLUP. Yes, I do; but it would not be mercantilist.

Representative REUSS. You said in your paper that the Europeans are not going to do idiotic things, that they are pursuing anti-inflationary policies, some even more successfully than the United States. But let us assume we all manage our economies successfully and do not have inflation at home. Do you really expect that the United States can run trade surpluses of almost infinite amount?

Mr. MACHLUP. This is not so much of a trade surplus compared with the gross national product.

Representative REUSS. Is that the proper thing to compare it with?

Mr. MACHLUP. I think it is.

Representative REUSS. I should think it is the amount of trade done in the world.

Mr. MACHLUP. I think it is the proper thing, and I think it is likewise for the rest of the world to make these comparisons. It is quite true that some other nations have not made enough appropriations for foreign aid, though others have been doing better than we.

Now, there is no doublt that some nations of Europe have been very much in surplus on current account, much more than they should have been, compared with their outflow of capital. So, I think they will have to get used to smaller current-account surpluses. But they may continue to have current-account surpluses because, after all, it is the developing world that will have the current-account deficits.

Mr. BUTLER. Could I add a point which may be useful? I mean this is not a sort of mercantilistic approach. We are trying to run a surplus to finance what we give away in support of the defense and economic development of the free world. If we ran a surplus to pile up gold or to pile up reserves then it would be mercantilistic, but what we are trying to do is to run a surplus big enough to support this outflow. This does not necessarily, well, it does not reduce world production and trade. It indeed enhances world production and trade, so

90-191—68—pt. 2——8

that I think it is a perfectly viable sort of situation. The problem really is the level at any one time. My argument would be that it is a little too big at the moment. But I would hope it would be as big very shortly as it is now, in a viable sort of way.

Representative REUSS. Could I have another minute or two?

Chairman PROXMIRE. Without objection, go right ahead.

Representative REUSS. To all this I say "Yes" to Mr. Butler and Mr. Machlup, but it seems to me you do not sufficiently differentiate between the mirror image of our deficits; that is, somebody else's surpluses. Foreign aid to Ecuador comes back to us. That is great. I am all for that. But keeping troops in surplus Germany? Just talking economically, I do not see how that bread on the water comes back to us in balance-of-payment terms.

Mr. MACHLUP. I think, sir, we should not decide our foreign policy in terms of balance-of-payments considerations. It would be a very severe restriction on our foreign policy if we always said "before you do anything, look whether our present balance of payments can afford it."

I cannot say as an economist whether it is the right policy or the wrong policy to keep troops in Germany. But if it is right for other reasons to keep troops in Germany, we should not say that the balance of payments is such that we cannot afford it.

It is a question of the foreign-exchange rate or, alternatively, it is a question of the rate of inflation here and the rate of inflation abroad, and these things can be adjusted.

Representative REUSS. While you may not want to stop doing a thing otherwise determined to be wise and necessary——

Mr. MACHLUP. Right.

Representative REUSS. From the standpoint of foreign policy because of its balance-of-payments impact, certainly the statesman making this decision should know what the balance-of-payments impact is; should he not?

Mr. BEHRMAN. Yes, sir.

Mr. MACHLUP. He should know what the impact is, but still he should also know what it is in relative terms. The present deficit in our balance of payments is only one-fifth of 1 percent of the gross national product. This makes a difference.

Mr. BUTLER. Somebody said it is a small thing but like an inch on the end of your nose.

Representative REUSS. In large part the recent proposals of the President seek improvement through measures involving private investment and private travel. In addition, the President has promised renewed negotiations with our NATO allies to minimize the foreign exchange costs of keeping our troops in Western Europe and in an altered context, dollar expenditures in Asia as well. The results of such negotiations will depend upon the cooperation of our allies; but if the private sector is to be asked to reexamine and curtail its plans there is an even greater obligation on Government to put its own part of the international accounts in the best possible order.

Dr. Joseph Aschheim, of George Washington University, has prepared a memorandum entitled "The Dollar Deficit and German Offsetting." His memorandum cannot help but throw light on the Government's place in the foreign exchange picture and thereby con-

tribute to the discussion of remedies for the overall balance of payments problem. I, accordingly, ask that it be included in the record.

Chairman PROXMIRE. Without objection, it is so ordered. (The memorandum referred to appears as part 4 of these hearings.)

Senator Miller?

Senator MILLER. Thank you, Mr. Chairman. Professor Machlup, you stated that there are some who believe that 1 percent gross national product ought to be about the amount of foreign aid. Do you share that belief?

Mr. MACHLUP. This is a normative statement, sir, and the question is whether, for humanitarian reasons and from a world outlook, we believe that more should be done for the development of backward nations.

Economists usually eschew taking such a normative point of view and confine themselves to analyzing the implications.

If you ask me, as a citizen, whether I believe that a rich person should give to the poor and that a rich country should give to poor countries, I would say "Yes." As a citizen, I approve of such policies. And, as an economist, I can say that the economy can make it possible to pursue such policies.

Senator MILLER. Well, as an economist you certainly recognize that there might be other factors to be taken into account in determining whether in one particular year this should be 1 percent or 5 percent or 3 percent or possibly even none, wouldn't you?

Mr. MACHLUP. As an economist I would say that the reduction of such items will not necessarily lead to a reduction in the balance-of-payments deficit. Sir, this is similar to what we hear now, constantly, about the effects of our Vietnam expenditures. As a citizen, personally, I am not happy about the whole Vietnam situation, and probably few people are. But, as an economist, I would not expect that a termination of our military operations in Vietnam will lead quickly to an improvement in the balance of payments. There may be strong offsetting changes. If we spend less in Vietnam for military purposes, we may spend more for economic aid. But, if we spend neither for economic aid nor for military purposes, then the Vietnamese will buy less, and other people will buy less, and our exports will decline. In addition, we will probably increase expenditures at home, and our imports will increase. So there may be offsetting changes in our balance of trade.

Thus, while the administration and others have great hopes that a cessation of our operations in Vietnam will quickly lead to an improvement in the balance of payments, I do not share this hope. I expect some slight improvement, but the improvement will probably be only a part of our reduction in military expenditures.

Senator MILLER. Do you have any figures on how much the Vietnam war means in terms of the balance-of-payments deficit?

Mr. MACHLUP. No, sir; and no one can have exact figures. We have figures for direct expenditures. That we do know. But we do not have the figures for the indirect effects for all that the military expenditures abroad and the defense expenditures at home do to other accounts of the balance of payments. These indirect effects we can guess, but we cannot know them.

Senator MILLER. It seems to me I have heard a guess by some administration officials that the figure of $2 billion is the impact on the balance-of-payments deficit of our expenditures in the war in Vietnam.

Assuming the validity of the guess, it would appear that if the cessation of hostilities would mean almost a complete drop or a very large drop—let us say over half of the outflow of funds to Vietnam—that this would perhaps have a $1 billion impact, which would be rather substantial; would it not?

Mr. MACHLUP. I do not know whether the guess of $2 billion is a good guess.

Senator MILLER. I know. That is why I said assuming the validity of that.

Mr. MACHLUP. Assuming the validity means trusting the guesses of the feedback effects, and this makes it all so hazy. We do not know the feedbacks. We do not know, if we spend $2 billion, how much of it comes back in the form of payments for American goods and services. On all these things we are very much in the dark, and we could not say what the impact of a cessation of military operations will be.

I would like to repeat that I very much hope for a cessation, even if I do not think that this would have such an enormous effect on the balance of payments.

Senator MILLER. You are covering your statement by saying "such an enormous effect," and in all fairness I do not know of anybody in the administration who has made the claim of an enormous effect. The only point I want to bring out is that it could be a substantial effect, in the neighborhood of $1 billion, and if it would be in the neighborhood of $1 billion this would certainly be a substantial impact on our balance-of-payments deficit.

Mr. MACHLUP. You are quite right; $1 billion is a lot of money.

Senator MILLER. You stated that there are other nations that are doing better than 1 percent of GNP. They are doing better in relation to their economies than the United States.

Mr. MACHLUP. Yes.

Senator MILLER. Are any of those nations involved in a war?

Mr. MACHLUP. No, sir.

Senator MILLER. Well, then you recognize that the impact of a war on the economy of a country can make a lot of difference in whether it can do as well or better than this 1 percent, do you not?

Mr. MACHLUP. I agree fully with that.

Senator MILLER. Another question: In the last 7 years, according to the figures from the Treasury Department, the purchasing power of the dollar has declined from approximately 47 cents to approximately 40 cents. Would this not have an impact on the desirability of foreign dollar holders to turn their dollars in for gold?

Mr. MACHLUP. To answer this, we would have to make certain distinctions. First of all, between official dollar holders and private dollar holders, and secondly, among different reasons for which these private dollar holders hold their dollars.

Most of the private dollar holders would not be greatly concerned by price increases within the limits that we have had during the last few years, because their own countries have had much greater price increases in terms of their currencies. In other words, they would not have fared better if they had held French francs or if they had held Italian lire. The point here is again——

Senator MILLER. Wouldn't they have fared better if they had held gold?

Mr. MACHLUP. They would not. The people who have held gold have made the most terrific loss. I have made calculations which show that someone who bought gold in 1954 holds now approximately one-fifth of the amount of wealth that he would have if he had bought American stocks on the New York Stock Exchange, of an average composition, the one used for the Dow-Jones index. So, anyone who bought gold was an absolute idiot. I cannot take it back. He was just an idiot. He has now only one-fifth of what he would have had, had he invested in the American stock market.

I do hope and pray that he will be an idiot also in terms of the future, because that depends only on you, gentlemen. If you will not raise the price of gold, then the price of gold will not be raised, and the gold speculators will turn out to have been very stupid indeed.

Senator MILLER. I do not want to interrupt your thinking, but you were talking about a foreign dollar holder.

Mr. MACHLUP. Yes.

Senator MILLER. Who in 1952 had invested in American stocks as distinguished from his investment in gold?

Mr. MACHLUP. Yes.

Senator MILLER. Now, what about an American dollar holder who had invested in stock? Would he have been as idiotic as his foreign counterpart?

Mr. MACHLUP. No. The American dollar holder would have been very right to invest in American stock.

Senator MILLER. Well, instead of that, suppose he transferred funds to Switzerland and ended up owning gold bars in Switzerland?

Mr. MACHLUP. He is a capital idiot.

Senator MILLER. Would he have been just the same as your foreign counterpart?

Mr. MACHLUP. He would have been not only an idiot but he would have broken the law of the United States at the same time.

Mr. BUTLER. Even if he had invested in Treasury bills, which are sort of the lowest yielding assets, again I made some computations. For the past 10 years, had you held gold, the value of your holdings would have gone down something over 20 percent. Had you invested in Treasury bills, it would have gone up by some 20 percent.

Mr. BEHRMAN. I would like to get into calculations, too, Mr. Miller, if I may. I made a few about what would have happened in the United States, if we had sold our gold right after the war to the rest of the world and held francs and lire and pounds. We would have come out, even with the revaluations, now holding $20 billion worth of assets and could have met all of our deficits out of the interest.

Mr. MACHLUP. In other words, to get rid of gold is the best business.

Senator MILLER. You made a comment which indicated that we ought to have, as a target, the management of our ecnomy so that we would have inflation of 1½ to 2 percent a year, I believe.

Mr. BEHRMAN. Yes, sir. I picked that figure simply because that would put us below the rate of inflation of the European countries and that is the comparative level that is important internationally.

Senator MILLER. You are thinking in terms of the balance-of-payments deficit proper when you make that statement?

Mr. BEHRMAN. Yes, sir.

Senator MILLER. That does not mean that you would advocate as far as our own citizens were concerned an economy that would result in a 1½- to 2-percent inflation rate a year; does it?

Mr. BEHRMAN. It is not that I suggest that we ought to have that high a degree of inflation for domestic purposes; no. I am saying that even that high a degree of inflation I think would put us internationally safe because it would be lower than the others.

Senator MILLER. Wouldn't it be preferable just not to have any inflation at all?

Mr. BEHRMAN. Well, as an economist I like a stable price level.

Senator MILLER. Sir?

Mr. BEHRMAN. As an economist, and as a citizen, I like a stable price level. I recognize at times it may be economically desirable to inflate a little to move the economy along, but this is a policy decision which is against the principle of a stable currency; yes.

Senator MILLER. That is one thing that bothers me when you say at times it might be desirable, because to me the Federal Government can take purchasing power away from the people either by inflation or by taxes.

Mr. BEHRMAN. Yes, sir.

Senator MILLER. And I am wondering why there would be times when it would be better to take it away by inflation than by taxes, especially in light of the statement by the President of the United States that inflation is the cruelest tax of all. Why would it be desirable to use the cruelest approach of all?

Mr. BEHRMAN. Well, this goes back to the impact of monetary and fiscal policy in a situation of relative depression or of stagnation where you want to move it up, and if one of the reasons why you are having a stagnation or a slight recession is people's desire for money, just plain liquidity, then one thing you want to do is to give them that liquidity, which means an inflating in the money supply, and that itself may lead at times to some inflation just to sop up the liquidity. We see the same thing internationally now.

Senator MILLER. What you are really saying it that there are times, in a situation like this, when we should use the cruelest approach of all.

Mr. BEHRMAN. I am suggesting that taxation at that time will not solve the same problem. In fact you are removing liquidity at that time when you should be supplying it.

Senator MILLER. Do we have any other choice except to use the cruelest tax or the cruelest approach at all? Is that the only alternative?

Mr. BEHRMAN. What I am saying is that in times of a depression, Mr. Miller, that the inflation is not a cruel tax, taxation might be even crueler at that time.

Senator MILLER. In other words, the statement by the President that it is the cruelest tax of all does not mean that there might not be occasions when we should use the cruelest tax of all approach; is that what it gets down to?

Mr. BEHRMAN. I am suggesting that the "cruelest" adjective applies to certain situations, not to all situations.

Senator MILLER. I see. Well, I do not remember that the President qualified that.

Mr. BEHRMAN. No; I am sure he might not have in this circumstance.

Senator MILLER. My time is up, but I hope I can ask a few more questions and I do appreciate the fine answers.

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman. The few questions that I will ask I propose that all of you answer. I think they are pretty much in point. Would you support imposition of a temporary import surcharge or a system of border taxes?

Mr. MACHLUP. No, sir; I would certainly not. I would say that this could even increase the deficit in our balance of payments, because it could lead to retaliation. Except, of course, if you can, in advance, secure agreements from our major trading partners. If they agree through GATT that we will be permitted to do this as a balance-of-payments measure, and the other nations accept it and will not retaliate, then it might be of temporary use. But let me immediately add that it would be a most inequitable and most unfair measure to take, because it would increase the protectionist effects of our tariffs and, therefore, the distortions in the use of our productive resources.

If you were saying you would like to have a tax on all imports, that would be something else, but a surcharge on import tariffs is very different, because there you change the differences between prices of different imported goods and homemade goods, and the products that already have protection would get more protection. So that would be a very harmful thing to do, and I would hope that the Congress would never consider such a move.

Representative WIDNALL. Mr. Butler, what is your reaction?

Mr. BUTLER. I agree completely. I think it would be a great mistake.

Mr. BEHRMAN. I also agree.

Representative WIDNALL. What would be the impact of the curbs on foreign investment on U.S. interest rates and on interest rates abroad?

Mr. MACHLUP. The impact of our curbs on capital outflows?

Representative WIDNALL. On U.S. interest rates and on interest rates abroad.

Mr. MACHLUP. Well, there is no doubt that any reduction in the outflow of American capital must make interest rates abroad higher than they otherwise would be, and if these interest rates should rise substantially, that would lead to an outflow of foreign capital from the United States, which would partly defeat the purposes of the initial restraint.

Mr. BUTLER. Interest rates in Europe have not risen since the imposition of these controls. Euro-dollar rates are down from the level that they were. I think this is important because foreign central banks have been feeding money into the Euro-dollar market. I would agree with the longer term impact that Dr. Machlup suggested, and there has been an increase in American companies borrowing in Europe, and in time I think this will lead to higher interest rates, but it has not to date.

Representative WIDNALL. Mr. Behrman?

Mr. BEHRMAN. There is an ancillary impact, and maybe Mr. Butler will indicate agreement in the same analysis, but there is an impact through the diversion of flow of capital. For example, Canada sustained a substantial outflow after our recent mandatory controls,

which the Secretary of the Treasury indicated came to the United States, but it also is indicated by the reduction in European interest rates that it flowed to Europe. This increased their supply substantially, keeping the interest rates down, but this put a terrific burden on Canada. So what we did was to say capital shall not flow from the Untied States, causing it to flow out of Canada, and now causing us to be concerned with the Canadian balance of payments. So these things have various repercussions which need to be traced out.

Representative WIDNALL. How much of a serious decline in our trade surplus during the fourth quarter of 1967 do you think is accounted for by deterioration of our competitive position in the world? What were the key factors?

Mr. MACHLUP. I would attribute it chiefly to two things. First to the increase in business activity and employment in the United States, the increase in incomes and spending within the United States, which increases our imports.

I attribute it, secondly, to the slack business activity in some of our European markets; especially Germany had a very bad year and, therefore, their purchases, their imports, fell, which means that our exports could not rise as much as they would otherwise have. So I attribute the recent decline in our export surplus less to a permanent deterioration of the competitiveness of our industry, and more to the changes in business activity here and abroad.

I must, however, add immediately that we have had a rate of wage increases during 1967, and expect a rate of wage increases for 1968, which may actually lower our competitiveness relative to foreign countries.

Representative WIDNALL. Mr. Butler, the figures that you have been compiling show enough to indicate where our competitive position has deteriorated. There are a number of items as against where our competitive position has held firm or has improved. Do you have any figures on that?

Mr. BUTLER. I am afraid I do not have them in mind. I think there has been a clear deterioration in steel, for example, in shipbuilding, some lessening of our competitive position in the general machinery area. I think it has not as yet affected things such as business machines. In the so-called high technology areas I think we remain very competitive.

Part of our problem in the fourth quarter was the copper strike and to some lesser extent the forthcoming labor-management discussions in steel which led to an increase in steel imports, but these two things can be fairly big in a fairly short time.

I think our problem is not that our competitive position has eroded so very greatly so far. It is that if we continue these policies and continue the rise in our costs, our competitive position in a few years will be very seriously eroded. If we could check it now, then I would have quite good confidence in the future. But, if we do not check it, I think we are clearly headed for trouble, and the time to deal with it is now and not 2 or 3 years from now.

Representative WIDNALL. Isn't there almost an alarming increase in the amount of services furnished as against goods produced? With the production of goods going down in many areas but balanced to some extent by the furnishing of services, that part of our economy is the healthiest as against the production of goods?

Mr. BUTLER. I do not know. I engage in production of a service which I think is quite valuable.

I think one can go too far in making this distinction. I mean, I think services can be as valuable as goods, that services we perform overseas bring us, in many cases, very good returns. I have never found this a very useful sort of distinction. I think what you want to produce are the things that contribute to your material well-being and your quality of life, and that many of these are services. I do not find it at all uncomfortable to see the relative production of goods decline while the relative production of services increases.

Again to some extent we are into statistical problems. One can never be quite sure what a goods is as opposed to what a service is. But I do not see any way in which this contributes to our basic, say, balance-of-payments difficulties or other difficulties.

Representative WIDNALL. Hasn't a lot of our trade surplus in the last few years been dependent upon the sale of airplanes?

Mr. BUTLER. Yes.

Representative WIDNALL. The sale of agricultural products, sometimes at subsidized prices?

Mr. BUTLER. Yes.

Representative WIDNALL. As I look at the figures, I am just worried that we seem to be getting ourselves out of the market in more than one field. We just concentrated and depended upon just one or two items for our trade surplus.

Mr. BUTLER. Yes. I think the sale of airplanes is a perfectly competitive deal. We produce better aircraft than other industrial countries. We sell these aircraft for dollars.

Now, we have given away a lot of argicultural products, and we continue to give away some. In looking at our trade surplus, and I think one has to take account of this and in effect take out what we give away from the real surplus, and to the extent that one does not do this, the overall figures can be misleading. A friend of mine in the Agricultural Department said that the problem now is to give it away cheaper than anybody else.

Representative WIDNALL. That is probably true. My time is up.

Chairman PROXMIRE. I would like to ask each of you gentlemen to take a crack at what is my bias perhaps, but one which is, I believe, shared by the overwhelming majority of the American people and by many Members of the Congress; it is that we should not pass the surtax; but I would like to ask you to confine your remarks strictly to the balance of payments. I feel that the argument is especially sharp and clear against the surtax on this issue.

I want to say why. No. 1, the sure and swift impact of a surtax would be to reduce the profitability of American investment. Obviously, if you imposed a surtax on corporations of 10 percent of the present tax, it sharply and directly and immediately cuts their profitability and discourages investment here and encourages investment abroad and results in an outflow of capital.

In the second place, the argument has been made that the one thing the surtax will accomplish—it was made here by Mr. Butler I think and it is often made by bankers—that the one thing the surtax would hope to accomplish would be to reduce our interest rates.

This may be true and it may be very beneficial and desirable but from the standpoint of balance of payments I cannot see why that would be an advantage. If our interest rates were lower than they are abroad, obviously capital tends to flow out. People would be less inclined to invest here, and more inclined to invest abroad.

In the third place, I think there is a clear case that to the extent that profitability is not reduced—that is, that the tax is passed on to the consumer—it will increase the cost of American goods, and, therefore, tend to diminish our advantage in competition with goods produced abroad and imported here; so, it will tend to discourage our exports and encourage imports.

Now just one other aspect to this question, and that is, let us see what it seems the surtax is designed to do. No. 1, the administration witnesses always say it is going to cut our imports. Is it? It will only cut our imports, it seems to me, if it reduces spending by our consumers. It will reduce their income but will it reduce their spending? Spending patterns are stubborn. They are hard to change. They change only over a period of time. The propensity to save was great last year. It is perfectly possible that the reduction in spending is going to be slow and gradual and not very sure.

But I think that the weakest part of the argument that you need a surtax in order to help our balance of payments is the kind of inflation the surtax is supposed to slow down. How is the pricing made on commodities that we sell overseas? Many of them are foodstuffs. In fact, a very large portion that we sell overseas is food. You are not going to reduce the price of wheat or the price of feed grain by any kind of a surtax. We all know it is not going to have any effect on that.

You take chemicals and machinery; there, I think, you cannot make a very strong case that the surtax is going to reduce the price in view of the pricing practices that we have found in those industries.

As far as imports are concerned, with steel, and the kind of foods we take in—coffee, tea, and so forth—the others that we do not have in this country—paper base stocks—which we are going to import in greater amount without much regard, really, to small change in price—rubber, minerals, fuel—and, of course, machinery and autos that come in; here again you have, it seems to me, a very weak argument that our surtax, by stemming our inflation, is going to have a retarding effect on imports or a beneficial effect on exports. Now, what is the case in favor of the surtax from the standpoint of balance of payments? Let us start off with Mr. Behrman.

Mr. BEHRMAN. Well, may I start off with encouraging investment abroad, your first point? Reduction of the profit rate here by surtax will certainly make a comparative difference in the profit rates. But, from my own investigation, Senator, I cannot find any good or clear correlation between the profit rates in the United States and Europe, and the flow of direct investment.

Most companies look at investment on a very long-term basis, and not at the immediate, this year or next year, profit return. There are even those who would indicate that a tax on their investments would not slow it down significantly. It is too important a long-term objective to get there to worry about differences in profit rates for any definite given period of time. I do not think it would have a very serious effect

one way or the other on the outflow of investment. It might cause some companies to look at it.

Chairman PROXMIRE. If I could interrupt at this point—isn't it true, however, that the deterioration of the profit ratio by European firms in the last year or so dropped from 1966—the 1967 figures apparently are not available—and the increase in investment here tended to be a good, natural free enterprise factor in encouraging more investment here and somewhat slightly perhaps discouraging investment abroad?

Mr. BEHRMAN. Sure. This is a free enterprise reaction. What I am suggesting is that we do not have enough information about the commitments of companies and what caused them to go to say that the decline of profit rates in Europe causes a decline in investments in——

Chairman PROXMIRE. Yes; I was not talking so much about the Ford Motor Co. or United States Steel. I was talking about an investor, sophisticated enough and so forth to invest here or abroad?

Mr. BEHRMAN. A portfolio investor looking at stock? Certainly, this would have an effect. Now, as to the reduction of interest rates: certainly, the increase in interest rates abroad and the decrease in interest rates here is going to pull capital out of the United States into Europe. By the same token, if—and this gets to the heart of your presentation—if the inflationary impact of the surtax or rather the deflationary impact of the surtax is adequate this would bring the money back in terms of export sales, services, or whatever else. The real question, as I see it, is one that you pose, and that is, Can the surtax itself have an adequate dampening effect on the inflation of items which affect the balance of payments?

Let me address myself to the two: the exports and the imports. I would tend to agree with you that our export structure, given the fact that there is a heavy element of agriculture and on the other hand a heavy element of technologically advanced goods which are priced on almost a tailormade negotiated basis dampens the significance of inflation or deflation on exports of the United States; that is, United States prices. What is more significant are the foreign prices, and the competitor's prices vis-a-vis the United States itself. If their prices are going up rapidly vis-a-vis the United States then there is pressure to look at the U.S. supplier. I would count that more significant from the selling standpoint than the U.S. price level, because, as you say, it is often an administered price.

But, by the same token, reverse it and put the United States in a situation of having inflation. This creates a pull on imports, on a variety of things which are not in the raw material area alone nor even in the agricultural area, but are in the consumer line; and this is why I think we have, besides this copper strike, a substantial increase in imports, notably even in December, as a result of successive inflation.

Now, if you could dampen consumer spending by the surtax, then this would also have an impact on the imports particularly. This is where I think the balance-of-payments effect is more likely.

It is also likely in terms of inflationary effect on tourist spending. If you can have a reduction of prices in the cost of vacation here, as compared to the other areas, then there is an impact on tourism. I would like the others to go on from there, or contradict me if they wish.

Mr. BUTLER. Again, I agree in general. I think that if you continue the sort of inflationary policies that we have run for the past 2 years, you are bound to have unfavorable impacts.

Chairman PROXMIRE. If I could interrupt at that point, Mr. Butler. I am refering to your prepared statement which I thought was very interesting because you have really suggested four proposals: (1) to cut spending sharply; (2) to pass the tax surcharge; (3) to restrict the rise in money and credit; and (4) to reduce our overseas military expenditures. I agree with three out of four with great force, but it is the surtax as far as the balance of payments is concerned that seems to me to be peculiarily unadapted to meeting our problem.

Mr. BUTLER. Well, I do not necessarily insist on the surcharge. I mean if you could do enough through cutting Government spending to get our deficit down to manageable proportions, then I think you would not need the surcharge. I think the important thing in terms of our balance of payments is the rate of inflation which will be necessarily associated with the size of the deficits that we are running and will continue to run unless we take action on cutting spending, raising taxes, or some combination. But it is the size of the deficit that I think is the critical thing.

If you can find ways to cut it down by reducing spending, then I would say that you do not need the surcharge. I am enough of a skeptic about our ability to cut spending that it is my personal belief that you need both, but you need them to reduce the overall deficit, the inflationary pressure that is inevitably generated by this deficit, and its longer term effects on the balance of payments. I think it does not hit the balance of payments very quickly, although there is some evidence in the figures of last year that it had an impact. I think if we could stop the inflation fairly quickly, that we would not suffer permanent damage, but I think if we do not stop it, we will have permanent damage, and it will not take very much longer to lead to this damage.

Looking at the surcharge itself, and there are many ways that one can raise taxes, at the moment I suppose that an across-the-board increase is perhaps the simplest and clearest way to do it. It will have effects in many ways, and in some of the areas you mentioned it will not. I mean I do not think it will have any immediate effect on foreign prices as you indicate.

On the other hand, I think it will, in combination with other measures of reducing the deficit, so reduce overall demand and overall inflation as to have a beneficial effect on our balance of international payment.

Chairman PROXMIRE. Mr. Machlup?

Mr. MACHLUP. Let me first pay you my respects, Senator, for the openmindedness and scholarly attitude with which you invite criticism of your own position. I think this is really most fair, and I bow to you.

But let me then proceed to that criticism. I agree with Jack Behrman about the rate of profit or profitability of American industry, and its effect upon capital movements.

We have had experience with such matters in the past, when we argued for a tax cut in 1963, and in 1964, when we actually cut taxes. Then it was argued that the tax cut would increase American profitability relative to that abroad, and that this would invite capital flows to the United States, which would offset the effects upon the trade balance. This was said by two Presidents and by their Secretary

of the Treasury, and several advisers—but, it was palpably wrong. It did not do it in fact, and I think it was a poor argument in theory.

Chairman PROXMIRE. Were you able to isolate that factor? How do you know it was wrong? The balance of payments improved when taxes were cut. He was right then. He must be wrong now.

Mr. MACHLUP. Well, we have seen that capital outflow increased after the tax cut.

Chairman PROXMIRE. But there are always so many elements involved.

Mr. MACHLUP. That is correct; but they said they would expect capital outflow to decline and capital inflow to increase, and we know that on both accounts the opposite took place. American capital had a bigger outflow and foreign capital had a smaller inflow, so we have definitely seen that the argument was at least not supported by the experience that we had soon thereafter. I would say, moreover, that on theoretical grounds the argument was not too strong.

Chairman PROXMIRE. That coincided at the time with a number of other things.

Mr. MACHLUP. I grant you that.

Chairman PROXMIRE. Including the Vietnam escalation, including a tremendous boom in plant and investment here, and so forth.

Mr. MACHLUP. Exactly. The investment boom here ought to have attracted foreign capital according to the argument, but it did not. I would say one should never rely on these supposed probabilities. Take your point about interest rates. The argument that interest rates will rise if we do not get an increase in taxes is correct, but you say, "all the better, the higher interest rates will invite an inflow of capital."

I would say that this would be a help in financing the deficit in the balance of payments for a very short period. We cannot, through short-term variations or differentials of interest rates, reduce the deficit. They may temporarily lead to movements of capital which, however, have no longrun influence on the balance of payments.

Your third point was about the incidence of the tax increase. We know so little about that. We know not enough about whether there will be a shifting of the increased corporate income tax onto the consumer. We do not know. I am doubtful about it, but I could not possibly take a strong position on this question.

Mr. BUTLER. In the short run?

Mr. MACHLUP. In the short run, certainly not. In the long run, shifting would be likely. But now comes the main point against which you argued. You questioned that the tax increase would really cut imports, that it would really cut domestic spending. I cannot see how it could fail to do that. If you take billions of dollars away from individuals and corporations, at least the individuals have no way of recouping that. They cannot all go to loan associations and get all the money that they are paying out as taxes. Hence, the effect upon individuals is practically certain. The effect upon corporations——

Chairman PROXMIRE. At that point, just recall the fact that up until 1966 people had been saving at a rate of about 5.2 percent. Last year they saved at 7.1 percent. If they go part way back to the 5.2—they went back to, say, 6 or even 6.5—it would wipe out virtually all of the diminution in their incomes from the surtax. The surtax would have no deflationary effect.

Mr. MACHLUP. Yes.

Chairman PROXMIRE. And the spending would be the same. There is a strong argument that one of the reasons why people have been saving as much as they have, according to the Michigan Survey of Consumer Intentions, is because they anticipate inflation. In doing so, they think they might not be able to have the income they need to meet their most important needs. If this is assuaged by a tax increase, then they would be more likely to relax and spend more.

Mr. MACHLUP. If they can. You see, there is the willingness to save and spend, on the one hand, and there is the ability to save and spend, on the other hand. If you take away more tax money from the people, the consequent changes in their saving will not equal the changes in their disposable net income. When disposable net income falls, there may be some decline in saving, but there will certainly be a larger decline in spending. So, the effects on saving are not likely to offset the effects of the decline of disposable income upon consumer spending.

Now, as far as corporations are concerned, it would, of course, be conceivable that they borrow all the money that they have to pay out in additional taxes. The question is whether they can get it and whether they want to. This is not very likely, because they will, at the same time, feel a decline in the demand for their products, which is precisely what they ought to feel if we really want to stop inflation.

Your last point was about the small likelihood of price cuts. I agree with you fully, we cannot expect price cuts, or at least not substantial cuts and not many price cuts, to be effected by the tax increase. But what we can expect is that price increases that would otherwise have come about will not come about, thanks to the siphoning off of money and the reduction of potential expenditures. If taxes take away money from people and firms, we avoid an increase in effective demand that would almost certainly lead to increases in prices. One purpose of the tax increase is to avoid that increase in prices, or to make that increase in prices somewhat smaller than it would otherwise be.

The same thing is true with increases in wages. I think we will get, this year, an increase in wages, in wage rates and employment costs, of at least 4 or 5 percent, perhaps more. The tax increase could save us from some of that in further contract negotiations.

Chairman PROXMIRE. My time is up. I would just like to say that the University of Michigan indicated that the surtax would reduce inflation from about 4.1-percent increase to about 3.8-percent increase. The Council of Economic Advisers argues it would reduce it from 4 percent to 3 percent. I just cannot see that either one of these—and especially the University of Michigan model, which I think is more likely to be precise because they have no ax to grind, they are not trying to push for or against a surtax—would have any very significant effect on the balance of payments.

Mr. MACHLUP. The effects on the balance of payments are not entirely price effects. They are chiefly income effects. So, even if prices were not affected at all, the mere fact that you take away some disposable income will have an effect upon the balance of payments.

Mr. BUTLER. These models are wholly misleading.

Chairman PROXMIRE. I know they are.

Mr. BUTLER. Neither of them give as much influence to the monetary factor. We have a model that we have developed which gives—if you give more emphasis to the monetary factor—almost no inflation.

Chairman PROXMIRE. The principal money manager of the Nation told us a few days ago that the monetary policy would be much easier if we had a tax increase than if we did not have a tax increase.

Mr. BUTLER. That is right.

Chairman PROXMIRE. If monetary policy is easier it means that you get your expansion from ease in monetary policy instead of an expansion from fiscal ease.

Mr. BUTLER. But you also get——

Chairman PROXMIRE. And it is perfectly possible in other words that these would tend to balance out. So monetary policy it seems to me would be a factor that would tend to remove the deflationary element of a tax increase. Is that right? It would tend to?

Mr. BUTLER. Yes; to some extent. On the other hand, if you take our model and you put in a reduction in the deficit of $6 to $8 billion, then you put in the monetary policy that would be consistent with such a reduction in the deficit, we come out with substantially less inflation for this year than without the fiscal policy. But more importantly we come out with virtual price stability for next year. I think what we are talking about is not so much this year as next year. A lot of these wage increases are going to go on, regardless of what you do, other than great depression.

Chairman PROXMIRE. You are right when you talk about the model. That is right. You cannot prove anything with a model. You are absolutely correct about that. I yield to Senator Miller.

Senator MILLER. Thank you. I would like to ask any one of our witnesses this: The point has been made that our apparent favorable balance of trade is really nonexistent; that for 1967 the balance of trade, favorable balance of trade, is listed at $3.8 billion, but that includes $1.6 billion of agricultural exports under Public Law 480, soft currency donations, so that that would reduce the balance down to $2.2 billion.

Further, that the figures on imports of $26 billion do not include the cost of freight, whereas our figures of $30 billion on exports do include the cost of freight, and that if we were to take a reasonable figure of 10 percent to add to the price of the imports, there would be another $2.6 billion which would eliminate the $2.2 billion adjusted figure in the balance ending up as a deficit rather than as a surplus. Do you have any comments on that observation?

Mr. BEHRMAN. It has been that way for years; what is important is yearly changes, so long as we understand what is in the figures.

Mr. MACHLUP. Concerning the cost of freight, may I ask, Do you mean the balance of merchandise or do you mean the balance of goods and services?

Senator MILLER. I am talking about the cost on the merchandise.

Mr. MACHLUP. Just on merchandise. Well, regarding the freight, whatever you do not put in merchandise appears in service. Hence, one really ought to, in order to compare exports and imports, take goods and services together. If you take goods and services together, then

the payments for freight are included. So I think it is wiser not to separate the two.

Senator MILLER. I would think so, too. But, the criticism is that we take into account freight on our merhcandise exports, but we do not take into account freight on our merchandis imports, and, therefore, the merchandise imports should be increased to reflect, comparatively, the freight bringing them in just as we include the freight in carrying our exports out, and this would eliminate our favorable balance of trade.

Mr. MACHLUP. We have to distinguish domestic and foreign freight, the freight paid within the United States and the freight paid between the United States border and the points of origin or destination. Which one of the two freights is that criticism concerned with?

Senator MILLER. I cannot answer that question, but I infer from the criticism that the freight is not equalized. In other words, the freight is not equalized in terms of its effect on the outflow of our dollars, and it should be equalized.

If I am not mistaken, I think both exports and imports are recorded on an f.o.b. border basis, and that would make them comparable. That means the merchandise crosses the border, the value that it has in going out or coming in at the border. So I believe that equalization is done.

Now to exclude an item like the agricultural exports under our support program would be quite arbitrary, because we could exclude many other things also with equal justification. We can exclude military expenditures abroad from our current balance. I have done exactly this in my statistical tables, because I felt they are better visible together with our financial transfers.

But, I do not think we can reasonably make the statement that we do not have an export surplus, sir.

Senator MILLER. Well, I take it from what you have said that you have done some experimenting on this, and from the standpoint of true balance-of-payments impact, there certainly should be some adjustment made in these figures that we receive from the Commerce Department; shouldn't there? If we are going to look at our balance of trade from the standpoint of its impact on outflow of dollars and inflow of dollars, there should be some adjustments made; should there not?

Mr. MACHLUP. I think the detailed figures are all available, and I am sure, sir, all figures that you request from the Department of Commerce, including the subgrouping of these figures, will become available to you.

Senator MILLER. I am sure the figures are available. The thing that bothers me is that when we ask for a favorable balance-of-trade picture, we are given a figure of $3.8 billion for last year. No backup detail; no adjustment apparently reflected in these figures along the lines which you have just mentioned. I was just wondering if it would be possible for somebody like you to give us an analysis in terms of the true impact on the dollar of these net figures with the adjustments, so that we would have some basis for evaluating those figures?

Mr. MACHLUP. From my reading of the quarterly reviews in the *Survey of Current Business*, I have concluded that they present a

fairly complete picture, with figures sufficiently detailed for me to be quite satisfied with the present statistics. Not satisfied in the sense that I would not like them to show more favorable results, but satisfied with the information that they reveal.

Senator MILLER. Then as far as you are concerned, when we receive a figure of a favorable balance of trade of $3.8 billion for 1967, you think that net figure has been refined enough for purposes of discussing the impact of the balance of trade on the outflow and inflow of dollars?

Mr. MACHLUP. Yes; I think so.

Senator MILLER. Is it possible that in order to make sure that spending would be reduced by a surtax, that there should be some kind of credit controls to accompany this?

Mr. MACHLUP. We do have credit controls by the Federal Reserve System all along.

Senator MILLER. I am talking about retail credit, for example.

Mr. MACHLUP. I do not believe very much in selective credit controls. I think the most general controls are more efficient, the one through Federal Reserve policy—through open market policy and interest rates—and the other through fiscal policy, particularly taxation.

Senator MILLER. I understand that, but if I gage Senator Proxmire's concern correctly, he suggests that even though a taxpayer's income is reduced by a surtax, that that would not necessarily prevent him from either going into his bank account to get the money or going to some credit agency to get the credit to engage in purchases, and if you want to cover that base, would it not be important to consider credit controls of some kind with respect to the individual consumer?

Mr. MACHLUP. I would warn against such a policy, which would lead us to more and more restraints and Government interventions. I would rely on the tax increase to do its job without being reinforced by selective credit controls.

Senator MILLER. You see we have received some intimations from some people of concern over the tremendous expansion of consumer credit, and at a time when we are trying to reduce spending and hold down inflation. This kind of a suggestion naturally is something that should be considered. I do not say it should be followed, but I would like to get your evaluation of it. I think at least we ought to give the tax surcharge a chance to work.

Mr. MACHLUP. Right.

Senator MILLER. Before we go to something else.

Mr. MACHLUP. Yes, sir.

Senator MILLER. Thank you. Now, Mr. Butler, quoting from your statement, you say:

> * * * and we must avoid actions on our part such as quotas, border taxes and other devices which provoke retaliatory actions abroad.

Do I infer from that statement that you would be agreeable to saying that we need not avoid actions on our part such as quotas, border taxes, and other devices which do not provoke retaliatory action? I mean, is the converse of this statement applicable to you?

Mr. BUTLER. I am not sure I would go along with that. In revising the text I took out border taxes, I would have to say, which, is a very difficult and complicated question. But, what I am trying to say is, that if we do what we have to do to deal with our domestic problem of inflation, which I think we need to do for domestic reasons as well as

international reasons, that if we review our governmental overseas expenditures and commitments, I think we can get our balance of payments back into balance, and this is the real way to do it, and that such policies would not provoke retaliatory actions on the part of those abroad.

Now, if instead we continue down this road toward more and more elaborate controls, one of my fears is that foreign countries will retaliate, that the world will move back toward a system of controls and restraints which I think would be extremely damaging to the world. I mean, that is what I am trying to say.

Senator MILLER. You see, your statement is the kind of a statement which certain individuals in the administration might seize upon to quote when they come over to testify before the Finance Committee with respect to some quota bills which are pending in the Finance Committee, of which some of us happen to be cosponsors, and they might cite that statement as evidence that the Chase Manhattan Bank, at least one of its officials, does not think that these quota bills should be considered.

Now suppose that these quota bills are designed to offset discriminatory action on the part of some countries. Would that change your view a little bit?

Mr. BUTLER. No.

Senator MILLER. Let me give you a classic example. Feed grains imported into the Common Market are subjected to a tariff. The money from the tariff is then used to subsidize exports of canned hams to the United States. There are a few of the producers of canned hams in the United States who think this is a one-way street, and they would like to have countervailing duties imposed against the imported ham, canned ham, from these countries. Not that it is a matter of inviting retaliation on their part but as a matter of retaliation, or, if you do not like that word as a matter of offset on our part. Are you opposed to that kind of action?

Mr. BUTLER. Yes; I am.

Senator MILLER. In 1960, the dairy imports into the United States amounted to 600 million pounds. By 1965, they had increased to 900 million pounds; in 1966, they had increased to 2.8 billion pounds; as of June, last year, there were at the rate of 4 billion pounds, whereupon the President did take some action to cut them down in the year 1967, to approximately the 1966 figure of 2.8 billion pounds. I take it that you would be opposed to this, and would feel that the President made a mistake in that action?

Mr. BUTLER. I am not aware of all the details, but I will stand on the general position that it is to the advantage of the United States and the world to have the maximum amount of free trade.

Senator MILLER. May I interrupt you at that point to tell you that general proposition is shared by, I think, every Member of Congress.

Mr. BUTLER. May I just continue. I think there are circumstances under which you can get disruptive effects from, in effect, free trade, et cetera, and that I would agree that there should be provision to make orderly adjustments in these areas. I have always thought that one of the geniuses underlying the idea of the Common Market was the idea that you went to it over a period of time, say, 10 years, or whatever period, and I would support measures to promote orderly adjustments

in these areas, but with clearly the idea that you would not get protection forever, that you would have a period to make an adjustment.

Senator MILLER. Well, I think that I certainly would subscribe to a mechanism for orderly adjustment, but when you do not have that mechanism, and, when, as a matter of fact, you have the discriminatory treatment in some countries overseas, which is causing serious impact on American industry, what are you supposed to do? Are you supposed to tell the affected industry in this country, "We are sorry we do not have any mechanism for reciprocal lowering of nontrade barriers. You will just have to get along in the name of good old free trade even though it happens to be a one-way street in this particular case."

It seems to me, Mr. Butler, that prudence indicates that if quotas are needed to offset discriminatory treatment, if a country is going to levy a tax on our exports of feed grains to them and turn right around and take the money that they collect on that to subsidize their imports into this country, we cannot stand still in the name of so-called free trade.

I recognize the desirability of free trade. This committee just put out a report on the future of foreign trade to the United States, pointing out that nontrade barriers which the Kennedy Round of negotiations had absolutely nothing to do with can be just as harmful and even more insidious than tariff barriers. So, I am just trying to elicit from you a recognition of the fact that while the general proposition of free trade is fine, we have to get down to cases and facts before we can determine whether a particular incidence of quotas not to provoke retaliatory actions but to offset actions, you might say, which are designed to provoke retaliation on our part are taken.

Mr. BUTLER. I would say only this. First, I would hope that whatever we did would be in this category of cushioning an adjustment and not moving in the direction of our erecting a lot of barriers. It seems to me that what we need is to negotiate on nontrade barriers around the world, and that that is the route that will lead to the greatest good of ourselves and other countries.

If we react to these measures, and I agree with you that we have been much more "simon pure" than other countries, although our record is tarnished in some areas, we are so powerful in this world that if we take this route there is the greatest danger that other countries will take it, that we will go back into systems of quotas and controls that will be extremely damaging.

Now, having said this, I recognize the problem of some particular industries, but I would support reasonable measures to ease their transition. I would support every possible measure on the part of our Government to try and reduce foreign nontariff barriers to trade. I do not known whether that is helpful.

Senator MILLER. I must say that I share your attitude. But what do you do in the meantime? What do you do during 2 or 3 years that it might take to negotiate? Do you let the plants close? Do you let the people become unemployed? Or during the interim do you establish some kind of a countervailing offset with the clear understanding that during negotiations you hope that these can both be eliminated?

Mr. BUTLER. First, it seems to me we carry a fairly big stick in the world, and I think we ought to get at the business of negotiating reduction of these barriers on the part of other countries. And, I think one

stick we carry is our ability to retaliate, if you like, if they do not agree. I think this is the next order of business in world trade negotiations.

Senator MILLER. Of course, when you talk about retaliatory action, let me make one last observation. Our position before the Common Market of our negotiating team during the Kennedy Round was that the Common Market should give us access for our grains based upon a base period percentage. That was our request.

Now some of these quota bills, vis-a-vis the Common Market, would establish a quota-guaranteeing access based upon a certain percentage of our market according to a base period. There is something that if the Common Market, if we should do this, should retaliate, we might end up getting exactly what we asked them for during the Kennedy Round of negotiations. Might this not be a desired result? This was our position. This was Ambassador Roth's position. They turned us down on it, but maybe this might be one way of obtaining what we asked for by way of retaliation.

Mr. BUTLER. Well, one of the great problems is that world trade policy in agricultural products has made no economic sense for many years, and I doubt that it will, so this becomes a completely political matter of negotiations, and this being the case, you try and get the best deal you can possibly get in the best way you can get it. But, I think, to go down the road of increasing quotas and industrial products would be a tremendous backward step in the development of the world economy, and I hope we would not get it, and I would argue this is true even if we do guarantee access based on a certain base period in the past. It is a bad route to embark upon, and I think the consequences, over time, will be extremely damaging.

Senator MILLER. Do you think it is a bad route to follow until such time as we are able to get into reciprocal lowering of nontrade barriers, which as the committee has found can be just as effective and even more insidious than trade and tariff barriers?

Mr. BUTLER. That is right.

Senator MILLER. You think that until such time that it would be better not to follow any quota route?

Mr. BUTLER. I made a calculation once which is very hard to document that something like 20 percent of the world's production of industrial products of movable goods as some economists call them enter into international trade, and the fact that they do so in view of the difficulties, the obvious difficulties of selling something in another country, I think, is a great tribute to the forces that make trade move. The fact that they do so despite these restrictions, again, I think indicates the tremendous propensity on the part of the world to trade and the very great advantages in trading.

Now, to the extent you can reduce the barriers, you can increase trade and the well-being that goes along with it very significantly, and my only plea would be that we move in this direction and not in the direction of enmeshing trade in control restrictions which I think would not be to the advantage of the world.

Senator MILLER. Thank you, Mr. Butler. I share your policy views in the long run. But, I must say, I think that looking at the hard facts we have to sometimes recognize certain situations which may delay the change of that policy but I do believe that we have a duty to the

people who are paying the tax bill in this country not to permit them to suffer under discriminatory duties and nontrade barriers overseas just in the name of the overall policy which you have enumerated. That policy should be a long-range objective and obtained as soon as we can, but in the meantime, I must say, I have to think of some of the people who are paying the bill on this side of the ocean. Thank you very much.

Chairman PROXMIRE. Thank you, gentlemen, for a most competent, stimulating, and provocative morning. I must say that the questioning at the end blends right into what we have this afternoon when we have four experts apearing on trade and investment followed by Mr. William Roth, the President's Special Representative for Trade Negotiations. This has been an excellent morning. Your papers were fine and your responses were most helpful to us.

The committee will recess now, and reconvene at 2 o'clock this afternoon.

(Whereupon, at 1:10 p.m., the committee was recessed, to reconvene at 2 p.m. on the same day.)

AFTERNOON SESSION

Chairman PROXMIRE. The Joint Economic Committee will resume its deliberations. We are honored this afternoon to have four outstanding experts on trade and investment. I have had an opportunity to look at most of these statements—two of the three. They are very good and helpful statements. We will be delighted to have you gentlemen go ahead. We have the President's Representative for Trade Negotiations who is scheduled to come before us at 3:30. That can be somewhat delayed, but I anticipate there will be other members of the committee here to question you gentlemen a little later, and we would appreciate it if you could keep your remarks to 15 minutes or so.

At least one of the statements is extremely short, which will be helpful. And if you other gentlemen hold your remarks down, it will leave us more time for discussion. Your full statements will be printed in the record in their entirety and made available to all members of the committee and to the Congress.

We will start off in alphabetical order with Mr. Cook. Go right ahead, Mr. Cook.

STATEMENT OF EDWARD W. COOK, PRESIDENT, COOK & CO., MEMPHIS, TENN.

Mr. COOK. Mr. Chairman, do you want me to read this or dispense with it? It is hopefully the shortest one. Shall I read it?

Chairman PROXMIRE. Yes; you have a very concise statement. You can handle it in any way you wish: If you want to read it, or summarize it, or whatever you want.

Mr. COOK. In the interest of time, I will just summarize it, if I may.

Chairman PROXMIRE. Fine.

Mr. COOK. I think the thing that disturbs those of us who are engaged in agricultural exports is the discoordination that is apparent in policy, particularly as it concerns the International Grains Agreement, on the one hand, which might require us, under certain condi-

tions, to impose an export tax on the exports of wheat, while at the same time, on the other hand, we are engaged in the exploration of export tax incentives and import tax barriers and travel disincentives.

This curious disparity of the two positions is disturbing to those of us who are engaged in international trade, for the simple reason that it seems to us that any effort to impose import tax barriers and export tax credits or incentives of a direct nature will result in retaliation and the climate for world trade would be substantially damaged insofar as ability to carry on volume of business is concerned.

I would like to suggest a possible tax incentive. I think the thing that induces most businessmen to work hardest is that money which they can keep. So, if I may make a businessman's approach to tax incentives, I have in my paper a suggestion that we expand more or less the idea of the Western Hemisphere trade tax provisions to a worldwide basis, so that if a man has $100 of gross sales, and $25 is export sales, and $75 is domestic sales, that the 75 percent would be taxed at the normal applicable income tax rate, be it a corporation or a partnership or whatever type of enterprise. The 25 percent of the profits would be taxed at, say, 5 percentage points less.

One of the problems encountered in the regional export expansion council work, and in the national export expansion council work, is the number of the export inquiries which are not answered. The reason that they are not answered is because if a man is highly engaged or involved in domestic business and he sits down to budget an export department, he is immediately faced with a sizable sum of money, and he says, "Well, I am doing pretty well as it is. Why should I chase a shadow when I really don't know anything about this business?"

With the proper incentive, I think he would be properly motivated to pursue our goals of expanded export trade, and thus build on the advantages which we have in our economy vis-a-vis the rest of the world.

Chairman PROXMIRE. Thank you very much, Mr. Cook. You have abbreviated a concise statement and have set a fine example.

(Mr. Cook's prepared statement follows:)

PREPARED STATEMENT OF EDWARD W. COOK

Mr. Chairman and members of the committee, I am Edward W. Cook, President of Cook and Co. of Memphis, Tennessee. Our company is specialized in the export of United States agricultural commodities, primarily wheat, cotton, feed grains and soybeans.

Elliot Janeway in his recent book, *The Economics of Crisis*, wrote, "The double base on which the American economy stands, combining world leadership in farm production with world leadership in industrial production, has from the beginning given it a distinctive advantage in world competition."

Without going into great detail let me further dramatize the importance to United States agriculture of world trade by quoting from a synopsis of "Agricultural Trade and Trade Policy," by Oscar Zaglitz, published by the National Advisory Commission on Food and Fiber in August 1967:

"(1) U.S. agriculture is one of the Nation's largest export industries. The degree to which it can use its resources depends on the extent to which it can supplement its domestic sales by sales in foreign markets.

"(2) Its dependence on exports has increased since World War II because, stimulated by technological progress and structural improvements, its productive capacity has grown faster than domestic demand for its products.

"(3) A major expansion of U.S. agricultural exports was achieved after World War II and particularly during the last dozen of years. Food aid has been an important foreign outlet for U.S. agriculture in the postwar period.

But the great expansion in its exports had its basis in the growth of foreign countries' commercial import of agricultural products.

"(4) Full use of the resources of U.S. agriculture will require further expansion of its exports. This will also be in the interest of our Nation; and it will be helpful in improving the U.S. balance of payments.

"(5) The future prospects for the agricultural exports depend largely on our foreign trade policy. In view of the frequent calls from some sectors of the U.S. economy, and also from some agricultural sectors, for more protection, American agriculture must not forget that the spiralling protectionism in the period after World War I, which culminated in the "beggar my neighbor" policies of the Depression, played a decisive role in the decline of the agricultural exports during the late Twenties and early Thirties and in the collapse of agricultural prices which resulted, and which brought distress to many thousands of farmers in all parts of the United States. Government price supports and other governmental measures, under such conditions, could not do more than mitigate the distress."

These observations by Dr. Zaglitz have greater relevance today than when they were written—only a few months ago. Our international balance of payments has worsened. Protectionism in the form of higher tariffs and import quotas is once again being vociferously sought by many segments of the American economy, and there are signs that such policies could rapidly spread to many countries that are important markets for American goods, particularly agricultural commodities.

The Kennedy Round of GATT negotiations failed to make any significant progress toward freer world trade for agriculture. Indeed, in one respect, the results of those negotiations are, in fact, a step backwards in trade liberalization for one of the largest U.S. farm commodities—wheat. I make specific reference to the proposed International Grains Arrangement, which would be an internally self-balanced commodity treaty.

For some 17 years world trade in wheat was in part influenced by the now expired International Wheat Agreement. That agreement sought quite rationally, at least during its early years, to stabilize short-run international wheat prices around the long-run world wheat price equilibrium. Its fault was that, of among the more than 50 member countries, the entire burden of carrying world wheat stocks was left to North America. This inordinate burden of world wheat price stabilization, falling heavily upon the United States, was the one principal reason why the International Wheat Agreement fell from favor.

Now we have proposed a new wheat agreement called the International Grains Arrangement, which sharply departs from the price stabilization objectives of the old International Wheat Agreement. The proposed IGA would raise the minimum world trading price for wheat by 23 cents a bushel from the previous IWA level. Many professional agricultural economists calculate the long-run world wheat price equilibrium as not rising at all, but rather slowly falling, based upon rapid increases achieved in farm productivity in the form of higher yields in response to fertilizers and new hybrid dwarfed wheat varieties. Clearly, the proposed IGA seeks to raise and hold world wheat prices above their long-run levels based upon the dynamics of world supply and demand. Secretary of Agriculture Orville L. Freeman himself, in his remarks before this committee on February 14, observed, "World trade is still an absolute necessity to a healthy U.S. agricultural plant, and world trade and world prices cannot be established by fiat."

Indeed, "The Annual Report of the Council of Economic Advisors," which is an important part of the *Economic Report of the President*, being studied by this committee, states on page 193, "Primary producers sometimes attempt through commodity agreements to raise prices above the long-term equilibrium level. They rarely succeed. Maintenance of a price above long-run cost requires restrictions on supply; the necessary export quotas are extremely hard to negotiate and to enforce."

So we have before us an almost unbelievable anomaly. This government, in struggling with a very serious balance of payments problem, is considering a tax rebate incentive program on exports; while at the same time proposing an international wheat treaty that would require us to raise our export wheat prices, perhaps, if necessary, by the use of an export tax on wheat. We can only lose our export markets by this type of inconsistency.

It is my personal judgment that any consideration, much less enactment, of export tax rebates and import border taxes is ill-advised. The proposed IGA is even more ill-advised.

Consideration might be given to some type of income tax forgiveness on exports. An export tax rebate merely reduces prices, by and large, but provides little real incentive to export. We have advantages which are not being fully utilized to reach our goal of more exports. Income tax forgiveness on export earnings might work this way: Assume an enterprise had total sales of $100, $25 being export sales and $75 being domestic sales. The enterprise's profits would be taxed at the normal applicable tax rate on 75% and 5 percentage points less on the 25% of profits attributable to exports. Exports need incentive more than anything else, and given appropriate incentives business will do an adequate job.

Thank you.

Chairman PROXMIRE. Our next witness is Mr. Lyman C. Hamilton, Treasurer of the International Telephone & Telegraph Corp.

STATEMENT OF LYMAN C. HAMILTON, TREASURER, INTERNATIONAL TELEPHONE & TELEGRAPH CORP.

Mr. HAMILTON. Mr. Chairman, if you don't mind I would rather stay rather close to the text.

Chairman PROXMIRE. All right, it is a relatively short statement. Go right ahead.

Mr. HAMILTON. Yes, sir.

My name is Lyman Hamilton, I am treasurer of International Telephone & Telegraph Corp., ITT, and in that capacity I sit on top of the flow of funds from the United States and to the United States. Happily, there is more of the latter. I welcome this opportunity to appear before this distinguished committee, and I hope to be able to contribute in a positive and constructive manner toward a solution to the serious balance of payments problem in which we find ourselves.

I might begin by saying just a few words about ITT for the benefit of those who may not be familiar with the corporation.

ITT is an American-owned international corporation whose principal business, despite its recent acquisitions, which are somewhat publicized, is the manufacture, sale, service, and operation of electronic and telecommunication equipment and systems on a global basis.

At the time of its founding in 1920, ITT had a total of 1,400 employees and in 1921, its first full year of operation, reported revenues of slightly less than $4 million.

Today ITT is a system of more than 100 affiliated companies and divisions located throughout the world. The system has a total of over 204,000 employees in 62 countries including the United States and Canada.

It will report total sales and revenues approaching $3 billion for 1967.

ITT also, is one of the 700 American companies which took a leading role in the Commerce Department's voluntary reporting program.

ITT is fully aware of the serious financial problems which have led to the regulatory program and we are prepared to do everything in our power to improve the balance of payments.

However, there is one key point regarding the balance-of-payments regulations that should be noted in the national interest. Productive foreign investments are not expendable. They are the very core of our ability to wage war or maintain peace. We assume that the importance of these investments is realized in the highest policymaking circles of our Nation. And, we assume it is also realized that the long-

range security of the United States and its allies is very much dependent upon the preservation of those investments. If you curtail investments over a period of time, you limit your external income, and with that your ability to sustain political and military positions abroad.

U.S. private investments and services abroad have been adding about $2 billion a year, net, to our cash receipts; and to relate that to the numbers that have been discussed with the committee that is about $5 billion of income offset by about $3 billion of outflow. In more understandable terms, this amounts to a net inflow to the positive side of the U.S. balance-of-payments ledger of about $5 million a day, every day, 365 days a year. If we allow this to be whittled away, we are going to find that we will be unable to maintain our commitments for collective security and economic development around the world.

There is a classic example of the "whittling away" process. Contrary to currently accepted theories of Great Britain's difficulties, the sole reason for the deterioration of the British balance of payments was not the trade deficit. While Great Britain has generally had a trade deficit, she was able to make up the difference through income on oversea investments and services. Twice—after World War I and again after World War II—British investments were liquidated in the amount of £1 billion or more each time. Her external debts increased at the same time for Government expenditures abroad soared. As a result, the income on her investments was insufficient to meet increased costs. The inadequacy of foreign investment income was a basic cause of Great Britain's recent fiscal retrenchment.

We are concerned now that the administration's short-term solutions to our problem do not cause irreparable damage to American companies and their ability to continue to repatriate earnings in the future.

Two areas concerning foreign direct investment covered by the regulations are:

(1) Restrictions on transfers of capital abroad; and

(2) The repatriation of earnings as fixed by the formula in regulations.

The first of these, the transfer of capital abroad, is directly within our corporate control and we can and will operate fully within the regulations. For example, just last Thursday, an ITT American subsidiary completed the borrowing of $50 million in Europe, which we especially negotiated with no sinking fund for 10 years, with the balance-of-payments problem in mind.

According to the Survey of Current Business for September 1967, compiled by the Department of Commerce, American companies in 1966 incurred outflows of over $3.5 billion of which $1.8 billion was to Europe. Since much of this was for new projects, there clearly would be room to achieve the Commerce Department's $1 billion 1968 improvement target through restraints in this area.

Mature companies like ITT, which have long operated abroad, are able to remit earnings to the United States without having to send large amounts overseas. So that there will be no question as to their moral right to this position, let it be remembered that such companies have at times during war and as a result of confiscation suffered as much as 70 percent of the loss of their company in order to remain overseas today. Certainly, the sacrifices which have been made

by these stockholders will warrant treatment to enable them to continue to compete in a normal way with their oversea foreign competitors, particularly when, as noted earlier, they have not been sending capital overseas.

Instead of concentrating solely on restraining outflows, the drafters of the regulations understandably attempted to close any loopholes by which earnings retained abroad could be increased above previous levels to offset reduced outflow. However, the regulations overreached this objective and prescribed repatriation at an increased and inordinately high level, particularly in Europe. Here again mature companies already have been repatriating at high levels like ITT's 54 percent, and have been financing their growth mostly through local borrowings. This compares with 42 percent paid as dividends, as an average, for example, by the top 100 U.S. companies to their shareholders.

On the other hand, the regulations on foreign direct investment announced by the Department of Commerce, January 3, imposed severe restrictions on U.S. companies operating abroad and, if applied literally and over a long period, might well prove detrimental to the national interest.

The regulations are especially harsh on companies that have, over many years, contributed regularly to the surpluses in the United States balance-of-payments account.

ITT has been a large annual net contributor to the U.S. balance-of-payments position for the past 20 years. Based on our 1967 performance, we are at present repatriating to the United States at the rate of $1 billion every 10 years. Based upon our past experience, this figure could double in the next 10 years.

A direct investor, according to the regulations, is required to repatriate annually an amount representing earnings from its affiliated nationals in the various schedules. The amount which must be repatriated from schedule C countries (Western Europe, South Africa, and the Communist countries), for example, is the greater of, and I repeat, is the greater of:

(1) the same percentage of total earnings from schedule C affiliates as was repatriated during 1964, 1965, and 1966, or

(2) any earnings of schedule C affiliates in excess of 35 percent of the direct investment, and note that that includes reinvested earnings, in schedule C countries during 1965 and 1966.

Where dividends have been substantial and capital transfers have been low in prior years, what we call the base years, as in the case of ITT and as called for by the voluntary planning during those same years, application of this second test for repatriation of earnings can force repatriation of so high a percentage of current earnings as to make it difficult for such subsidiaries to compete with foreign companies. Such subsidiaries also would encounter difficulty in borrowing locally because, with forced repatriation of earnings at an abnormally high rate, they would not accrue sufficient equity to support additional borrowings.

Mr. Chairman, if I may, I would like to refer you to the table at the back of the testimony.

In this table we have provided an illustration of three companies: X, Y, and Z, all foreign affiliates of an American direct investor, and

to make it simple, we have assumed each is the sole such affiliate. Each of these companies had 1968 earnings of $1 million.

If we start with Company X, whose situation most reflects the subsidiary of a mature company in the United States, a mature direct investor, we find the company had earnings, without any growth, averaging $1 million in the base period, but was paying dividends of 50 percent of distributable income.

By definition, 50 percent also was being reinvested. It is assumed that the U.S. parent was not sending money abroad to that affiliate, and this again would be typical of ITT and other mature companies.

However, by virtue of the requirements for repatriation as they are written, in 1968 that company can only retain 35 percent of the amount it reinvested during the base period. That is, 35 percent of a half million dollars, which is $175,000, as shown lower in the column.

By definition, if you earn $1 million and you retain $175,000 you have to distribute $825,000, that is an 82½-percent dividend payout rate, and I submit that, with this rate, it would be difficult to sustain operations. Nobody in the United States, anxious to continue in business, would consider a distribution at that level, and certainly not if they were going to compete and grow.

Obviously, if the 1968 earnings, instead of being $1 million, hopefully had grown to $1.5 million, then that 82½-percent payout could only increase accordingly.

We have also shown Company Y, just like Company X, except that instead of paying out 50 percent and bringing it back to the United States year after year, it completely reinvested the earnings in expansion and new projects in Europe. Accordingly, Company Y had no dividends, so it retained earnings of $1 million. As with Company X, nothing was sent abroad by way of a direct transfer of capital.

Applying the same formula to the base which is now $1 million, 35 percent of $1 million is $350,000. Therefore, under the program, Company Y, assuming it is the only foreign affiliate of the direct investor, can pay out $650,000, or 65 percent.

Now we come over to Company Z, which is really another case of Company Y, paying out nothing and retaining all. However, during the 1965–66 base period, we assume it received a yearly average of $1 million in additional capital.

Applying the formula provided by the regulations, 35 percent of $2 million is $700,000. Now Company Z has earned, in 1968, the same $1 million. Therefore, simple arithmetic tells you that if it can retain $700,000, it has to pay out only $300,000 of that $1 million, or 30 percent.

Chairman PROXMIRE. At this point, will you clarify Company Z? What capital transfers could be and could not be? Would they be transfers from foreign accounts or from domestic?

Mr. HAMILTON. Well, the most classic example, I think, would be an increase in equity in the foreign affiliate by a U.S. investor or a long-term loan to that affiliate. We are not sure exactly what the regulations mean, but we think it could also mean increases in the current account between the parent and the subsidiary.

Chairman PROXMIRE. Does it make any difference whether it is from this country or from abroad?

Mr. HAMILTON. Oh, yes; these capital transfers—category (d)—shown in the schedule, would be transfers of capital from the United States by the direct investor to its foreign affiliate as defined in some detail in the regulations. However, transfers to this affiliate from other affiliates of the U.S. investor outside the schedule C area would be similarly treated.

But the point I was leading to is that if capital transfers, during the base years, had been $5 million instead of $1 million, obviously not in compliance with the spirit of the voluntary program, then you can see that the required dividend actually decreases and could approach 10 percent, or in certain cases it could be zero.

We felt from the beginning that this was a helpful way of explaining the effect of the regulations as they are written.

I believe there has been considerable misunderstanding of these regulations. Many persons, in and out of Government, believe they require, on the one hand, repatriation only at the rate existing during the base period, or, on the other hand, at the maximum rate of 65 percent. This latter figure is one that is usually reported in the press.

Because the regulations are complex and difficult to understand, their actual effect has been overlooked. The facts are that, in many cases, they could lead to the extreme results I have described.

It is recommended that, as an alternative, companies be allowed in Europe a target of the equivalent of a 65-percent payout, to be achieved by dividends at a rate no less than the prior dividend rate mentioned in clause 1, plus repatriation through other means available to the company, such as foreign borrowings. Consideration also should be given to bringing all companies at least to the present average level of dividend payout and remittance for foreign subsidiaries of U.S. manufacturing companies.

Gentlemen, these regulations are also being read in Europe and an increasing number of examples are finding their way into the European public press, reflecting mounting irritation for needless interference regarding repatriation of earnings.

Importantly, and as evidenced by the data from the Commerce Department, referred to earlier, there is no need to interfere with any company that is repatriating earnings at a reasonable rate. Nevertheless, because of the high repatriation rate required by the regulations as they now stand, it is essential that they either be modified or administered with extreme flexibility if the reactions in Europe are not to jeopardize the earnings themselves, to say nothing of their repatriation.

Already, the French have warned that if U.S.-owned companies there—which are organized under and subject to French law—are compelled to pay out a disproportionate amount of earnings, the French Government may regulate the amount of payout. The French Government has already discussed this subject with its partners in the Common Market, and if relief is not granted on a judicious basis, it can be expected that not only France but the rest of the Common Market—certainly to be followed by the rest of Europe—may impose restrictions on the amount of earnings that may be returned to the United States.

We have also learned that the Spanish Government is preparing a brief for a change in its classification under the regulations so as to

receive the same treatment as Greece and Finland. If not granted, there is danger it may take retaliatory measures.

The foreign governments take the understandable position that the United States has no more right to tell them how companies in their countries should be operated than those governments have to tell the United States how to run companies in the 50 American States.

The European governments, on the other hand, are willing to cooperate within reason.

ITT's oversea affiliates, like many others, are run by foreign national citizens. Our boards of directors are almost wholly foreign national citizens who are often distinguished leaders of business and finance in their respective countries. In carrying out their duties they have and are obliged to follow the rules and laws of the countries in which they are domiciled, in corporated, and operated. These boards are also composed of representatives from labor and minority stockholder interests. It should be noted that in some places in Europe employees by law participate in profits and management.

Because ITT has been reasonable in its manner of operation, these directors have been fair in their manner of dividend declaration. This is shown by their record of 54 percent dividend distribution which is almost one-third better than the average level of domestic dividend declaration in the United States.

In short, in managing these companies we cannot be unaware of local laws, local boards and long-standing supply commitments to their own Government. Indeed there is reason to believe that many of our friends would consider such disregard morally wrong and perhaps indefensible.

The regulations themselves, therefore, if applied literally, would be self-defeating. They would not solve the problem at which they were aimed . . . unless revised and amended on the basis of justice for all concerned.

Under repatriation regulations U.S. companies in Europe, for example, will not be able to expand and grow and compete effectively in the marketplace. They will be under extreme pressure just to stand still—to maintain their previously hard-won positions—while their competitors take over the market. Eventually, U.S. companies may be unable to send back dollars at all. Thus, an absolutely vital source of dollars flowing into the United States—from the American business investment abroad—could be dried up at a time when the dollars are most needed.

If the regulations are to stand, then we believe they should be administered with flexibility so as to alleviate the harsh results I have described. We believe further that companies that historically have contributed to a favorable balance of payments should be the first to receive selective treatment for the practical assurance of continuing their inward cash flow.

ITT has requested an exemption from the repatriation formula from the Department of Commerce on the basis of just this logic. We are asking for permission to continue to contribute to the overall balance-of-payments gain in 1968 through all the means available to us without the damaging consequences which would result from the repatriation targets of the present regulations.

I would like to add that the able staffs of the Office of Foreign Direct Investment of the Commerce Department and the members of the

Inter-Agency Committee have already demonstrated a genuine interest in helping us to solve these problems, including those that would be created by the literal application of the regulations regarding repatriation.

U.S. private investment overseas has generated a continuous surplus for the balance of payments. I hope you will agree that such investment as is already in place especially should not be penalized, nor deprived of the capability to continue generating a net dollar flow into the United States.

A reasonable dividend flow from U.S. earnings in Western Europe would recognize the need for balance between today's dollar inflow and tomorrow's growth and ability to compete, and, therefore, tomorrow's dollar inflow.

There are many searching questions about the new balance-of-payments regulations that have yet to be answered publicly, and in closing I would like to point out just a few today. Gentlemen, what specific changes occurred in the last several weeks of 1967 which caused the administration to impose severe restrictions, in the private sector, and to recommend further restraints to the Congress? What will happen after the overseas reservoir of private earnings is dried up through forced high repatriation if the gold flow problem still exists? Will we repeat the history of the British Empire? Will we lose our position of world leadership because of our inability to pay our way? Lastly, is there a plan—a plan that includes drastic cuts in public spending—in existence now? All the options should be considered before embarking upon a premature and possibly dangerous course of action.

Finally, I would like to say that ITT's interest to strengthen the dollar is just the same as the administration's. This is everyone's dollar—it is a public dollar, a private dollar—it is your dollar, and mine. It would make good sense, then, to give the private sector some encouragement and some leeway while it helps to defend this U.S. dollar.

Thank you.

(The chart referred to follows:)

	Company X	Company Y	Company Z
1968 earnings	$1,000,000	$1,000,000	$1,000,000
Base period averages:			
(a) Earnings	1,000,000	1,000,000	1,000,000
(b) Dividends	500,000	0	0
(c) Retained earnings	500,000	1,000,000	1,000,000
(d) Capital transfers	0	0	1,000,000
1968 requirement:			
Retained earnings (35 percent of (c) plus (d))	175,000	350,000	700,000
Dividend amount	825,000	650,000	300,000
Dividend rate (percent)	82½	65	30

Chairman Proxmire. Thank you.

Our last witness is Mr. Robert M. Norris, President of the Foreign Trade Council of New York. We are delighted to have you, Mr. Norris.

STATEMENT OF ROBERT M. NORRIS, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, INC., NEW YORK; ACCOMPANIED BY MELVILLE H. WALKER, VICE PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL

Mr. NORRIS. Mr. Chairman, I think we can live within the bounds of our time requirements, and we attach sufficient importance to our statement that we would like to go over it with you in full.

We appreciate, of course, the opportunity to appear here in behalf of the council. I think most of the members of your committee and other members of the council comprises a broad cross section of the U.S. companies engaged in all major fields of international trade and investment, including manufacturers; exporters and importers; companies engaged in rail, sea, and air transportation; bankers; and insurance underwriters.

It is my understanding that the emphasis, this afternoon, is upon that part of the President's Economic Report dealing with the balance-of-payments program announced on January 1, 1968, and its implications with relation to our foreign trade and investment policy. The need to correct the recurring deficit position is manifest.

Among the specifics under the programs with which we thus far have had to deal are the foreign direct investment regulations issued by the Department of Commerce, pursuant to Executive Order No. 11387, and the travel tax program proposed by the Secretary of the Treasury in his statement before the House Ways and Means Committee hearings on February 5. Consequently, within the basic framework of our position on the balance of payments, my statement deals primarily with these two matters.

The Council and its membership have long been concerned with the U.S. balance of payments and have been reviewing balance-of-payments data annually since 1951. For some time we have stressed the paramount need for the United States to take meaningful measures to restore a sustainable balance in the U.S. international payments and to assure the integrity of the dollar. In this connection, the Council, since 1914, has annually sponsored and conducted the National Foreign Trade Convention. At these conventions U.S. business executives examine important issues in our foreign economic policy and develop recommendations related thereto.

The 54th National Foreign Trade Convention, in its declaration adopted on November 1, 1967, included the following resolution concerning the balance of payments:

BALANCE OF PAYMENTS

Notwithstanding the encouraging steps toward strengthening the international monetary system, the need remains paramount for the United States Government to take meaningful measures to restore a sustainable balance in the United States international payments and to assure the integrity of the dollar.

The need fundamentally is for the United States to orient its balance-of-payments policies to expansion of both world trade and investment. Remedial measures should be derived basically from an overall integration and consistency of monetary, fiscal, taxation, export financing, trade promotion and investment policies. The Convention regrets the harmful lack of consistency in some measures taken in recent years.

Primary requirements for strengthening the United States balance of payments at the present time are the restraint or offsetting of inflationary pressures,

from whatever source, and the preservation of cost-price levels in the United States, compared with other countries, which will enable the products and services of American industry to compete in world markets.

To this end, the Convention emphasizes the importance of collective bargaining settlements and pricing policies which are consistent with price stability, and the reduction of Federal spending that is not absolutely required to support the war in Viet-Nam and other needs of national defense or for domestic programs of urgently high priority.

A particular requisite for the longer run strengthening of the United States balance of payments is the increased availability of export financing and of capital for expansion of the facilities abroad which are required for holding and expanding the United States position in world markets.

When the "voluntary program" was initiated in 1965, the United States Government acknowledged that over the longer term United States investments abroad created substantial net receipts—that inflows from incremental exports, interest and dividends, royalties and fees more than offset the dollar outflow from initial and continuing investments. The Convention holds that these more significant long-term benefits should no longer be penalized and recommends the termination of the "voluntary program" without further restrictive controls.

The Convention urges the United States Government to continue to explore possibilities for export expansion through tax and credit incentives, competitive terms for export financing, and for greater access to foreign markets through further trade liberalization, particularly by removal of nontariff barriers.

The Convention urges continued efforts by the United States Government to persuade other developed countries to assume a greater share of the payments burden of providing military and economic assistance to nations of the free world. It points to the desirability of attracting foreign investment in the United States and to the need for continued action by business and the Government to this end. It supports efforts of intergovernmental cooperation which will assist in bringing about a lasting reduction of the United States balance-of-payments deficit.

Foreign Direct Investment Regulations

While fully recognizing the emergency impact of international financial developments in late 1967 upon the U.S. balance-of-payments position and the need for the U.S. Government to take prompt steps to meet the situation, the National Foreign Trade Council is seriously concerned with that part of the balance-of-payments program which imposes mandatory controls on foreign direct investments as provided in the regulations issued on January 3, 1968, by the Department of Commerce. We have communicated to the Secretary of Commerce the main problems and areas of immediate concern which these regulations pose for U.S. direct investors and their foreign affiliates, and have suggested certain amendments and changes in administrative procedure to minimze as far as possible adverse effects on the normal conduct of international business and the balance-of-payments earnings of the United States.

The points covered in our communication to the Secretary of Commerce on January 15 are:

1. Repayments of Outstanding Loans and Future Borrowing Abroad

Many companies, particularly in their efforts to cooperate under the "voluntary program" since 1965, have had their foreign affiliates raise their capital requirements through borrowing abroad. Many of these arrangements have provided that such borrowings would be repaid out of the foreign affiliate's revenues. Many foreign affiliates will be placed in difficult cash positions when they are mandated to repatriate earnings and also obliged to repay borrowings expended for capital requirements.

This pressure on the cash position of foreign affiliates will be intensified in those instances in which repatriation of earnings, as urged under the "voluntary program," was at high levels during 1965 and 1966, and will be accentuated where companies in order to comply with the "voluntary program" guidelines

on repatriation borrowed for that purpose. Under Section 1000.202 a corporation is required to remit at the same percentage as it remitted under the "voluntary program" when that percentage is higher than the prescribed percentage under the mandatory program, whereas a company that did not remit under the "voluntary program" is limited to the percentage prescribed under the mandatory program.

The effect of these provisions, together with the moratorium on new capital inflow into Schedule C countries, will be to force foreign affiliates into further borrowing. Their capacity to borrow, however, will be seriously impaired by Section 1000.312 (e) (1) and (2) of the regulations which provides that any satisfaction of an obligation of a direct investor incurred as a result of a guarantee of an obligation of an affiliated foreign nation, or the assumption of a liability of an affiliated foreign national, is deemed to constitute a transfer of capital. Such transfers are prohibited to Schedule C countries and are otherwise limited for countries in Schedules A and B. Thus, since a U.S. parent would no longer be able to guarantee the loans of its affiliated foreign nationals in continental Europe, these affiliates will be forced to obtain their short and medium capital requirements in the increasingly expensive long-term money markets. this will diminish future earnings available for repatriation to the United States.

These provisions reduce both the capacity of foreign affiliates to repay loans and to secure further borrowings, thus weakening their competitive position and closing the door for required capital to meet their normal growth needs. Accordingly consideration should be given to permitting the net long-term portion of borrowings expended in direct investment to be included in calculating the investment base. In addition, an amendment of the regulations is urgently required to permit U.S. parent companies to perform under their guarantees of the loans of foreign affiliates and to offer guarantees of the loans of foreign affiliates that would be acceptable to foreign lenders. We welcome indications that clarification on this point may shortly be expected.

We take cognizance of the fact that there was an amendment to the regulations on January 23 and a general authorization issued which does permit the entering into and performance under guarantees in accordance with that general authorization. Of course, that is a welcome step to overcoming some of the problems.

Turning now to the next item:

2. PRIOR CONTRACTUAL COMMITMENTS

The regulations present serious problems with respect to work in process and commitments under investment programs which were entered into prior to January 1, 1968. Such commitments, for example, can involve purchase of additional shares of capital, the requirement to supply industrial property, services, equipment, raw material, parts and components. Basically the question is how such commitments and contractual obligations can be honored, particularly in respect of Schedule C countries in view of the limitations imposed by the moratorium on new investments, the limit of 35% of earnings for reinvestment, the requirement for repatriation of earnings and of short-term assets. and the prohibition against satisfaction of an obligation of a U.S. parent company as a result of a guarantee.

The only relief for the foregoing problems afforded by the regulations is by exemption on a case-by-case basis. Is this administratively feasible? Any delays and uncertainties will unduly penalize and disrupt companies in the conduct of international business. Could not some of these issues better be met on a broad policy basis either by revision of the regulations or by issuance of instructions under which companies would have assurance that, under specified conditions or limits, exemptions would be granted to permit carrying out prior investment commitments.

3. REPATRIATION OF DIRECT INVESTMENT EARNINGS

In addition to the adverse effects of the repatriation requirements referred to above, U.S. direct investors are confronted with problems under the following situations:

(a) A direct investor is defined under Section 1000.304 as a U.S. person who owns or acquires 10 percent or more of the voting power or a right to 10 percent

or more of the earnings and profits of any foreign national and is subject to the mandatory requirements of the regulations. It is impossible for a U.S. direct investor, owing as little as 10 percent of the stock in a foreign corporation where the remaining stockholders are foreign nationals, to repatriate funds against the will of the foreign nationals. In this connection it should be pointed out that the ability to average out repatriations within a particular schedule of countries will prove of little benefit to U.S. corporations with limited operations overseas or within a given schedule of countries.

(b) A U.S. investor having a majority position in a foreign national who is required to and does repatriate the amounts prescribed in Section 1000.202 of the regulations may be liable to a stockholder's suit by an aggrieved minority shareholder. This problem is aggravated where the U.S. investor can not repatriate all or part of the earnings of a wholly owned foreign subsidiary and, in an attempt to average, repatriates funds from an affiliated company within the same schedule of countries to the detriment of the minority interests.

(c) Many countries prescribe partial or complete restrictions on any remittance from such countries. For example, in Finland dividends may be remitted currently only to the extent of 25 percent of capital stock with the balance being remitted over a 5-year period. In Brazil, there is an excess remittance tax ranging upward to 60 percent of any remittance exceeding a prescribed limit. Other countries prohibit repatriation of current year's earnings until some time after the close of the year in which earned, while other countries may block the repatriation of funds where capital has been impaired in prior years but where the company does have a profit in the current year.

In these situations, the regulations should also provide relief from the mandatory repatriation formulas. Here, too, it should be pointed out that averaging within a particular schedule of countries will, in many instances, prove of little benefit to U. S. corporations.

4. OPEN ACCOUNT SALES TO AFFILITATED FOREIGN NATIONALS

Expansion of U.S. exports is a fundamental objective of the U.S. program for strengthening the balance of payments. U.S. exports to foreign affiliates constitute a substantial percentage of our total exports and have increased significantly in recent years. However, Section 1000.312(d) provides that a net increase in advances upon open account to an affiliated foreign national constitutes a transfer of capital.

Limitations on net increases in open account as governed by the limitations on transfers of capital under the regulations, will inhibit the growth of U.S. exports to affiliated foreign nationals. Provision, therefore, should be made for some growth in outstandings on open account, for example, by allowing such outstandings to grow commensurately with the rate of increase in the value of exports.

Clarification is needed also as to whether advances on open account between affiliated foreign nationals are excluded under Section 1000.312(d).

Our communication was acknowledged by the Secretary of Commerce with appreciation for its clear statement of the problems raised by the regulations, advising that it would be carefully studied and considered by the Department in the management of the new program.

As you have already seen, it has done this with respect to guarantees. We again emphasize that the recurring deficits of the U.S. balance-of-payments position cannot properly be attributed only to direct foreign investments or to any other single item or class of transactions. Nor can restriction upon the outflow of any one item or class of items in itself assure reduction in the overall U.S. balance-of-payments deficit. Even in the short run, as under the voluntary program, gains from restraint of foreign direct investment will be offset by subsequent losses. Strains on international capital markets as well as retarded exports and diminished inflows of investment income will reduce receipts on the credit side of our international accounts. In connection with stemming outflows, action to reduce Government expenditures overseas is a vital element in the program.

Efforts should continue to be maximized to this end and to assure that governmental procurement requirements are met as far as possible from U.S. sources.

Historically, international trade and private oversea investment have been favorable factors in our balance-of-payments. Over a 10-year period through 1966, the cumulative capital outflow for direct investment was $21 billion, whereas, from investments the cumulative income to the United States was more than $29 billion, and fees and royalties have amounted to more than $5 billion. Exports to affiliated companies, and here I am referring to exports of finished goods and services, represent approximately 25 percent of all U.S. exports. There has been a steady growth in the export of goods and services. The controls which have been placed on the direct investor can serve only to make it more difficult for business to make a positive contribution to our admittedly critical balance-of-payments situation. We are concerned with the indications that these controls will lead to retaliation by other countries against the best interests of the United States.

Proposed Travel Tax Program

The National Foreign Trade Council as well as the Declarations of National Foreign Trade Conventions have long emphasized the constructive force of travel in the expansion of foreign trade, and have supported positive efforts both of Government and of the travel industry in promoting travel to and within the United States. Measures intended to restrict or curtail international travel as a means of narrowing the balance-of-payments gap have been opposed as shortsighted since any meaningful curb on tourist expenditures abroad can only constrict exchange receipts and consumer incomes in many of our most substantial export markets which rely on these earnings to balance their own accounts.

The Council is most seriously concerned with the proposals now under discussion by the Treasury Department with the Congress, as described by Secretary Fowler, on February 5, in testimony before the Committee on Ways and Means.

The proposed plan would place upon that section of the business community which is contributing to the positive side of the balance-of-payments ledger penalizing additional taxation on the necessary work of doing business. The inclusion of business travel in any proposed travel tax program would be clearly self-defeating in that it would hamper the efforts of businessmen and companies to increase exports and would increase the costs of maintaining market positions already established and of managing foreign investments which are contributing favorably to the Nation's balance of payments.

Conclusion

Mr. Chairman, in concluding my statement may I revert to our basic position regarding the balance of payments and the paramount need for our Government to take remedial measures to restore a sustainable balance in our international payments and to assure the integrity of the dollar. It is our conviction that the basic overriding task in a balance-of-payments program is to assure that all of its essential related elements involving monetary and fiscal policies will be

carried out so as to check inflation, reduce governmental spending, and strengthen the competitive position of U.S. industry in world markets.

We have emphasized to the Secretary of Commerce, and again today we stress to you that the significant longer term benefits of expanding trade and investment should not be penalized by any undue prolongation of controls.

Chairman PROXMIRE. Thank you, Mr. Norris.

Congressman Boggs?

Representative BOGGS. Mr. Chairman, I think these gentlemen have all made very fine statements. I have just one or two questions, because I have a meeting in just a few minutes. Mr. Cook, what measures do you suggest for the expansion of exports?

Mr. COOK. Well, I think the first thing that we should do as far as exports are concerned is to not enter into something like the International Grains Agreement which, as you will note, will raise the trading limits to a point which is out of kilter with the long-range price equilibrium as the professional economists have calculated it.

I think we get into a residual supply position. We are in that area in cotton anyway. We get even more in a residual supply position, and I am afraid that in view of what is being discussed in New Delhi right now at UNCTAD II that this is the beginning of another series of international commodity agreements, such as the famous coffee agreement which has cost us, I believe, something like $500 million to $800 million in excess prices. And I am doubtful that the money ever got exactly where everybody hoped it would get.

So, I would say that the current policies of the administration are excellent insofar as cotton, wheat, corn, and perhaps even soybeans, but anything that tends to restrict trade and step backward rather than look ahead, is a great mistake.

So, to be specific and responsive, do what we are doing, but let's don't turn the clock back.

Representative BOGGS. I don't quite follow you. The coffee agreement, for instance, I believe, was supported by every participating country. While it may have had some small effect upon the price to the consumers of the United States, it in turn has had a tremendous effect upon bolstering the economy of the affected countries, particularly in Latin America. What substitute would you have for that; foreign aid?

Mr. COOK. Well, I don't know that it really has had quite as much effect as you imply, because they are engaged now with a tremendous coffee surplus, and in Brazil they are plowing up coffee trees and putting them in cotton. So, I would argue, Mr. Boggs, a little bit with the statement that it has done quite as much good as it looked like it was going to do on paper, although I hasten to say I am not an expert on the International Coffee Agreement. It has cost us $500 million to $800 million over the life of the agreement in excess coffee payments.

Representative BOGGS. Aside from some of these international agricultural agreements, what other suggestions do you have?

Mr. COOK. Well, as I said before, the thing that gives incentive to a businessman more than anything else is his ability to keep money in his company or in his pocket, and an export tax rebate, which has been discussed, seems to me to be the wrong way to go about it.

What we would be more interested in is getting more people into the act, and taking advantage of the natural advantage we have, which is in the balance of trade, and in agricultural commodities. I think they amount to 22 percent of the total and 50 percent of the net on our favorable balance of trade, and I think the policy is fairly successful as it is. I have no suggestion that it be changed. Rather, I am suggesting that it not be changed as we are threatening to do under the International Grains Agreement.

Representative BOGGS. I don't want to put any words in your mouth, but doesn't it seem logical that we should continue in rather hard negotiation with the import countries? We tried to do that in the Kennedy Round. We succeeded very well in the nonagricultural commodities in the Kennedy Round. I know it wasn't in the agricultural commodities, but it was the question of either negotiate, or erection of new barriers and retaliation. Isn't that just about what it was?

Mr. COOK. Well, I think that is true. Insofar as the GATT negotiations of the Kennedy Round, I really think that nothing was achieved for agriculture.

Representative BOGGS. Nothing was achieved?

Mr. COOK. No, sir.

Representative BOGGS. That is a pretty broad statement.

Mr. COOK. I would be willing to repeat it, but maybe I should say "very little" rather than "nothing."

Representative BOGGS. Mr. Hamilton, I would like to ask you a question or two. First, let me congratulate you on the very fine job that your company has done all over the world for so many years. I would be terribly distressed if anything that is done by our Government would have an adverse effect upon the continued expansion of your company.

But, what really gives me concern is that both before this committee and before the legislative committees which have responsibility in these areas, the Ways and Means Committee, for example, I can't find anyone other than the administration advocating any positive programs.

There is a dollar drain, and the last quarter of 1967 witnessed one of the heaviest balance-of-payments deficits that we have had. We are beginning, it seems to me, to lose in the relative position of exports with respect to the imports.

What I am interested in is what do you recommend to curtail dollar outflows? I know your company has a big dollar inflow, so maybe you haven't thought about it from that aspect, but when confronted with these problems, you always have to have some kind of a solution. What would your solution be?

Mr. HAMILTON. Mr. Boggs, I would really rather not try to deal with all of the aspects of the balance-of-payments problem. You have had far greater experts advising you in other areas.

But, clearly, where you have a source that is contributing regularly, the last thing you would want to do is take shortrun measures, which may or may not be helpful, and in the process actually jeopardize the source. That $2 billion has been very important, and this is not just in 1966 and 1967, but going back quite a few years you find in the Commerce Department statistics the same contribution.

Representative BOGGS. Maybe I should ask you a specific question. Do you know any practical way of resolving the problem that seems to be almost unique with ITT in light of these regulations? Have you gotten any relief from the Commerce Department?

Mr. HAMILTON. Well, obviously, I have gotten to know the administering staff quite well since the first of the year, and there is a general recognition by them that as they apply in any one case these regulations may have some rather unusual and harsh consequences. In effect, they say this merely gives them the right to ask us to come in and sit down and talk about our entire program. What are we going to do during all of 1968 with respect to our net flow abroad?

We are perfectly willing to do that. In fact, the exemption that I mentioned we had filed is an application to do just that and to agree on a level of inflow that shows some progress over last year's, but to permit us to bring it back in all the ways available to us, so that we don't have to rely so heavily on dividend repatriation. Their position is that we should come in and talk about it and they will try to be understanding. I think our complaint——

Representative BOGGS. Try to do what?

Mr. HAMILTON. To try to be understanding about the peculiar problems of ITT. I must say these are able and hard-working men, and they have had a very difficult time since the first of the year. Personally I am grateful that I am not put in their position where I am supposed to have the wisdom to review the international programs of 700 or 1,000 or eventually 3,000 or 4,000 companies, many of whom have the complexities of ITT, and make judgments about them in such a way that there is equity, that there is an understanding of the needs of the companies and their shareholders, and that the long-range interests of the U.S. balance of payments are properly served.

Frankly, this is taking on a tremendous responsibility.

Representative BOGGS. Do you feel under the existing circumstances, with special reference to your own organization, that you may incur some degree of retaliation from some of these other countries?

Mr. HAMILTON. I think ITT is not alone in this. I think any time that seasoned companies in Western Europe which are not now receiving additional financial support from their parents, but are merely repatriating a fair portion of dividends every year, are asked to go from a level of repatriation from, let's say, as in my example, 50 to 80 percent, then I think it is clear that you would be jeopardizing the long-range interests of your company. Part of it would be the relationship of the affiliate with its Government, part of it would be the relationship with its creditors and, finally, with its competitors.

Representative BOGGS. You have built up a great deal of capital, have you not, in these other countries, that you are able to use without any recourse to American capital?

Mr. HAMILTON. This is correct. In our particular situation, these subsidiaries have been over there for 40 and 60 years. As I mentioned, they are staffed almost entirely by nationals. The boards are almost entirely nationals, and their relationships with the local banks are intimate.

These are good bank relationships, and this is why these companies can grow and expand without asking for assistance from the United States. When we do borrow at a senior level as we did in the

case of last week's issue that I just mentioned, this is mostly so that we can do new things such as acquisitions and new ventures.

Representative BOGGS. Mr. Norris, I would like to continue with you for a while, but we have a rule on this committee limiting each member to 10 minutes.

Mr. Hamilton, I must congratulate you on a fine statement.

I do have a question that I would like to address to Mr. Norris. I might say, Mr. Norris, as you know, as chairman of the Subcommittee on Foreign Trade Policy of this committee, that I have, I think, worked as hard as anyone to make trade freer between nations of the world. I gather that you are opposed to most of these recommendations, including the proposed travel tax and the others, and in the last paragraph here of your statement, or the second to the last paragraph, you say:

> It is our conviction that the basic overriding task in a balance-of-payments program is to assure that all of its essential related elements involving monetary and fiscal policies will be carried out so as to check inflation. reduce governmental spending and strengthen to competitive position of United States industry in world markets.

I notice you don't say anything about a tax increase.

Mr. NORRIS. There, again, I think it is a part of a basic overall integrated program, Mr. Boggs. I am not here as an authority on fiscal matters.

Representative BOGGS. You know what you are talking about.

Mr. NORRIS. I realize that, but I say this: My basic concern is the fact that we must take steps to halt an increase in the deficit.

Representative BOGGS. Let me ask you specifically, do you think it is possible, to use your own language, to assure "that all of its essential related elements involving monetary and fiscal policy will be carried out so as to check inflation," and so forth? Do you think that is possible without a tax increase?

Mr. NORRIS. I don't think it is possible without a tax increase, sir; but, what I am trying to say is, I think that in invoking a tax surcharge, I think there must be other things done as well.

Representative BOGGS. Spell out exactly, if you don't mind, what we have to do.

Mr. NORRIS. I think there should be every effort made to reduce our Government expenditures abroad——

Representative BOGGS. Excuse me for interrupting, but will you spell out where we should do that?

Mr. NORRIS. I think this can be done by bringing back unnecessary troops from abroad.

Representative BOGGS. From where?

Mr. NORRIS. I would think from Germany.

Representative BOGGS. You think they are unnecessary in Germany?

Mr. NORRIS. I think to the extent that they are maintained there along with their families they probably are.

Representative BOGGS. How many do you think are unnecessary there?

Mr. NORRIS. I don't have that.

Representative BOGGS. I am trying to figure out how much this would save. You see, we are confronted with specific problems, and it is very easy to give generalized answers. I think when you appear before these committees that you should be prepared to give specific

suggestions. Now, you say return troops. How many troops and how many dollars would you save?

Mr. NORRIS. I am not in a position, Mr. Boggs——

Representative BOGGS. Then, let me spell out others. Where else would you save money?

Mr. NORRIS. I think we could reduce the number of people we have abroad on behalf of the State Department and certain Government agencies.

Representative BOGGS. They have reduced them considerably. How much more would you reduce them?

Mr. NORRIS. I am not in a position to give you figures because I haven't studied it, sir.

Representative BOGGS. Do you have any specific recommendations on domestic expenditure reductions?

Mr. NORRIS. As we say in our basic position, we think that domestic expenditures should be maintained only for those of high urgent priority.

Representative BOGGS. Do you have any suggestions as to priority? Understand, we are confronted with legislating on these proposals.

Mr. NORRIS. Yes; and I am well aware that this is a problem right within the Congress today.

Representative BOGGS. It certainly is.

Mr. NORRIS. In attempting to reconcile some of the things that the administration would like to do with what the Members of Congress feel should be done, I realize this is a problem. I am not in a position to deal with the specifics. I think that this is a matter of basic policy that we should adopt.

Representative BOGGS. But you are dealing with specifics. You are talking about sound fiscal policy. You are talking about balanced budgets. You are talking about monetary restraints. You are talking about no tax on travel abroad, the removal or modification, at least, of the regulations with respect to investment abroad.

Do you have any recommendations, specific recommendations, in respect to increasing our export position?

Mr. NORRIS. Yes. I think that we must always do everything to increase exports, but we should not curb investments unnecessarily. I recognize at the same time that we are faced with an emergency situation, that we must take immediate steps to do whatever we can to correct our payments imbalance.

At the same time, I think that there should be a full recognition within Government of the very positive inflow and contributions which these investments make, and the fact that these investments do generate considerable exports. Consequently, I would be very reluctant to see any substantial curbing of these direct investment programs. I think that there can be certain tax incentives adopted to promote exports.

Representative BOGGS. Spell that out a little bit. What kind of tax incentives?

Mr. NORRIS. I think that this can be done perhaps by particularly encouraging those who have not entered the export field—to encourage them by allowing some tax credit based upon their export business. That is one approach to the subject.

Representative BOGGS. Would you try to balance that off with some kind of a restriction on imports?

Mr. NORRIS. I think when you talk about restricting imports, you get into all sorts of questions such as quotas, protectionist measures, and so forth.

Representative BOGGS. Of course, that is the other country's exports.

Mr. NORRIS. Sure. I would like to see some specific proposals on it. I have none to make, actually, at this stage of the discussion.

Representative BOGGS. Mr. Chairman, I have consumed my time. I want to thank you gentlemen for being so courteous, and I thank you for your testimony.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Gentlemen, I appreciate the statements you have given here before the committee. They are very helpful to us, I assure you.

Mr. Cook, I just returned from out west, and when I was out there I had a meeting with some of our wheatgrowers, and they complained to me that the world price of wheat was too low, that they could not grow wheat and survive at present world price of wheat.

The International Grains Agreement, as you said in your statement, would raise the minimum world trading price of wheat by 23 cents a bushel. Yet, in your opinion, the way I read your statement, we would only lose our export markets by this type of inconsistency. Is that you position?

Mr. COOK. Yes, sir.

Senator JORDAN. And you believe that it would be self-defeating, if we were to raise the minimum world trading price of wheat by 23 cents, that it would be self-defeating because you believe we would lose our world markets by so doing.

Mr. COOK. Well, sir, I would like to say that it is probably true that the western wheatgrowers cannot survive at the world wheat price. The current loan, as you know, is $1.25, the base loan, and they get a cash subsidy payment of approximately 45 or 46 cents a bushel, so they are not growing wheat at the world level. They are getting paid in excess of that, as you know, I am sure.

That is the problem if we are to keep pressure on the common agricultural policy of the European Economic Community, in particular, France. They sold 500,000 tons of wheat to Red China on credit last week at $47 a ton f.o.b., against an internal support price of $2.87 a bushel, or a little over about $100 a ton. Now this is considerably less than we can sell wheat at, even at $1.25.

I would say that France is probably contributing 25 percent of the funds to the CAP, and getting, say, 75 percent of the benefits, and I think it is against our national interest to take the heat off in this area and induce the production of wheat in other parts of the world where they are relatively inefficient, and run into the same thing in wheat that we have run into in cotton, where we have seriously damaged our world markets.

This is my position on the raising of the levels.

Senator JORDAN. Thank you.

Mr. Hamilton, you made a good case for your company and the effect of these regulations on your foreign operations. What do you

think will happen to the competitive position of U.S. companies abroad, if the investment regulations are not modified?

Mr. HAMILTON. I would like to make it clear, Senator Jordan, that I don't think ITT is completely unique in this regard. I think there are a number of mature companies that may fall into the same category.

But, when you have a situation which I have described, where we have really had many benefits of having a foreign national character in terms of our ability to borrow, our ability to sell, and for other aspects of our business, and then apply these repatriation requirements, we would begin to appear like a mainly American corporation pulling out undue portions of our earnings. This would invite retaliation from the governments, perhaps in the form of controls which, in turn, would concern our creditors. It would give our competitors an advantage. In short, you would begin to whittle away and erode what really is an unusual national asset.

But, I repeat, while ITT in many ways is unique, I think there are other mature corporations, operating particularly in Western Europe, that represent the same kind of asset for the United States, and should be protected, really, in the same way.

Senator JORDAN. How do these repatriation requirements affect your company, taxwise? Do you pay more or less taxes?

Mr. HAMILTON. There aren't many countries that have a withholding tax on dividends of less than 15 percent. As Mr. Norris mentioned, many of them operate progressively, so that by the time you get into high percentages of payout, you are not dealing at the 15-percent level, but, rather, at the 35-percent or higher level.

In summary, if you bring more dividends back, not because it is desirable either for affiliates or to the parent but solely to accommodate a regulation, then you will leave, at the very minimum, 15 cents of every dollar on the counter of the foreign government.

Senator JORDAN. Something was said by one of you—and I don't recall who—about the effect of the U.S.-owned production facilities abroad on our balance of payments. Do they tend to reduce exports and increase imports or vice versa?

Mr. HAMILTON. I happened to attend this morning's session, and I heard the comments at that time. I know there was a study made at the time Mr. Behrman was in the Commerce Department that indicated that probably 24 or 25 percent of all American exports were affiliate related. I think, in your testimony, Mr. Norris, you used the same percentage.

When you consider the net contribution of these foreign investments, including the income from dividends, and the income from royalties and fees, less the net outflow, you should consider, also in this arithmetic, the additional plus that comes from the affiliate-related exports.

Senator JORDAN. From the additional exports?

Mr. HAMILTON. The incremental exports; yes.

Senator JORDAN. By the affiliate operation in the foreign country.

Mr. HAMILTON. Correct.

Mr. NORRIS. I would certainly subscribe to that. I think that the figures do demonstrate it is about 25 percent. There is also the very fundamental position that it is the only way very often that Ameri-

can companies can get their market positions abroad. Experience demonstrates that often the only way to get these positions is to start some assembly or manufacture abroad, and once you establish a market position for your so-called run-of-the-mill products, this in turn, leads to the ability of the U.S. company to export its more sophisticated products as they are developed and they certainly are developed.

Senator JORDAN. Mr. Norris, you have a very fine paragraph on page 8 of your statement starting, "Historically, international trade and private overseas investment have been favorable factors in our balance of payments."

I think in that paragraph you speak about the exports to affiliated companies representing approximately 25 percent of all U.S. exports. It looks to me like these regulations are killing the goose that laid the golden egg. Mr. Hamilton, do you think that the regulations will be effective in stemming the balance-of-payments deficit?

Mr. HAMILTON. Well, there is no question that as they are constructed that they would have some effect. I must say that——

Senator JORDAN. Short run or long run?

Mr. HAMILTON. They may have a shortrun effect of curtailing the outflow. The question is whether they will have the longrun effect of actually damaging something that is much larger, and, therefore, more important, and that is the inflow.

I must say that I don't envy the position of our friends who have to administer the program. As I understand it, they were handed the $1 billion target, and the regulations, with two hands at the same time. I think good administrative practice might have dictated that they be handed the target and then asked to develop the regulations that are designed to meet it.

At the moment, I don't think anybody, either in the corporate world, or in the agencies, knows exactly what the shortrun effect of the present regulations would be, whether they would generate savings less than the $1 billion target or whether they would generate $2 billion. This frankly, makes the administrators uneasy, because they can't afford to be too understanding of any one company's problems, because they are afraid that they thereby may miss the target.

I must admit if I had been handed the assignment of saving $1 billion in 1968 over 1967, from this private sector, I would have done it somewhat differently, although I am encouraged by Professor Behrman's view that new investment abroad is really returned on a net basis in the balance-of-payments statistics very quickly. I think he said in about 2½ years.

Senator JORDAN. Yes; I remember that figure.

Mr. HAMILTON. It should have been easier to take up slack there, and maybe reduce the $3 billion outflow to $2 billion, without, at the same time, requiring a greater return of income, the $5 billion figure I mentioned.

They had their choice of attacking either the $5 billion coming in and the $3 billion going out, or both. I think it might have been sounder to draft the regulations to reduce the $3 billion down to $2 billion to reach the target.

Senator JORDAN. Thank you, gentlemen. My time has expired.

Chairman PROXMIRE. Gentlemen, all of you seem to disagree, more or less, with the President's balance-of-payments program. Mr.Cook

concentrated on one specific limited element of it, but, certainly, Mr. Norris and Mr. Hamilton, you most emphatically disagree with much of what he has proposed.

I would like to ask you to tell me whether or not on each of the elements in the President's program you think, No. 1, his estimate of savings is about right or exaggerated, or even in the wrong direction for the first year; and, then if you care to do it, how long before you think this kind of a program, if persisted in, would become perverse.

In the first place, the mandatory investment program. As I understand it, mandatory investment restraints, the President said, would save $1 billion, or he wants to save $1 billion; that is the goal. The Federal Reserve restraint would have $500 million additional restraint; the travel restraint a half billion dollars; the repatriated earnings, which I guess is about a half billion dollars; and the Government expenditures overseas, a half billion dollars.

I presume there is no argument on the last part. That is pretty simple. So, let's take the $2.5 billion of the program other than the Government expenditures overseas. Mr. Hamilton.

Mr. HAMILTON. With your permission, Mr. Chairman, I will stick to the aspect I know best, the mandatory program.

Chairman PROXMIRE. There is no reason you should stick to the parts you know best. We don't do that in the Congress. Give me your impression on all of them. It would be helpful.

Mr. HAMILTON. On the mandatory program, the savings of $1 billion could be made by either controlling the outflow or asking companies to increase the inflow, not necessarily through the repatriation of dividends, with all of the consequences I have mentioned, but, if necessary, bringing it back through other sources, including the proceeds of borrowing.

Chairman PROXMIRE. So you think that the estimate may be in the right amount? I am just asking whether you do?

Mr. HAMILTON. I think the $1 billion would be achievable. Obviously, if only 50 companies bring back $20 million more in 1968 than in 1967, the target is achieved.

Chairman PROXMIRE. How long before it has a perverse effect for reasons that you have so well spoken of?

Mr. HAMILTON. If you are doing this through new investment, then, of course, I think we have to rely on Mr. Behrman's estimate that it is probably 2 or 3 years before this begins to——

Chairman PROXMIRE. Within 2 or 3 years. In other words, this will contribute a negative element to our balance of payments.

Mr. HAMILTON. Right.

Chairman PROXMIRE. Not a positive element.

Mr. HAMILTON. But, if this is attempted through the repatriation route, and you get the kind of retaliatory and competitive problems which I have referred to, then, of course, the consequences would be much quicker.

Chairman PROXMIRE. Well then, the repatriated earnings you would agree could be a half billion dollars. It would be deteriorating more rapidly than the investment.

Mr. HAMILTON. The question is, rather, whether you bring it back solely from native companies by having to have them declare and pay out extremely high dividends, or whether the Department gives

us some flexibility as to whether we bring it back from the various sources available to us.

We think we can generate the same plus for the balance of payments, and by that I mean an improvement in 1968 over 1967, but without the damaging consequences of having to do it through divided declarations.

Chairman PROXMIRE. How?

Mr. HAMILTON. Purely by bringing back more. Please don't misunderstand me. As I said earlier in the testimony, we want to do everything we can, not only to continue——

Chairman PROXMIRE. I am sorry; maybe I missed something earlier. You said just by bringing back more. If you don't bring it back by dividends, and you don't bring back repatriated earnings, how does the Federal Government administer a program to bring back more, without either of those?

Mr. HAMILTON. Well, under the voluntary program, on occasion we brought back the proceeds of long-term borrowings, we brought back additional amounts in fees, and so on.

Chairman PROXMIRE. This is my question.

Mr. HAMILTON. There is an alternative.

Chairman PROXMIRE. On the assumption that the voluntary program continues?

Mr. HAMILTON. Right.

Chairman PROXMIRE. Now my question is: Will the mandatory program increase, or rather diminish the outflow by the $1 billion the President estimates? I am a little confused by the last part of your answer. You are implying now that you don't need the mandatory program, that the voluntary program would work to diminish the outflow by $1 billion.

Mr. HAMILTON. I think the $1 billion could have been obtained without a mandatory program; that is correct.

Chairman PROXMIRE. With the 1965 program.

Mr. HAMILTON. I think the $1 billion also could be obtained under the mandatory program, solely by reducing the outflow side.

Chairman PROXMIRE. So that what you are saying is that 1968 will be a better year than 1967, in part because you don't have the peculiar conditions which you had in 1967—with the British devaluation and other elements—and that if you continue the voluntary program, that you could make a billion-dollar-better showing on net capital outflow, absent having the compulsion; is that correct?

Mr. HAMILTON. When we talk about reducing the net dollar outflow, that applies to many companies.

When we apply it to ITT, it is a question of increasing our inflow. We would be able to do that, and make a positive contribution in 1968 over 1967.

Chairman PROXMIRE. Now, how about travel?

Mr. HAMILTON. From my point of view, the only thing I can say here is——

Chairman PROXMIRE. I am not asking you if it is good or bad. We have our own impressions of that. Some of us are very critical of it; but will it work?

Mr. HAMILTON. In the first place, I don't think it will work. Second, ITT people are, all over the world, making sure that we generate the

earnings which we are counting on here. I think the people had better stay abroad and continue their travel.

Chairman PROXMIRE. You have no particular objections to the Federal Reserve program, I take it; that is, the restraint on banks and financial institutions abroad?

Mr. HAMILTON. No, sir; in fact, we have some credit organizations that are subject to that program.

Chairman PROXMIRE. Very good.

Mr. Norris?

Mr. NORRIS. Oh, I think that under any mandatory program, you can do anything you want; I mean if you insist that you bring back a half billion dollars.

Chairman PROXMIRE. So, you say it will work, but for how long?

Mr. NORRIS. Only because it is mandatory, and I think the actual results will depend upon the degree of flexibility that is exercised in the management of the program, and there must be flexibility because a lot of companies hurt not only short run but they certainly hurt long run.

Chairman PROXMIRE. You have answered the first part of the question that you think you will get the billion dollar saving. But, the next part of the question is, How long before that will deteriorate?

The burden of the testimony, including Professor Behrman's testimony this morning, was that there is such a quick payback that if you cut investment abroad by $1 billion, presumably within 2½ years, you lose your benefit and you begin to worsen rather than benefit your balance-of-payments situation.

Mr. NORRIS. I agree with what has been said this morning.

Chairman PROXMIRE. Would you agree that is right?

Mr. NORRIS. Yes; and I think there are also short-term losses, too.

Chairman PROXMIRE. How about on repatriation of earnings?

Mr. NORRIS. Here again, I think, if it is mandatory, you can force anybody to do something under threat of penalty, and imprisonment and fines. But I think the real problem here is whether U.S. industry isn't going to run into really difficult problems with respect to their partners abroad, where you have nationals who have majority interests, and where you have laws, as in the case of France, under which you are actually precluded from doing various things; for example, depending upon whether your interest is in a society of limited responsibility or a société anonyme.

There are these other restrictions that I have attempted to point out, such as in Brazil. In many cases you can't do these things by law. Or you do them against the rights of minority shareholders, and you can't force your position as a majority holder.

Chairman PROXMIRE. You make a very, very strong case. I simply wanted to get your notion. Now, how about on travel? Will that work?

Mr. NORRIS. The main thrust of our position on travel, Mr. Chairman, is that under no circumstances should this program apply to business, because I think there is an immediate loss and I think that there is a very long-term penalty that is paid.

Chairman PROXMIRE. Is there? Secretary Fowler testified that in his judgment this wouldn't diminish the amount of travel at all—just the amount spent. He argued that there would be the same num-

ber of students going abroad and teachers going abroad, businessmen going abroad, but he contended that with a graduated tax and with a 30-percent tax on everything spent over $15 a day, that Americans would be much more careful about where they stay, and how much they pay. They would be much more careful with what they are spending. Is there any validity in that to you?

Mr. NORRIS. Of course, if you want to pay the cost of travel, you can always travel under the proposed program.

Chairman PROXMIRE. Businessmen would certainly tend to travel in spite of the 30 percent tax. It wouldn't stop them from traveling; would it?

Mr. NORRIS. But at great penalty and at great cost. They can't anticipate as an example what their expenditures are going to be, which you are obliged to do under the explanation of the program that was put out by the Secretary. That is a very cumbersome proposal.

Chairman PROXMIRE. I think they would be the least likely to curtail their travel, because they are going abroad for a specific business purpose. The cost of that travel as compared—not in all cases, of course, but as compared to the great majority of the cases with the necessity for having the businessmen travel—the cost would be relatively minor.

On the other hand, a tourist, a student, a teacher, because, of course, they have to pay the whole thing themselves out of their own pockets, in many cases I think that they would not travel.

Mr. NORRIS. I think the cost to business would be substantial.

Chairman PROXMIRE. It undoubtedly would be substantial. I am just wondering if it would deter, actually deter, prevent travel.

Mr. NORRIS. It certainly would not deter necessary travel.

Chairman PROXMIRE. Yes.

Mr. NORRIS. I think, however, that there may be some curbing of travel which you would normally take for long-term objectives in the management of your programs abroad to develop your market position, and I think this in turn would have an effect upon our inflow, short term and long range.

Chairman PROXMIRE. Do you want to comment, Mr. Cook? I wish you would.

Mr. COOK. I would only say this: We have had some experience with foreign exchange controls, particularly with English sterling. These regulations we have are called direct investment controls.

By definition of the word "investments" they are actually exchange controls, I mean that is so if you cut away all of the fat. These are exchange controls.

I have never had any experience with exchange controls except with sterling exchange, and the rules applied to nationals of all countries, whether they were English or Americans. We were doing the switch business after the war in sterling.

This was fine as long as they didn't catch our money going through the system. If they did in violation of the regulations, they confiscated it.

Well, I wonder if any exchange controls such as these are having any real length of life, because I can't imagine a sophisticated investor in Europe subjecting himself to having his money locked up.

He can make 3 percent a month in Brazil tonight, but if you get it down there you can't get it out. There are lots of other places to go with money. So, I am suspicious that these exchange controls will be self-defeating because of the fear that they create in the minds of foreigners.

Chairman PROXMIRE. You think they will be self-defeating and quite rapidly.

Mr. COOK. In my judgment, like the battlelines during the Civil War, the value of the bonds in France went up and down based on the value of the collateral in the South.

I think the same is true. As our balance-of-payments deficit or surplus fluctuates, so will the efficacy of the exchange controls, particularly when we have $30 billion in short-term assets abroad on call.

Chairman PROXMIRE. My time is up.

Senator Percy?

Senator PERCY. I am sorry I was not here for the testimony, but I read your statements. Mr. Hamilton, I can only say I wholeheartedly concur with virtually everything you have said. The positions are sound, and we deeply appreciate your giving us the benefit of these views.

I would like to ask this. I have read several newspaper articles indicating there was some reluctance on the part of companies to testify, because of the procedure being used for specific exemptions. There is a good deal of discretion in the Department of Commerce as to who gets exempted. The implication in the articles was that if someone came down and testified, they might not be exempted. Do you think that this is a legitimate concern as expressed in this newspaper article?

Mr. HAMILTON. I guess I had better answer that, Senator Percy. No. Obviously, if we thought this was a problem, that we weren't going to be treated fairly by the administrators, we would have had to consider—rather, we would probably have been up here earlier, let me put it that way. No, we fully expect the people in the agencies to render effective and fair treatment.

As I mentioned, before you came in, I think the problem is that they have been given both a set of regulations and a target, and they are very reluctant to ease up in places where it otherwise obviously makes sense, because they don't know what the quantitative results will be on that target.

I said earlier that I am glad I do not have to manifest the wisdom that they are going to have to have to review, let's say, our whole corporate program as it affects the international flow in 1968, and do it in such a way that it provides equity among companies, that it duly recognizes the rights of shareholders, and that it takes the proper long-range view of the U.S. balance-of-payments interest.

It would have been better if we could have had a more well-considered and well-thought-out regulation. The regulation frankly was drafted quite harshly, with the thought that administratively it could be made more lenient, more responsive to need. But the resulting load on the people in the Office of Direct Foreign Investment is tremendous and may prove to be nearly impossible.

Senator PERCY. Mr. Norris, I wonder if you could comment on the small percentage of export business done by small business in this country and the vast proportion of it done by major business.

Now, the point I made with Government witnesses on the travel tax is that it will not impede the travel of those 3 percent of our companies in this country who are in the category doing 95 percent of our foreign trade.

But what we have been trying to do for many years is interest the rest of American business in business abroad. I don't see how they can understand how to do business abroad, develop those markets, and adapt their product for those markets, unless they travel.

It seems to me that the travel tax will impose an undue hardship on the very small business that we want to encourage to go abroad to develop these markets that will improve our balance of trade over a period of time. Would this concur with your judgment, being in the practical world of business?

Mr. NORRIS. I thoroughly concur with that viewpoint, and I go further and say that it will impose a considerable hardship on the large companies also who are doing a substantial part of the export business today.

There is not only the matter with respect to the large companies in developing their export business, but it is the management of their investment programs which is extremely important also. If one tries to look at our total position in world trade, I did an exercise on this a few years ago. I think it must have been 1964 or 1965. If you took the total trade that was generated by reason of our own exports, and exports out of affiliates of American companies abroad, I think at that time it amounted to around $64 billion or $67 billion. This is in my view the true measure of the stake of our companies, and of our country's stake in world trade.

There is a very definite interrelationship between trade and investment. Each supports the other. Overseas investment generates exports, so that I don't think you can separate the functions. They are very definitely dependent one upon the other.

With respect to the smaller company, that is afraid to get its feet wet in the export business, this is essentially a matter of orientation. I think it is an educational process which we must continually go through. I sit on the executive board of the National Export Expansion Council and much is being done to try to generate this interest with the small businessman. But I think it needs some help. It needs some help in the form of some incentives for the smaller company which has never been in the export business to start, to get its feet wet. I do feel very strongly that small business would be particularly harmed by any travel tax program as far as it relates to business.

Senator PERCY. I wonder if the travel proposal is not terribly discriminatory in favor of big companies as against medium-sized companies. My concern is generated by my experience representing a medium-sized company abroad. We would have to send people from this country to develop sales abroad. But we are competing against huge companies that have resident people abroad who don't have to come back to this country except for infrequent trips. Those fellows don't have the tax. Those smaller companies and medium-sized companies that have to send people back and forth have to pay an unusually discriminatory high cost in the form of the travel tax.

Mr. NORRIS. I think your reasoning follows very clearly.

Senator PERCY. One last question, Mr. Chairman, if I have a minute left.

Mr. Hamilton mentioned a figure of 82½ percent as against the Commerce Department regulation 65 percent figure. Could you explain this difference?

Mr. HAMILTON. Well, Senator Percy, 65 percent has been a much misunderstood figure.

There has been some discussion that American corporations operating abroad have been paying out approximately 65 percent of their disposable income in the form of dividends, and have been remitting this back to the United States. When we dug into these figures, we found some interest payments in the figures and we found some branch profits which probably reduced the actual payout to around 50 percent payout.

But, nevertheless, the thought would follow, even if the number were 65, that since the regulations provide you only have to pay out as much in1968 as you paid out in the base years 1964, 1965, and 1966, that you could retain 35 percent.

However, as you will recall, Mr. Chairman, in my testimony I mentioned that the regulations limit investment in 1968 to 35 percent of the direct investment in the base years, and direct investment includes reinvested earnings, so in effect what can be retained in 1968, under the more harsh of the two provisions as they affect a company which has been paying out at a 65-percent rate, is not 35 percent, but, unfortunately, is 35 percent of 35 percent, or 12 percent. I assure you this is a very little understood situation. In fact, I must admit that there are many treasurers of large corporations that don't yet understand that this is what the regulations say.

Senator PERCY. Thank you.

Chairman PROXMIRE. Have you checked that with the Department of Commerce? Do they agree that it is 35 percent of 35 percent?

Mr. HAMILTON. Yes, sir; for a company that has been paying out 65 percent.

Chairman PROXMIRE. Ambassador Roth has arrived. I understand Mr. Widnall has one question and then we will hear from Ambassador Roth.

Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Hamilton, do you believe that the informal ad hoc approach currently being used by the Department of Commerce is the best procedure for covering specific exemptions?

Mr. HAMILTON. No, Mr. Widnall. I think it would be much preferable if time could still be given to developing a set of regulations which, on the one hand, recognized the target of a billion dollar improvement in 1968 over 1967 in the private sector, but, on the other hand, sought improvement in those areas where there would be less longrun damage or where it would at least be postponed the longest.

My own feeling is that with $3.5 billion flowing out annually, it is about $3 billion net of what is being borrowed abroad, that there probably is room in there for reduction of as much as $1 billion in any 1 year, if indeed that is necessary. The corporations, at least, can control what goes abroad.

They also are, to some extent, free to determine what they borrow abroad. But, when you deal with the income side, the $5 billion worth of income, this becomes much more difficult for any corporate head-

quarters on this side of the water to control, partly because the income itself is subject to competitive conditions over which they have no control, and partly because repatriation at excessive levels is dangerous, for reasons I have mentioned, such as having nationals on the board, having a rather delicate situation of trying to fit into the local national scene as much as possible to further our relationships with our customers, the governments, and our competitors. Therefore, I would conclude that we should stay away from the income side, and from any targets with respect to that area, except for the one requiring the same percentages of payout as in prior years.

I would accept the latter as being perfectly reasonable, and I would even have gone a little further and said you could have had a modest increase in that payout rate which might, in our case, mean something slightly above the present 50 to 55 percent, but not, sir, in the area of 80, 85, or 90 percent.

Representative WIDNALL. Do the other witnesses have the same opinion with respect to that?

Mr. NORRIS. I think so. Basically; yes, sir.

Representative WIDNALL. Is that true with you, Mr. Walker?

Mr. WALKER. Yes.

Representative WIDNALL. Mr. Cook?

Mr. COOK. I am not suffering from the pangs of maturity that my friend on the right is, so we have never repatriated any money, so anything you do to us in my type of business, which is a high borrowing, low equity position in agricultural commodities, quite frankly, I don't know what it is going to do with our overseas trading. I don't really think that is an issue right here as far as my balance of payments. We have some serious problems, and frankly, we don't know what we are going to do. In the first place, we can't understand the regulations.

Chairman PROXMIRE. Thank you very much, gentlemen, for excellent testimony on a very complicated problem. We will now hear from Ambassador William M. Roth, the President's Special Administrator on Trade Negotiations, and if he cares to bring some of the gentlemen on the staff with him, he may do so.

We are delighted to have you. We know of your reputation in this situation. We are proud and happy to have you here. We have some serious questions about the trade problems. You have a prepared statement. If you will introduce your colleagues for the record.

STATEMENT OF HON. WILLIAM M. ROTH, PRESIDENT'S SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS, ACCOMPANIED BY THEODORE R. GATES, CHIEF ECONOMIST; JOHN REHM, GENERAL COUNSEL; AND WILLIAM KELLY, COORDINATOR FOR NEW TRADE POLICY STUDY

Mr. ROTH. This is Mr. Ted Gates, who is our Chief Economist; Mr. John Rehm, who is our General Counsel; and Mr. William Kelly, who is the Coordinator for our New Trade Policy Study. If I could, I would like to read my statement.

Chairman PROXMIRE. Very good. You may proceed.

Mr. ROTH. I have made some changes in it since the one you have before you.

First, let me say that I welcome this opportunity to appear here and to talk not about the past, but the future, and what we are doing to prepare ourselves for it.

Last July I appeared before your subcommittee and outlined the results of the Kennedy Round, which had just been successfully concluded. Today I shall discuss the next step, the future of American trade policy, which our Office is engaged in studying at the direction of the President.

I shall begin today, with fundamentals—what our trade policy has been for these past 34 years, why we have consistently pursued it, and why we should continue to do so.

Taking into account the hard lessons of experience—the Smoot-Hawley Tariff Act of 1930 and the downward spiral of world trade which followed it—the United States embarked in 1934 upon a policy of trade liberalization and expansion. That policy has gone forward under administrations of both parties, and has had the support of congressional majorities of both parties. There has been steady progress toward the removal of trade barriers over these three decades, culminating in the Kennedy Round last year. World trade during this period has steadily expanded, and its benefits have been ever more widely diffused among nations and people.

Why have we and other nations been steadfast in our trade policies and goals? Fundamentally, because we have all recognized the great economic advantages of the division of labor among nations as well as within nations—with each doing what it does best. Keener competition is an ever-effective stimulus to efficiency, productivity, and innovation. All of us benefit, as consumers, from access to a greater range of variety and quality in the goods we buy, and their more competitive pricing. Trade among nations is, after all, only the extension beyond our borders of the basic elements of the free enterprise system—competition, specialization, the price mechanism, the free market, freedom of choice, and mutually advantageous exchange.

The gains, in the real economic world, do not come entirely without some pain. Therefore, we have sought—through an evolving set of programs and statutory provisions—to maximize the benefits to the great majority of our citizens while minimizing injury to the few.

We must be prepared to adjust to changing circumstances—indeed, our free enterprise system is in itself a potent force for change. Therefore, while steadfast in our goals, we must reexamine from time to time the means of achieving them. This is the purpose of our study.

We are beginning with a thorough examination of our competitive position in world markets—now and in the future. Much has changed since 1962, when we last took stock. The pace of economic development has greatly accelerated. Industrial technology and agricultural productivity have grown by leaps and bounds. New industries have sprung up, both here and abroad. New competitors are appearing in virtually every market.

Some of the critics of a liberal trade policy see ominous portents for the future in this rapid pace of recent change. America, they say, is rapidly losing its competitive edge. Ignoring our high technology, our sophisticated management techniques, our advanced and flexible capital market, and other factors relevant to our competitive position, they predict that lower wages abroad will drive our industries to the

wall. But a sound assessment, we feel, should take into account all the elements which contribute to success in the world's markets.

There are more positive reasons, too, for a careful look at the nature of future competition. Sound policies can come only from sound forecasts of our needs. We need to know what will be the nature, the terms, and the problems of competition in future world markets—what difficulties our exporters will face and in what areas the imports of 1970 may cause domestic hardship.

What will be the implications for our trade of the rapid and continuing development of regional economic blocs? Or of the continued evolution of the restrictive agricultural policies adopted in some of our major export markets? What contributions could expanding East-West trade make to world prosperity and peace?

What is the interplay between our future trade and our now enormous stakes in oversea direct investment? Each of these involve many factors which must be carefully sifted out and appraised—in terms of jobs, productivity, income, growth and, above all, the national interest.

We are considering the specifics of trade policy as well—such as the various ways of conducting trade negotiations, the impact upon trade of the remaining tariff and nontariff barriers, the trade interests of the developing countries, the problems of adjustment within our own economy to foreign competition, and the ways in which trade policy is formulated and administered, both within our own Government and in multinational forums.

One of the most important questions with which our study is concerned is that of future negotiating goals and techniques. We are looking at several possibilities. It has been suggested that the linear approach of the Kennedy Round, having been successful once, should be tried again. But for a number of reasons, such as differing tariff levels among countries, the linear approach encountered many problems in the Kennedy Round, which might prove insurmountable in any similar future negotiation. The item-by-item method followed in previous negotiations could be again tried—although, of course, it was earlier experience with the tedious difficulties inherent in the item-by-item method which led to the adoption of the linear approach.

Eric Wyndham White, the retiring director-general of the GATT, has proposed that future negotiations be conducted on the basis of industrial sectors or groups of products and include both tariff and nontariff barriers. One problem with this approach is trying to find sectors in which the participants could achieve reciprocity. Logically, such negotiations might also include such matters as international investment and research and technology, as well as tariff and nontariff barriers.

Tariff harmonization has also been suggested and, in fact, was tried on a limited basis with the steel negotiations in the Kennedy Round. The advantage attributed to tariff harmonization is that it would put producers in all countries on a more equal and competitive basis. Harmonized tariffs, however, may have more the appearance than the substance of equality, because the same tariff applied in different countries provides different degrees of protection to the domestic industries concerned. Furthermore, other factors, such as nontariff

barriers, may play a very important role in determining the actual level of protection.

During the past few years, as Senator Javits and Congressman Reuss have brought out, considerable interest has been expressed in possible U.S. participation in free-trade areas. Conceptually, these could cover either all products or particular sectors, such as in the United States-Canadian automotive agreement. Much attention has been given to a North Atlantic free trade area—either as an alternative to United Kingdom entry into the ECC or, possibly, as a first step toward an enlarged free trade area that would embrace most, if not all, of the developed countries. We are trying to measure the economic impact of such arrangements, as well as their advantages and disadvantages to U.S. trade.

All proposed methods of negotiation must, of course, take full account of the fact that nontariff barriers as well as tariffs would have to be covered.

Prior to the Kennedy Round, and during it, the United States successfully negotiated for the reduction and elimination of nontariff barriers.

Through the GATT, which the United States took the initiative in forming, we have succeeded in obtaining the removal of most import quotas maintained by other industrialized countries. The relatively few remaining ones are mostly agricultural. We are continuing to press for liberalization in this field, but it is a slow and difficult process, since all countries resort to some restrictive devices to maintain the income of their farmers. We ourselves, as you know, use quotas for this purpose. Under section 22 of the Agricultural Adjustment Act, we limit imports of cotton and cotton products, wheat and wheat products, most dairy products, and peanuts.

We made substantial progress in the Kennedy Round toward liberalizing nontariff barriers. We negotiated an antidumping agreement that should limit the imposition of antidumping duties to cases of actual injury, as in our own law, and insure that regular and open procedures are followed to avoid their arbitrary and protectionist application. No change in our own statutes will be required.

We also negotiated a separate agreement involving a nontariff barrier of our own—the American selling price system of customs valuation. In exchange for its termination, we would, under the terms of this balanced agreement, receive deep cuts in the chemical tariffs of the ECC and the U.K. In addition, the ECC countries would eliminate discriminatory taxes against American-type automobiles, the United Kingdom would reduce its Commonwealth preference on tobacco, and Switzerland would eliminate its import limitations on canned fruit preserved with corn syrup.

This agreement was negotiated on an ad referendum basis for later submission to Congress, and we received some criticism to the effect that it amounted to an invasion of the prerogatives of the Congress, although we do not believe this to be true. The agreement, of course, will not become effective unless and until Congress acts to abolish the American selling price system. Let me say that this will be a very real test of our determination to come to grips with nontariff barriers and will have considerable bearing on the course of our future trade policy

in this area. We welcome the full examination of the agreement by all Members of this Congress.

Nontariff barriers are the trade negotiation frontier of the future. We have a long way to go. One reason is that too often in business, in government, and in legislative bodies, the term "nontariff barrier" is used without precise definition, facts, or analysis. In preparing for the Kennedy Round, we often found it impossible to get the close and detailed information we needed to formulate a negotiating position. Often business had not done its own homework in this area, filled with analytical traps for the unwary.

For instance, what trade impairment will chemicals X, Y, and Z suffer in the German market because of an upward shift in their border taxes last January 1? We do not know, and the chemical industry does not know. It involves a study of the price consequences of the tax increase as well as a host of other factors. Oversimplified answers will not help.

For this reason, my office will hold public hearings shortly to enlist the advice, information, and expertise of business and agriculture in nontariff barriers, and in other areas of trade. Shortly thereafter, in Geneva, all the major trading nations will submit their own analyses of each other's nontariff barriers. This will lay a foundation for a later negotiation looking to the dismantling of as many as possible of these nontariff barriers—the most difficult, most complicated, and most tenacious of trade barriers.

However, events in the world are moving with such rapidity that certain kinds of nontariff barriers cannot await the conclusion of our trade study. An example of this is one I just mentioned, the effect of border tax adjustments on trade, which figured in the President's balance-of-payments message of January 1. We hope and expect to have this complex and often exaggerated problem examined in the GATT in the near future.

With respect to the developing countries, I need not tell this committee that the needs are great and the problems involved in meeting those needs equally great. There is certainly no easy way of bringing the economy of a developing country to the point of takeoff. Nevertheless, the developed countries must do all in their power through their own commercial policy to assist these countries.

Last year at Punta del Este, the President declared the willingness of the United States to explore with other developed countries the possibility of a joint program to grant generalized tariff preferences to the developing countries. A number of questions, however, require careful examination, such as the following:

What kinds of safeguards and what exceptions should be provided to protect sensitive domestic industries? What countries ought to benefit from these preferences? What kinds of products might be most appropriate in terms of the export prospects of developing countries? What should happen to existing preferential arrangements such as the Commonwealth and ECC preferences? How long a period of preference would be desirable? What margin of preference would be helpful, while at the same time not disrupting the U.S. market?

These questions, and others, were debated at a ministerial meeting of the OECD last November. The United States took the position that tariff preferences must be generalized and not of benefit only to a par-

ticular region. In addition, it emphasized the reverse preferences, or giving a developed country a special position in a developing country market, should be phased out. There was no agreement, certainly, on all aspects of a developed country preference position. But the desirability of a general preference scheme was sufficiently recognized so that the developed countries could take a more or less concerted position to the UNCTAD II meeting in New Delhi, which is now in progress. However, it is still too early, in my judgment, to know whether the many varied and complex questions which preferences involve can be answered to our satisfaction and that of the other countries concerned.

Aside from tariffs, the developing countries place considerable emphasis on commodity arrangements. Experience has shown that any consideration of a commodity arrangement raises questions relating both to the stabilization of primary product prices at remunerative levels for efficient producers and to the commercial impact of commodity arrangements on users of the products covered by such arrangements. More work is required, in my judgment, to determine the true commercial benefits to be derived from such arrangements.

My office does not have the primary responsibility for the negotiation of commodity agreements on tropical products. Nevertheless, we have a great and continuing interest in areas of such great significance to developing country trade. Therefore, our current study will place emphasis on the long-range implications and the possible benefits of such arrangements, including their implications for a sound U.S. commercial policy.

As you know, the United States has supported the joining together of developing countries in regional trading arrangements—for example, the Latin American Free Trade Association. However, in part, because we do not have a large body of experience to guide us, their impact upon member and nonmember countries needs further examination. For example, how do these regional trading arrangements affect U.S. export interests? Moreover, it is not clear what kinds of conditions the United States should seek in relation to the establishment of such arrangements in order to render them as consistent as possible with an open international trading system. I think this is a point that most certainly should be underlined.

Another topic to which we attach great importance is the problem of adjustment to import competition.

In 1962, as you will recall, the executive branch proposed, and the Congress enacted, a program of adjustment assistance to help firms and workers hurt by increased imports caused by tariff concessions.

Conceptually, this was a significant forward step in the evolution of our trade agreements program. It amounted to an acknowledgment that increased quotas or duties need not necessarily be the most appropriate or effective form of relief for injury due to import competition. Unfortunately, the program did not, in fact, become operative, and, therefore, has not yielded us any experience upon which to base future policy, although we will be proposing liberalized criteria for adjustment assistance in this field shortly.

But, even without such a body of experience, we must continue to explore alternatives to quotas or higher tariffs. We should also examine other existing programs, such as the manpower training and

development program, and insure that they also make a maximum contribution to our ability to adjust to import competition.

As you know, there are some who say that there should be an overall economic mobility program which is not tied to any specific cause of economic distress. While this is obviously beyond the bounds of a study of trade policy, I would personally think it worthy of greater consideration.

Recently, I have heard it said that the conditions for escape-clause relief are just as unrealistic as those for adjustment assistance, especially since they turn on the same causal factors. This conclusion seems to me premature. I think an examination of the escape-clause petitions made since 1962 would reveal that they involved weak cases in which the tariff concession was a very old one or in which it was not clear that there had been an increase in imports. In short, I am not persuaded that the criteria for escape-clause relief are unduly rigorous. However, I do believe that import restrictions should be an available remedy in certain cases and that we should not reject out of hand any objective attempt to reevaluate the sufficiency of the conditions for escape-clause relief.

The final topic of our study concerns the administration of trade policy. Domestically, this has to do with the organization and administration of trade policy within the executive branch and between the executive branch and the Congress. It was the Congress, of course, which was, in effect, responsible for the creation, in 1962, of the Office of the Special Representative for Trade Negotiations. The role of this Office has been evolving, particularly since the conclusion of the Kennedy Round. Others can best judge how effective our role has been. At the very least, however, we have raised the issue of how trade policy could be coordinated within the executive branch—and, hopefully, even shed some light on it.

I am aware of some feeling that the relationship between the Congress as delegator and the executive branch as delegate is not what it should be. It is obvious that there cannot be an effective trade policy without full congressional participation and, indeed, periodic grants of authority to the President to work in this field with other countries. I think that the institution in the Trade Expansion Act of the congressional delegates proved to be a most effective one. I would certainly hope that other mechanisms, both formal and informal, could be established to maintain even greater rapport and understanding between the two branches.

Likewise, consideration should be given to the continuing development of effective forms of cooperation between Government and business, labor, agriculture, and consumer organizations in the formulation and implementation of our trade policies.

Internationally, it is clear that there is one organization which is first and foremost in all trade matters, although there are others that play a very important role. For this reason, American support of the GATT is absolutely vital, since it is the only agreed code—however imperfect—by which countries trade with each other. For certain specific issues, the OECD and UNCTAD have proven effective. Considerably more attention, however, needs to be given to the orderly interrelationship of these and other international organizations.

This, then, is a quick survey of the matters we are dealing with in our trade policy.

I welcome your questions, now and at any time, and thank you again for this opportunity.

Chairman PROXMIRE. Thank you, Ambassador Roth, for a very comprehensive and yet concise statement.

Ambassador Roth, I would like to ask some questions that are not directly related to trade policy perhaps as much as they are to the economic impact of trade and what we can do about it.

Why, in your view, did our trade balance deteriorate as badly as it did in the fourth quarter? I noticed that exports declined and imports increased very rapidly.

Imports increased from an annual rate in the third quarter of $26.2 billion to an annual rate of $28.4 billion, about a $2 billion increase; and exports—which have been disappointing all year after the first quarter, which was a good quarter—remained around $30.7 billion in the first quarter, $30.8 billion in the second, $30.5 billion in the third, and down to $29.9 billion in the fourth.

What is the reason for this deterioration?

Mr. ROTH. I am sure there are a great many. In part on the export side, among other things, our agricultural exports declined, partly due to better crops in Europe.

On the import side, it is difficult at this point to be entirely sure, but I think, in part, some overheating in the economy, certainly the copper strike, and the possibility of a steel strike had something to do with it.

Chairman PROXMIRE. You see, it seems to me, it is very important in making economic policy, to try and separate out those temporary elements. I think you are very wise in going into the copper strike and the steel strike; both of those were significant elements, but obviously temporary we hope. We hope we are not going to have a copper strike that will go on for years, and we hope that the steel situation will be settled one way or the other by July 1.

But, what I am concerned about is whether this could be anything like a fairly permanent or at least a long-term thing, in which case it seems to me that our policy action is more urgent than if it is simply a temporary problem.

Mr. ROTH. I think it is wise to separate them out. One of the temporary elements in the last quarter was the heavy increase in imports of whisky. But, in relationship to our trade account as it affects the balance of payments, the most important thing is that we maintain the stability of our economy, in terms of prices and costs, and, on the other hand, that the economies of the surplus countries, the European countries, be expanded by one measure or another.

Chairman PROXMIRE. One way is to invest more abroad to help them expand.

Mr. ROTH. Apart from the balance-of-payments implication of the outflow of direct investment, when you look at the long term this is certainly an element.

This is why I say that one part of our study will be to analyze, in a way that hasn't been done as thoroughly as we need, the relationship between direct investment abroad and trade, because there is such a relationship.

An American plant abroad tends to buy American components from here, and the fact that plants go abroad does not necessarily mean a reduction in profits and employment in this country.

Chairman PROXMIRE. Is there any kind of a study that you know anything about—in view of the importance of this, I hope maybe there is—that would show how significant a difference it would make in both imports and exports if we have an inflation in the coming year of 3 percent instead of an inflation of 4 percent?

You see, as I look at the elements involved in our trade—food, automobiles, and so forth—so many of them are fairly insensitive to a change in the Consumer Price Index. I am just wondering if that much of a difference in inflation, which is all the Council of Economic Advisers claims for a surtax, could make any big difference in our trade situation?

Mr. ROTH. I know of no detailed studies of this. I think, on the other hand, it is quite clear that a heavy expansion in our own economy would certainly, as it did in 1966, draw in a large increase in imports. This is one of the problems that I don't think is sometimes appreciated. When it is pointed out in a certain industry that there has been a tremendous increase in imports, the underlying factor—there are a number of them, but certainly one basic underlying factor—is always that there is an inflated economy into which the imports are coming.

Chairman PROXMIRE. Let me ask this: You refer to the export rebate and import tax, and as I understand it, this is a possibility that the administration has been considering.

When I was briefed on the balance-of-payments situation by an administration official 8 weeks ago or so, he mentioned this as a real possibility and said the President was sending officials around the world to discuss this possibility with our trading partners.

I am just wondering if we are likely to vitiate any prospect of eliminating some restriction we haven't used, but which other countries have used by this kind of discussion and negotiation now?

If the Congress is already getting in the mood to act in this way, it is an appealing kind of action for those who have import problems in their State, and I just wonder if this doesn't seem to be working at cross purposes with your overall presentation?

Mr. ROTH. This is a very good question, Senator. Actually there are two possibilities under consideration. One, a modest border tax adjustment to offset certain indirect taxes of our own. Second, a modest import surcharge because we are in a deficit position.

There are other possibilities, but rather than—and this goes back to the reason for the consultations in Europe and with our other trading partners—rather than use any restrictive measure in the trade area, the most desirable course would be for our trading partners to take expansionary measures of their own.

We feel, as I mentioned, that the surplus countries have a responsibility in a grave situation such as we face just as much as the deficit countries. This is why it makes no sense at all in adjustment terms for the Germans to increase their border taxes, even though it is fully justified in terms of the system. For in effect this means a devaluation of 1 to 2 percent when they are in a surplus position. And this is why we are saying to them now, as our team, under Ambassador Tresize, goes

throughout Europe, that there are many things you can do to quicken your economy, to untie aid, and the like. If they could take some action, then it would be less necessary for us to do so.

If ultimately it is decided by the administration that something must be done, I think the most important thing is not to do anything that in any way would undermine the basic trade rules of the trading world, the rules of GATT. Therefore, consultation and working through GATT procedures becomes of great importance. As I say, no final decision on this has been made, and consultations in Europe and other countries are currently being conducted.

Chairman PROXMIRE. Thank you very much.

Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I am particularly pleased to see Ambassador Roth and his team here to testify. Along with the President's Economic Report, he will help keep this committee updated on what has transpired in the international trade area. Certainly the impact of trade today on our economy and the problem that we are now experiencing in the international balance of payments makes it most timely.

I am pleased to see that your Office is moving forward in this comprehensive study. May I ask a little bit about how you are formalizing these studies? Is it correct that these studies are going to be done in conjunction with public hearings?

Mr. ROTH. That is correct, Congressman.

Representative CURTIS. Who will be actually conducting the hearings? Will the format be similar to that of the Committee on Reciprocity Information?

Mr. ROTH. Yes. They will be run very much like we ran the hearings we held at the beginning of the Kennedy Round. Our Office chairs them, but there will be representatives on the panel from other agencies.

The thing this time that we tried to do last time—and we were not satisfied we were entirely successful—is to encourage industries to really do their homework, and to come to this not with platitudes, not with problems of general restrictions abroad, but with very specific ideas of what those restrictions might be.

In many cases we found, during the Kennedy Round, that certain companies couldn't give us the detail we needed because the data was confidential, such as cost data. So we hope in these cases we could meet privately with these industries, because this is the kind of gutty material we need, in order to put our case together in this complicated area.

Representative CURTIS. This, I think, is most essential. I know Members of the Congress and I have received due complaints from time to time of alleged unfair trade practices by countries abroad. Yet, frequently we don't get the details.

Mr. ROTH. Congressman, could I just interrupt to say that there are two parts of the setup of our study which have not been completed?

One is that there will be appointed, as there was for the Kennedy Round, a blue-ribbon advisory committee of leaders from industry, labor, and agriculture.

We also need to develop a method of congressional participation, and this mechanism has not been developed yet. We are even considering the possibility of putting something to this effect in our proposed

trade bill, but whether it is done formally or informally, this is the critical ingredient.

Representative CURTIS. Yes. I am most anxious to see the Congress take an active part. Just how to do it is the question.

Of course, the Joint Economic Committee, to some degree can follow this, and I know it will. Then the legislative committees, such as Ways and Means and Senate Finance, will follow this, also. But this wouldn't adequately bring about the coordination that I think is necessary in conjunction with these studies.

I guess you will be getting into techniques of handling unfair trade practice and unfair tariff barriers when you find them. Why haven't we developed and utilized the countervailing duty approach a great deal more. Will you be getting into that kind of a study?

Mr. ROTH. We already are, in several ways. We have asked, during the ministerial meeting of the GATT last November that a group be set up specifically to talk about countervailing duties, subsidies, and related factors. We will be talking about that.

Representative CURTIS. I have felt that counterveiling duty as a method of eliminating the use of an unfair trade practice or a subsidy, does relate to alleged subsidies. But it seems to me that it would be possible to have them serve a further purpose and relate to any kind of an unfair trade practice, just as we did with the international antidumping agreement. It looks to me that maybe we could come up with an international agreement on counterveiling duties, because everyone should be concerned about how to handle an unfair trade practice, one that has been found to exist.

Mr. ROTH. As you know, our countervailing duty law does not have an injury requirement as required under the GATT. However, in talking about countervailing duty law, we also want to talk about subsidies, bother the overt ones and the hidden ones, if you will, that are inherent in the common agricultural policy of the EEC.

Representative CURTIS. One other area, the treaties of friendship, commerce and navigation that we have with many of these countries seem to have in them the provisions of machinery to do something about nontariff trade barriers or subsidies or any of these things.

Would this be an area that you would be investigating to find out what could be done through these treaties that we already have to bring about a cessation of unfair trade practices, if they are found to exist?

Mr. ROTH. This is, certainly, an area we can look at.

Representative CURTIS. And I notice in the steel report this was one of the things they pointed out; that here was the machinery if it was, and had not been utilized, at least it was not available to them in a practical way.

Mr. ROTH. May I say, Mr. Congressman, that in our study we are taking a few industries and looking at them, as it were, under a microscope.

Representative CURTIS. You are doing that with steel, aren't you?

Mr. ROTH. We are doing that with steel.

Representative CURTIS. I was most pleased with that, because I thought the Senate Finance Committee did an excellent job. They are doing some more work on steel which will enable you to use that study in carrying it on beyond that.

Mr. ROTH. It is an important sort of prototype industry, and I think in terms of a review of basic trade policy that a study of this industry can give us a great deal of useful material.

Representative CURTIS. One other area.

Senator Proxmire asked whether you would be getting into direct investment and how it relates to trade. I was most pleased to have your affirmative response. I have been very much concerned.

We have not really related our foreign aid programs—AID, Public Law 480, or various development banks, loans, and so forth—to trade.

There is a slogan, "trade not aid," which I happen to agree with. I think there is a place for aid.

I think it is very important to help get nations on their economic feet. But I have been fearful that there hasn't been the kind of coordination between trade and aid.

Would this be an area that you would be exploring at all?

Mr. ROTH. As of now we had not thought that this would be a part of the study.

Representative CURTIS. Yes; and yet you have to do it in respect to the agricultural agreements where one of the hopes is that these other countries will provide more aid.

Mr. ROTH. That is true. We will certainly be dealing with the problems of developing countries.

Representative CURTIS. But it illustrates how closely these things are coordinated. I appreciate you have a problem here. You do have your jurisdiction.

But I am at least in the position where I can make these comments that somewhere in the administration or in the Congress we have to bring together, just as you did mention, the commodity agreements which are not under your jurisdiction. Yet, in so many areas, how can we readily deal with the problems of trade without having to do those commodity agreements?

Mr. ROTH. I would like to comment on this problem of the interrelationship between the various areas that affect trade. I think, certainly, one of the things that has become clear to me in the last several years, and perhaps particularly in the last 6 months, is the relationship, for instance, between trade policy and fiscal and monetary policy. And we do have a balance-of-payments committee in which all the agencies concerned are involved, so we are all aware of what is going on.

But, looking to the future, and, certainly, in terms of a study such as ours, this is an interrelated world. You cannot separate trade out from the more general economic and fiscal problems. You just can't.

Representative CURTIS. I see my time has expired. Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Miller?

Senator MILLER. Nice to see you again, Mr. Roth.

Mr. ROTH. Thank you, Senator.

Senator MILLER. At the beginning of your speech you referred to the Smoot-Hawley Tariff Act of 1930. I wonder if you could refresh my memory of that. Was that a high tariff act?

Mr. ROTH. That is correct.

Senator MILLER. It was not a quota act, was it?

Mr. ROTH. No; it was a high tariff act.

Senator MILLER. The reason I asked, I notice that some accounts in the press and some witnesses have referred to some of these quota bills that are pending in the Senate Finance Committee as Smoot-Hawley Act measures. Since the Smoot-Hawley Act did not have anything to do with quotas, I just thought perhaps we ought to bring out that difference.

Mr. ROTH. I think that is a good point. It could be argued that a tariff at a sufficiently high level in effect has the effect of an absolute quota.

Senator MILLER. Of an absolute quota.

Mr. ROTH. But you are correct.

Senator MILLER. Which would mean nothing. I assume when you say absolute quota, you mean that there would be no imports at all because the tariff would be so high that nobody would be able to buy.

Mr. ROTH. I mean a more limited amount.

Senator MILLER. Sir?

Mr. ROTH. A more limited amount of imports. A quota is not an absolute prohibition.

Senator MILLER. I understand that. A quota is certainly not an absolute prohibition. You might have, for example, a quota on behalf of our domestic consumption. That would certainly not be an absolute prohibition, but it would mean that goods would come in at a low price, probably, whereas if we had a Smoot-Hawley Act approach it might put a very, very high import levy on it, and it might narrow the import quantities down to 50 percent, but they would be at a very high price; would they not?

Mr. ROTH. That is right.

Senator MILLER. You referred to the President's balance-of-payments message of January 1, relating to border tax adjustments on trade. Do I understand that there is some intimation that the Congress might be asked to enact some kind of a border tax as sort of a countervailing offset to border tax arrangements in other countries?

Mr. ROTH. As I mentioned, this is one possibility we have looked at, but not in retaliation against the border taxes of other countries. The whole area, as you know, of border taxes is a very complicated one. It is based on the theory that an indirect tax, like a sales tax, is passed on into price fully, whereas a direct tax such as we have, the corporate income tax, is not. Therefore, based on economic theory of 20 years ago, a border tax for one is legal, and for the other is not under the GATT.

In the last 20 years, economic theory has become more sophisticated. It is now, I think, clearer that not necessarily all of an indirect tax is passed on into price and perhaps some part of a direct tax is, depending upon elasticities. Therefore, we feel that there is a basic inequity in the GATT rules.

On the other hand, because we do not have the analysis we should, it is not entirely clear that in the past our trade has been impaired by the offsetting border tax. But this is one we have to get into in great depth.

Senator MILLER. Do you have any idea how soon we will have hard statistics that would enable us to make an intelligent decision on this?

Mr. ROTH. There are two problems. One, what we might consider the basic inequity and the basic difficulty of two systems of taxation operating together. The other is a more specific and immediate prob-

lem; namely, that Germany, on January 1, moved from the so-called cascade tax to an added value tax. Accompanying that was an adjustment at the border from undercompensation, because they could not calculate what the tax was, under the old system, to full compensation, which meant an increase in tax from 4 to 10 percent.

Before we can know what effect this will have on our export trade, we will have to know what the price effect in the German economy is. I think it will be a number of months before we get this in a definitive way. Then we have to begin looking at individual American exports and see whether there has been an effect.

Senator MILLER. Do you think that we are going to have adequate statistics to enable us to legislate on this at this session of Congress?

Mr. ROTH. No. In terms of the problem of border taxes, as such, we have asked for negotiations on the GATT rules, but it will be a long and complex process. Now this problem, the basic problem of border taxes as such, is perhaps separate from the balance-of-payments question of whether we should do something moderate and temporary in the trade sector to help our export position. They are really two different problems.

Senator MILLER. Well, I can see where they might be two different problems, but I can see where they could be related, too.

Mr. ROTH. They are related, also.

Senator MILLER. And, I can see where if we are not careful on the relationship, we might get ourselves into some problems that we do not want to get into. That is why I am wondering what we are going to have by way of hard statistics that will enable us to legislate prudently on this, if we are asked to legislate on it. You apparently do not hold out much hope of having those statistics for quite a long time.

Mr. ROTH. Not on the basic problem of border taxes. This will take considerably greater analysis both within our own Government and internationally. If we did come to the Congress with something in the trade area affecting the balance of payments we would, I hope, have a supporting case. But, I think the most important thing, as I mentioned before, is that should we do anything, we do it within the trading rules of the world, and that in no sense will we undermine those rules and set up a spiral of reaction on the part of other countries so that we net out nothing in terms of our trade balance.

Senator MILLER. You state: "I do believe that import restrictions should be an available remedy in certain cases."

Does this mean that in certain cases that you believe that import quotas should be available?

Mr. ROTH. That is right, as they are where the national security is brought into play pursuant to an OEEC finding, or where it can be shown that an entire industry is severely damaged by imports—then there is the escape clause, and I think that this is an important out that any economy needs.

What I was trying to say here is that I feel that the present escape clause is adequate. On the other hand, I do not want this study to be, in any sense, doctrinaire. There should not be anything we cannot look at and should not look at in depth.

Senator MILLER. I have just one more question. You are continuing to operate and do some negotiating in your office; are you not?

Mr. ROTH. Yes, sir. We do not have any authority, but we are continuing to negotiate.

Senator MILLER. I appreciate that. I understood from Secretary Freeman when he testified last Wednesday that there were negotiations being carried on on this particular problem. As I understand it from a speech by the Foreign Agricultural Service, one of the officials of the Foreign Agricultural Service, the Common Market has been charging import duties on our grain shipments to the Common Market, and they have been taking some of that money to subsidize—to pay a subsidy for exports of canned ham.

Last fall, 46 of us joined together in a telegram requesting countervailing duties. We have not seen any action on that yet. Secretary Freeman believed that this was in the process of negotiations. Are you familiar with this or any member of your staff here?

Mr. ROTH. No; I am very familiar with it.

Senator MILLER. Can you tell us where we are on this?

Mr. ROTH. Yes. It is still under investigation, but this comes after a period of very intensive negotiation in which I took part. I went to Geneva to talk to the Community about it. As a result the Dutch decreased the amount of the subsidy; they would say they have, in effect, eliminated it. It was a very considerable figure. I think it was around 23 percent. The Treasury, along with Agriculture and ourselves, is looking at the figures to see whether or not we are satisfied. But may I explore this just a little bit more with you?

This comes back to the question of countervailing duties.

Chairman PROXMIRE. Could I interrupt just for 1 minute?

I, unfortunately, have to leave, Ambassador Roth, and I apologize. I have asked Congressman Curtis to take over the chair as he will do. He is, as you know, the ranking minority member, but I want to thank you for a very, very fine presentation and for your particularly excellent responsiveness to our questions.

Mr. ROTH. Senator, thank you very much. And should the committee at any point, as our study goes on during the year, think it would be useful to you—as I think it would be to us—to have an interim report and to go into these problems in more detail, we would be delighted.

Chairman PROXMIRE. Fine, that is an excellent suggestion. Very good.

Representative CURTIS (presiding). Proceed.

Mr. ROTH. Senator, our countervailing duty law does not have an injury requirement as it is supposed to have under the GATT. Therefore, any time that a party claims that a subsidy is in existence—this goes to industry as well as to agriculture—the Treasury must make an investigation.

We try sometimes first to see if the problem can be worked out, because it is to the benefit of our domestic economic interest as well as to international relationships to do away with the subsidy, if at all possible.

In certain cases countries are not entirely cooperative, and therefore, there is nothing to do but to begin official investigations. Even when they are cooperative, it still may be necessary. You may have noticed just last week in the Federal Register that we are beginning investigations on tomatoes and tomato paste.

90-191—68—pt. 2——12

Last year we took countervailing duties against Italy in the area of electrical transmission towers. This is an instrument that is difficult for us to use in international relations, because it is not entirely consistent with the GATT. Nevertheless, we feel it is an important one for us to use, because in agriculture, in particular, when you look at third markets, we are disadvantaged by subsidies.

Senator MILLER. May I interrupt you at that point?

Under the GATT rules, would that subsidy have been legal, too?

Mr. ROTH. Under the GATT rules, and Mr. Rehm, you can correct me, if it was shown that the subsidy caused injury to a competing industry, in that case the country would be responsible. If there were no injury, then it would not be illegal.

Senator MILLER. Then here is the problem. What happens during the period of time that all of this is going on? You see, we received requests, urgent requests, that countervailing duties be put on immediately, and then let the investigation proceed, and if it was determined that there was indeed no harm, then, of course, the countervailing duties would go off. But, if it was determined that there was indeed harm, the countervailing duties would stay on, and the idea behind this request was that we ought to take the protective measures before it was too late and the damage was done.

Do I understand from what you say that that is impossible?

Mr. ROTH. Under the law the investigation must take place first, because the case must be proven. On the other hand, once you announce an investigation, often that in itself has an impact. I think this is an important point you raise. This is the reason why we have requested in the GATT a discussion not only of the countervailing duty laws, but also of subsidies, because they are closely related.

Basically we would be willing to do away with subsidies, because we think we are competitive. Poultry is a good example.

Senator MILLER. As I understand it though, the answer to my question is that what you have worked out is now being analyzed by your people—by Agriculture.

Mr. ROTH. Treasury.

Senator MILLER. And Treasury, to determine whether or not it will be necessary to have a countervailing duty.

Mr. ROTH. That is correct. Meanwhile, there has been this decrease of a substantial sort.

Senator MILLER. Thank you, Mr. Roth.

Thank you, Mr. Chairman.

Representative CURTIS. Senator Percy?

Senator PERCY. Ambassador Roth, Republicans have not only seized control of this committee this afternoon but by our presence have indicated our deep interest in your work.

Mr. ROTH. Thank you, sir. We have no fear from Republicans.

Senator PERCY. I personally would like to express great admiration for the work that you have done with the Kennedy Round. I know how tough this job has been, but I think the reaction of the business community has been unusually understanding and moderate and appreciative of the tough jobs you have had. I think, also, your educational efforts to prevent us from going into a disastrous round of quotas and restrictions that would set back our policy 35 years, has been very, very good.

Having said that, I wonder if you enthusiastically and wholeheartedly support the President's travel ban and travel tax which, in effect, seems to me to be a highly restrictive, protectionist program. A tax on tourists abroad is the same as a very steep tariff on the import of tourist services. Do you feel that this is a good example to be set by the world's leading nation in liberalizing trade?

Mr. ROTH. I do not think that I can comment on that problem. I must say that when Secretary Katzenbach and Deming and I made this rush trip, on January 1, throughout Europe, to discuss the total program, I was impressed with the fact that the Europeans recognized that a very drastic program of this sort was terribly necessary. And I think I would have to agree that to have a balanced program means something on the current account as well as the capital account.

I do feel, as I relate all this to problems of trade, that the important thing is that any program, whether it be on the tourist side or any other, not bring about retaliation, not bring about any downward spiral, and in effect not undermine what we have been trying to do.

Senator PERCY. Do you think we can carry this out without retaliation?

Mr. ROTH. I think we can without severe retaliation, as I think it is a moderate program. This is one thing that I think is important in talking about any such measures and any measures that might be proposed in trade areas, if they are. I do not know whether they will be or not. The Europeans' deep concern is that they should be temporary. This is why they are so terribly concerned more than anything else.

Jean Rey, when he was here last week, made very clear their terrible fear of this type of quota legislation that is now before the Congress, because this is——

Senator PERCY. What leads you to believe though, Ambassador Roth, that this could be a temporary thing? We have had "temporary" excise taxes for 23 or 25 years. Once you get adjusted to this, what is going to cause a rectification? Do we see a substantial reduction in our oversea expenditures and commitments? Can we perceive in the immediate future a drastic reduction of our expenditures in Vietnam and foreign aid? Do we see a dramatic reduction in inflation in this country, to dramatize the ability of our country to increase our exports substantially, rather than suffer a decrease because really of a lesser competitive position?

What is going to happen that will make this temporary 2-year situation?

Mr. ROTH. Let me relate this to the area of trade—rather than tourism—where I am somewhat more at home. If, for instance, we decided to ask for a small import-export adjustment, as it were, to do this under the GATT we would need an IMF finding. We would do it through the GATT and we would be policed by the GATT. I think this is the important part of going through international channels, that it would be under review in relationship to the balance of payments.

Now, as to your second problem, which really is how long will the balance-of-payments problem last, I certainly will not try to forecast that. But, certainly, again in Europe, when we talked about the problems, they were understanding of them, and we talked about some of the measures that would have to be taken. They said, "The first thing you have got to take, particularly if you want our cooperation, is the

10-percent surtax." They said, "We, in no sense, want you to deflate your economy. This would have strong repercussions in Europe. But, you have got to do something to tighten." I think their feeling is that if some of them could expand—France has taken some measures already—this in itself would have an important influence.

Senator PERCY. On the travel tax, I wonder whether or not the experience of the British, who have tried to restrict and have restricted the amount that British citizens can spend overseas, would not really warn us that such curbs are pretty hard to enforce. It causes the best citizens to find a way to get around it. They get pounds abroad and have been spending them for years.

Europe is full of Britons, none of whom were permitted by law to take more than 50 pounds or its equivalent out of the country, all of whom exceeded that, and yet they are there.

I wonder how many dollars we have lost since the President's announcement. Is everyone not finding some way to protect themselves, if they feel this is going to really hurt, in the long run, their goal to do business abroad, their ability to get an education? Have we not been trying to regulate and control the farmers' output for 30 years and have not yet found out how to do that? They always are able to produce more on less acreage. You cannot find enough regulations to outwit 200 million people.

I wonder whether we have not already lost far more than we would gain, just by people taking preventive measures to get around an oppressive government that tries to strike a blow at a free people. All of us who have fought to free the movement of goods, it is repugnant to have us, as the richest nation on earth, to have a restriction on the movements of people. Imagine making it unpatriotic for a clergyman to go abroad to Africa or Asia, a student or a teacher or someone to visit the homeland or the fatherland.

I really feel this has been a disastrous decision by this administration. It is a terrific blow to our prestige. We have to weigh how much these things save us, and then how much at the end they really cost us in lack of confidence in America's ability and in the dollar, I think.

I wonder whether or not you could not be a voice that within the administration could get them to withdraw what I think is an impossible requiry they are making, a mandate that I find the American people are revolting against, I think the Congress will revolt and it will do us far more damage than it is ever going to do us good.

Mr. ROTH. One part of the President's program in this area, I think, perhaps should be emphasized, because I think it has more long-range implications, and that is the encouragement of tourists to this country. Hopefully some of the money that could be collected from, say, the 5-percent tax on international tickets, which, after all, merely equates the domestic one, could be used for this. Actually, when the Katzenbach-Deming party got to Switzerland, the first thing they said was that we should increase our tourism. Obviously we were not very good at this. They were, and they would put together a technical assistance program for us.

I think this is something we can use, and I think Ambassador McKinney's study group is going to come up with some useful answers in this area, in order to bring a lot of people here who want to come.

Looking to the future, because I think this goes to the heart of your question, Americans should travel more and more, after we get over

this immediate problem, but this should be balanced by more and more other people coming to this country. It is the gap that is the problem, not the absolute numbers on either side.

So, I think there is a positive element, and I think this is the important long-range problem.

Senator PERCY. I certainly concur with you, and I think you know that a group of us put in a bill to increase substantially the amount of money we spend to encourage tourism. That is the positive approach. That is our way of doing things, to avoid restrictions and fear and intimidation and avoid making a person an unpatriotic citizen if he goes abroad. We must lead with the positive.

That leads me to the second point. I wonder whether you would not concur that, really, to solve this problem our biggest hope is to expand the trade surplus that we have—which is declining now—and to see that we can get this back up to the $7 billion, $8 billion, $10 billion category, to finance all of our operations overseas, and expand them rather than finding ways to keep restricting.

To me this means we must encourage more businessmen to go abroad, to study markets, to look at what we can do to get products over there, to set up merchandising organizations abroad, and see that the world market of 3 billion people is a big market for them as against the little 200-million-person market in this country. If my figures are correct, only 5 percent of our companies do 95 percent of our overseas trade.

This is why I think the travel ban strikes a blow at what we have been trying to do for years: to open up the eyes of American businessmen to the opportunities abroad and encourage them to go abroad.

Mr. ROTH. I certainly feel that the long-range answer is to improve our trade surplus, and, as you know, there are a number of tools that the President is asking Congress to bring into play. I think these will be important. But I certainly agree with you that American industries have a fat market behind them, have not gone abroad to the extent that they should or could with profit, and they should be encouraged to do so.

I was thinking about the remark on the patriotism of people traveling abroad, and I was thinking how difficult it was to make wives feel unpatriotic—at least, some wives.

Senator PERCY. I would just like to try to modify one aspect of this in my own personal judgment. You may disagree with me. I do not think the expansion of trade is too much a long-range program. To me that is about the quickest thing we could do. The factories are in production. Goods and services are available. If we can just find ways to open up more markets abroad, I think we can rectify this balance more quickly than any other way. Now, the restrictions that we voluntarily made just a few years ago already are starting to cost us very desirable dividend income from abroad. Some of those investments abroad yield three to four times as much as the investment opportunities we have in this country.

I am all for trying to get more dividends back into this country, and doing things to encourage them to come back, such as stamping out all the tax havens. But, to restrict investment abroad, for a very long period of time, and keep us out of markets is a very dangerous thing over the long run.

Everything you have done and everything I read in your testimony is positive, forthright, forward-looking, and yet, these several things that have been done vis-a-vis the balance of payments have been completely contrary to that whole philosophy.

I hope we will put the emphasis on the positive side rather than restrictive measures which are just contrary to everything we believe in. There is not anyone in this Government smart enough to outwit the American businessman and the American public if they do not believe in what you are trying to do, and they are going to try to get around your restrictions.

Sorry to have talked so long, but I am deeply concerned about this situation.

Mr. ROTH. Certainly no one, including the administration, would want to see more than a temporary control of direct investment. It is interesting, I think, that even before the voluntary program was in effect, it has encouraged the creation of a Euro-dollar market, a European capital market. I think this has been a good thing. I think this should be encouraged.

You know, you hear about the problems of imports in this country, but when you are in Europe you hear the opposite thing; namely, the problem of competing with American industry, which has the availability of capital resources and much better management skills and higher technology. You see the reverse and that American industry can compete.

Senator PERCY. That is right. There is not any question about it. But the one thing I am really concerned about is how long we can continue to sustain this tremendous inflationary pressure at home. Efficiency can overcome a lot. But whether it can overcome $20 billion to $30 billion in inflationary pressure, with the kind of deficit the administration now proposes and the resultant wage increases that are going to keep coming well above productivity increases, remains to be seen. Inflation is already putting pressures on American prices abroad.

I do not know whether American technology can work fast enough to overcome that.

Mr. ROTH. This is why the Europeans were so concerned about the tax increase. And, really, this is the basic thing, keeping prices and costs, as you said, stable here, and then having some expansion in the surplus countries. This would have a most immediate effect on trade. I think you are absolutely right.

Senator PERCY. I thank you very much, Mr. Chairman, for your generous time, and, Ambassador Roth, once again, my great commendation to you for your great service to this country.

Mr. ROTH. Thank you.

Representative CURTIS. Thank you, Senator.

I have a couple of questions. In your reference to the Europeans' concern over our having a tax increase, you mean they are concerned with the size of the deficit. The Europeans I have talked to are more concerned about seeing us cut our expenditures. I know it is the proper thing for an administration official to put the emphasis on the tax increase, but it is really the deficit that is creating these inflationary forces.

When Senator Proxmire asked you about what was the cause of the cutback of our exports, vis-a-vis the increase in imports, you mentioned several things. But you did not mention inflation.

Mr. ROTH. I think I did.

Representative CURTIS. Did you?

Mr. ROTH. Yes.

Representative CURTIS. Then I misunderstood. I think this, of course, is the basic concern, and it is going to be increasing.

Restricting private investment abroad does get at the very base of our increased exports. This is another factor which has concerned me greatly. Another point I wanted to make is the reason why I was not here this morning for the committee interrogation. I was over in the Ways and Means Committee, where we were hearing public witnesses from the private sector on the problem of the proposals of the administration on the travel tax. The point that was made and that needs to be emphasized in respect to encouraging tourists here, is that we are today the largest host nation——

Mr. ROTH. The largest what?

Representative CURTIS. We are today the largest host nation. You might not believe it listening to the kinds of testimony and statements that have been made, but this is true. We produced some data showing that this has been increasing at a very rapid pace. I think there are figures there for a period of 6 years.

Mr. ROTH. That is correct; it has been.

Representative CURTIS. Much more than elsewhere. We now have 9 million people coming over, so what we are really talking about is a rapidly growing economic development; and can we make that growth faster? But, when you are dealing with growth, you can damage it. I fear that this administration's package is going to damage what is already going on. I am sorry Senator Percy left, because his reference to having Government increase the amount of money that they are spending to encourage tourism over here leaves me quite cold. That is what a lot of the witnesses wanted.

I asked these questions: How much private capital is invested abroad right now, and spent abroad, in promoting tourism into the United States, and what has been that increase?—because it has been increased.

I am not so concerned whether the Government spends it. But, I am concerned by the inconsistency in the administration's position. It would restrict private investment abroad in this very area of travel, too, and yet ask for an increase in Government spending abroad to promote tourism in this country. Well, it just so happens that Government people, dedicated as they are, will not spend the dollar as effectively as the airlines and the travel people and the combines that have developed in our society with our Hertz organization and our motels and people that derive money from having people come over here. They are spending money. But I do not have the data for which I asked.

What is this restriction on private investment going to do to their plans for expanding their efforts to bring tourists to the United States?

Mr. ROTH. Another factor which goes back to something you said earlier affects tourism just as much as it affects trade; namely, the need to keep prices and costs stable in this country.

Representative CURTIS. Oh, yes.

Mr. Roth. Because it is the same thing. The more we can maintain stability, the more travelers we can get.

Representative Curtis. This has not been done well. I am being sarcastic. By having the highest interest rates since the Civil War, we, at least, have been encouraging investors to come to this country.

Thank you very much, Ambassador Roth.

This adjourns our hearings for today. The committee will meet tomorrow at 10 o'clock in this same room where we will hear the Secretary of Labor, the Honorable Willard Wirtz.

(Whereupon, at 5:15 o'clock p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, Feb. 20, 1968.)

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 20, 1968

Congress of the United States,
Joint Economic Committee,
Washington, D.C.

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

Present: Senators Proxmire, Javits, and Percy; and Representatives Curtis, Widnall, Reuss, Moorhead, and Rumsfeld.

Also present: William H. Moore, senior economist.

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

Our witness this morning is the distinguished Secretary of Labor, the Honorable W. Willard Wirtz. As we all know, Mr. Wirtz is in a position of great economic importance, as the principal official of our Government, not only on economic statistics, as we are all aware, but also on manpower policies, on wage-price policies, and on other policies that deeply concern this committee and the Nation.

Mr. Wirtz, we are delighted to have you. You may proceed with your statement.

STATEMENT OF HON. W. WILLARD WIRTZ, SECRETARY OF LABOR; ACCOMPANIED BY ARTHUR ROSS, COMMISSIONER OF THE BUREAU OF LABOR STATISTICS

Secretary Wirtz. Thank you, Mr. Chairman.

First, may I identify—although I am sure it is unnecessary to this committee—Mr. Arthur Ross, Commissioner of the Bureau of Labor Statistics, who is here with me this morning. Mr. Ross is also my adviser on economic affairs. When we get into the area of economics and statistics, whatever you may have included in your reference to me could only apply to him, and not to me.

I have filed with the committee, Mr. Chairman—unfortunately somewhat belatedly—a statement which I think, if it best fits the committee's convenience, I could summarize fairly quickly, as a basis for whatever questions you may have. I would be glad to do that, if it meets your convenience.

Chairman Proxmire. Yes. It is an excellent statement.

Secretary Wirtz. The statement recognizes that there is ample basis for these hearings and for your questioning, in the Economic Report of the President and in his message to the Congress on January 23—and then in the Council of Economic Advisers report. And I hardly need say I identify myself completely with the matter in those reports, and

have, in this statement, simply tried to emphasize one or perhaps two points which are covered in those reports. There is nothing here, so far as I know, inconsistent with them, but this does represent an emphasis on two points—the first of which is this very stubborn fact that now, after 7 years of uninterrupted, unprecedented economic expansion, there is an extraordinary amount of remaining unemployment, which is hanging on. At this point, almost by definition, that unemployment is what is left after we have pressed the economy to what most of us consider its maximum effective point, so that it could not be pressed further without danger of what is recognized generally—although I realize there is disagreement on this—of overheating. So, what we are talking about here has been called hard-core unemployment; it has been called structural unemployment more traditionally. It could also be identified as subemployment, or long-term unemployment. For purposes, I believe, of the committee's current analysis, it is that unemployment which remains when the economy has done all that it can, and when fiscal and monetary policy have been pressed as far as they can be pressed, and what it leaves is a picture of 3 million unemployed as of a particular time; 10 to 11 million unemployed at one point or another during the year, with a concentration of that unemployment in particular areas——

Mr. Ross. Ten to eleven million unemployed——

Secretary Wirtz. At one time or another during the year, and with a concentration of that unemployment in particular areas, and among particular groups, particularly the minority groups and, in age terms, the group between 18 and 19. And so, Mr. Chairman, members of the committee, my statement is an attempt to focus as sharply as possible on that particular fact, and on what we are trying to do about it.

I have summarized in the statement the approach that is being taken to this problem on two fronts. First, we are increasingly a country which does whatever we can measure, whether for better or for worse. And there has been a little-noticed development of very real significance—I think particularly in the kind of thinking for which this committee is responsible—a real development in the last 12 or 24 months in the identification and measurement of the hard-core kind of unemployment we are talking about, which, from here on, I will use as a shorthand phrase, referring to that unemployment which fiscal and monetary policy and the expansion of the economy alone will not meet.

In this last 2-year period we have tried, under Mr. Ross' leadership in the Bureau of Labor Statistics, and throughout the Department, to try to bring our forms of measurement of the problem, of personal economic disability, into line with the recognition of this hard-core kind of unemployment. And, in this statement, there is a summary of what has been done there.

There are really three steps in it. First, we have taken those monthly reports which the country is familiar with in terms of only a single percentage—you pick up the paper and read that unemployment is 4 percent, or 4.1 percent, or 3.8 percent, and the matter is left in the headlines there. Very frequently, we have tried to get behind that, and bring out what has been in those figures but has not been emphasized promptly—the facts of the unemployment rate for minority groups, the facts of the unemployment rate for women, the facts of

the unemployment rate for youth. And I simply want to point out here what is old learning to this committee: Whenever we see a monthly report of a 3.5-percent unemployment rate, as we did in January, unfortunately it is an average which conceals both the success which we have reached—a rate for adult males and heads of families, which is now about 2 percent—and the failure, which is reflected in rates for minority groups which are twice the majority group rate, and in the rates for youngsters, which are again about twice whatever they are for older people.

So, to carry it to the extreme, it is too bad, but true, that when the country is advised, in the short television program or in the newspaper headline, that we have a 3.5-percent unemployment rate, it does not get through that as far as adult males are concerned it is down to 2 percent, which is about as far as it can go, but very probably, although our sample is quite small, it is also about 30 percent for Negro girls between the ages of 16 and 19. All of that is lumped together.

Now, the first thing we have done is to try to get behind that, and I think quite successfully.

The second thing that is being done now, which will represent the most sophisticated measurement which is going on, is reflected in the statement and it is in the description of a completely new approach to, or at least a new emphasis on, these monthly figures. This approach is going to let us give you, within the year now, a very clear picture, on the basis of regular monthly checks, of how much of what kind of unemployment there is where—not only in terms of the demography of the group, but also in terms of its location physically. And then beyond that, we are also moving in this measurement into an area in which we have so far been able only to guess—namely, the amount of what the public thinks of as unemployment, but what we do not call unemployment at all, because traditionally when we describe unemployment to the country, we are describing the number of people who are actively looking for work and unable to find it, and we are not including those who are not even looking for work, but who should be. And, so, I report to you as the second development in this area, that within the year we will be getting information which breaks down the unemployment figure in terms of the type of people who are involved, the area in which they are located, and which on the second hand adds this nonparticipation in the work force.

Now, the third thing which we are doing—and it is to some extent on an interim basis—is to take the information which we already have, and to use it as the basis for what are necessarily estimates, but quite reliable estimates, of the picture in the 20 largest cities. Before, it has been on a nationwide basis. As of today—and timing it deliberately to coincide with this hearing—we are releasing reports now on the 20 major cities, with a breakdown of unemployment in the standard metropolitan statistical areas. We are releasing today this report which also shows the unemployment rate for the center city of 14 of these standard metropolitan statistical areas, rate for the center city, as well as the unemployment rate for the part of the area which is around the city, and these are broken down also on the basis of race; broken down also on the basis of sex; broken down also on the basis of age.

Now, there are copies of that report which will be released later today. They have been given to you and the committee. And I have summarized them in my statement.

I think it is a pretty significant advance.

We had 15 of them ready about 6 weeks ago, and did release those. We are now working on the 20, and this is the first release of those.

I have, in my statement, summarized some of the results on a 20-city basis, but I point out that in doing that we really defeat the purpose of that approach, which is to get away from the averaging of a lot of matters, and to present the picture which will probably be most useful locally—to present the picture in terms of the situation in a particular city.

In my prepared statement, I have suggested some of what we are finding here.

Again, one of the biggest lessons is how much difference there is in the situation—so that you have unemployment rates today in Minneapolis-St. Paul of 2.2 percent, 2.3 percent here in Washington, but 5.6 percent in Los Angeles, and 5.4 percent in San Francisco and Oakland.

Just to take another illustration, when you get into the Negro unemployment rates, which we have referred to quite generally in their relationship to white unemployment rates, you find that Negro unemployment averages 2.3 times as high as white rates, and yet, here again, there are differences which are perhaps more important than anything else.

So that here in Washington, the ratio between Negro and white race is 1.6 percent—1.6 to 1, rather. In New York, it is 1.5 to 1. You turn to Cleveland, it is 3.1 to 1, which means three times as much. You go to St. Louis, and it is 4.2 to 1.

So we have really totally different situations.

Chairman PROXMIRE. 4.2 to 1, meaning there are four times as many Negroes out of work as whites?

Secretary WIRTZ. Taking account of the difference in the size of the group.

Chairman PROXIMIRE. Sixty percent more in this city?

Secretary WIRTZ. That is correct. Or on a pro rata basis—taking account of the fact there are fewer Negroes, it is still true.

And then when you turn to the tables, too, you will get what I think is a very important lesson.

We have sort of escalated our figures about some of these matters by talking in percentages, which often seem to imply a good deal more than the facts show. And we forget that although this problem, for example, of minority group unemployment is exceedingly serious, it is still well within reach.

So, in my statement, I have suggested a little of that. If you take these 20 areas as a whole, the nonwhite unemployment in 1967 totaled 269,000. That is in the 20 cities. In these tables, incidentally, we have taken all 12 months of 1967, averaged those figures together. The 1967 average of those 20 cities' nonwhite unemployment is 269,000. It is surely within our reach, if we really go after it.

Incidentally, that is about half of the nonwhite unemployment in the whole country. We can scare ourselves sometimes with the percentages, and the figures, and forget that in a work force of 70 million to 75

million, this is something we ought to be able to get if we simply get down to business on it.

I have used Chicago as a single illustration. There the nonwhite unemployment includes 9,000 adult men, 11,000 adult women, 16,000 teenagers. A total of 36,000; 33,000 of them are in the central city, in Chicago. That should not be too much of a job for a city that size, or a country this size, to get at, if we get down to it.

Now, that is enough perhaps to summarize the changes that we have taken in the approach to analyzing this problem. But, I cannot emphasize too much the significance of our getting the indexes now into line with the social priorities in this country. And, of course, what is involved is a very basic difference.

We have been approaching unemployment, to a very considerable extent on the theory that we have it on a nationwide basis, involving aggregate policy. It is very important these figures do now substantially tell us what it is in terms of the individual approach to the problem that has to be taken.

Mr. Chairman, members of the committee, a good deal of the unemployment that remains is more personal than it is economic, although no one of the three terms is very good any more. They all have old, blunt, rusty meanings—unemployment, economic, personal. They are just the best words lying around.

In the second part of the statement, I have summarized the approach that is being taken as far as the operating programs are concerned, but have not gone into it in detail here, because I am assuming that it falls, if not outside, then on the edge of the committee's interest. But I want to just summarize it very quickly.

The emphasis right now on the manpower program, which is what I am talking about, are these:

First, to concentrate that program where the problem is concentrated. And by concentration, I am talking now about specific census tracts, in specific areas in the city—the concentrated employment program is aimed at, or will be in the course of this year or next, 146 specific census tract areas, where unemployment still hangs on.

Then in the President's job program, we are looking at the 50 cities; we are taking the 50 largest cities, because we know that over half the remaining unemployment is in those 50 largest cities.

Now, this does not mean that the other areas are being left out. But, what it comes down to is, we are taking about 25 percent of our program funds, and aiming those right at the areas in which this situation exists.

The second major development, as far as this programing is concerned, is that we are relying much more strongly than we were before on the enlistment of private business in these programs. These programs represent a sophisticated development of the original on-the-job training concept. I will be glad to go into further detail about those programs, but in a very meaningful way we are turning now to the enlistment of and close cooperation with employers in these programs. There has been set up a committee, the National Alliance of Businessmen, headed by Henry Ford, a 65-man committee, around whose advice and counsel the jobs program will be quite thoroughly developed.

Along with the model cities program, what you have here is the reflection of an aiming of the manpower program, a shooting with a rifle—or, I would like to think, with even heavier artillery—but not with a shotgun, as we were before.

There are other parts of those programs I would be delighted to talk about, but I do not want to intrude my particular interest on those of the committee.

There has been a good deal of talk, I should say, about the extent to which there has been a lack of consideration of priorities. I do not believe that is true as far as this area is concerned. I sense, in my official capacity—not sense, but know, in my official capacity—a complete acceptance of the priority of the manpower program. It is reflected in this fact—but only illustratively of the one fact—that in the budget which the President has transmitted to the Congress for fiscal year 1969, the total for the manpower programs—and I am taking a comparatively narrow definition of manpower programs—is to be $2.1 billion. That compares with $1.6 billion in 1968. It is a 20-percent increase. It will mean, in another way of suggesting its magnitude to you, that in fiscal 1969 there will be, in work and work training programs in this country, which include both allowances and partial wage payments to cover the training part—1,300,000 people involved in these programs, receiving not only training, but allowances or stipends of one kind or another. It becomes a much more sophisticated form of a public work and training program than the one most of us grew up with in the 1930's.

So there is a strong emphasis on it, a strong priority attached to it.

In conclusion, Mr. Chairman and members of the committee, I have tried to suggest this. I think it is terribly important to recognize the unmet part of this problem. It is terribly important, too, to recognize, because it is so little noticed, it is so much overlooked, the fact of the gains that are already being made. I know it is not popular today to suggest the gains that are being made in any particular area. It is more sophisticated, it is more liberal, it is more newsworthy to talk about bad news. I do not mean to depart too much from that pattern of discussion and publicity. But, I would like to point this out: I believe it is true that every single group in this country, not just the country as a whole, but every single group in it, Negroes, youth, any group, is infinitely better off from the standpoint of employment opportunity than it was 5 years ago.

Now, you can take the other side of that case, or anyone can take the other side of the case. And if you do, it is to suggest, in my judgment, that a selected use of statistics can be used to support almost any proposition you want to. I hope it is not heresy to suggest that today the computers, like the Scriptures, can be quoted to support almost any proposition, if you take something out of context.

I believe the statement remains solid and true—that regardless of what is left to be done, every single group in the country is today better off from the standpoint of employment opportunity than it was 5 years ago.

That leads you to another development which I suppose is the most important development in the last 5 years.

Five years ago, I believe, we were still accepting in this country what was virtually a deterministic philosophy, and it was not very

far removed from predestination and foreordination, although we did not quite realize it in those terms. I think the most important thing that has happened is today we have rejected any comparison with the past as being almost irrelevant, almost immaterial, and we have accepted the proposition that we can do almost anything that we set out to do—at least as far as this area is concerned.

I think that is the most important change there has been.

Now we meet this situation. Every gain we make today means instead of approaching our goal, we are a little further from it than we were before, because we are setting a new goal in terms of human capacity. And this is a very realistic thing. It is as real as the fact reported in the newspapers last week, that when Detroit recently opened its employment gates almost without limit of any kind, the result was to increase unemployment in Detroit, because it brought more people into the work force, indeed it brought more people into town.

We face the fact that as we make our programs to meet unemployment in the slums more effective, unemployment in the slums is likely to increase because of the people coming into the city from outside the city. It is a significant fact that several million people will move from the countryside to the cities in this decade, a great many of them, the underprivileged, the disadvantaged—because of the superior opportunities that they feel are presented in the cities as far as employment is concerned.

Now, I do not say this in complaint. It is simply a reflection of the fact that the country now senses that it can meet a much higher standard than it did before. And it is a grand thing to throw away the measures of the past, and to have a new standard set for you every time you approach the old one. I have suggested here that it does sometimes, at the end of the day, make you feel like a greyhound chasing a mechanical rabbit, that you can never catch up with it—and yet, it permits you, the next morning, to wake up realizing that in a kind of economic way man has rejected the old idea of determinism, and has accepted the proposition that we can perfect the human ideal.

That leads me to my final point. It is a point of emphasizing the unfinished part of this business. There have been three stages in evolution of the manpower program. They ought to be clearly marked. The third one we are just moving into, and it is the one I want to mention here in conclusion.

We started our first official recognition of the unemployment problem in the middle thirties—we started out by talking about unemployment insurance, and employment exchanges—the Social Security Act of 1935, and the Wagner-Pizer Act of 1933.

The closest we came to a recognition of the individual's significance in the unemployment situation was to say if you are out of a job, drop by such and such an address. And furthermore, if you have worked for the system, we will now pay you unemployment insurance benefits for a while. That is the only road of recognition of the individual there. It was a system-oriented kind of thinking about the whole business—the only jobs we were thinking about were those which the system wanted to have filled. And we furthermore thought about unemployment in this country, until this decade, in terms of

its being simply a product of the equation of fiscal and economic policy and of the expansion of the economy.

We just assumed there would be employment or unemployment depending on whether times were good or bad. That was the first stage.

We have been for about 6 or 7 years now in the second stage, which represents a very considerable advance. Now, in the manpower program we are recognizing that a lot of people are unemployed even when there are job possibilities, and we have to develop their capacity to fill the jobs, as well as develop the job opportunities.

That is a very important second step, and one which I do not mean to minimize in its significance at all.

But I think we are well reminded that we are in danger of taking a new form of deterministic approach in which we set up the economy as an end instead of a means, which is all it can be—we set up manpower programs as programs. And we are leaving out, or not yet paying enough attention to the fact that in a very real sense, man does not live just by a job alone—at least in the income sense.

What I am trying to suggest is that I think we are moving now into a third stage in which the quality of work is going to receive a good deal more attention than it did before—when we talked only about the quantity.

We are still measuring unemployment, even in our most advanced current stages, in terms which mean that if an individual has half of his or her capacities used, he or she is fully employed.

Now, that is an old barnacle definition of employment, which is cast entirely in terms of what the system wants instead of what the individual can do.

Now, this is very relevant all the way up and down the employment line. But, it comes into its sharpest focus in connection with our approach to the problem of the currently disadvantaged workers. And I am suggesting in this statement, Mr. Chairman and members of the committee, that we will make a great mistake if we conceive of this civil rights revolution as being an economic revolution, when in fact it is a social revolution. It would be entirely possible to offer every Negro in this country a job as a hired hand, or as a permanent Government employee, give him a permanent Government shovel, or give him guilt-edged Government guarantees—and I spell that g-u-i-l-t. You can give him all of those things and not get to the heart of the civil rights revolution—because it is not going to answer the problem that this country brought on itself, simply to offer any kind of job, on any kind of terms, to the people that we are talking about here. It involves a great deal more than that. It involves making them full participants in the whole work relationship. It involves a great deal more than just a paycheck for whatever job may be involved.

I would be glad to go into this further.

I would recognize it has not a great deal of immediate relevance, except for this point. We have not got time to make another round of mistakes as far as the civil rights revolution is concerned. And to whatever extent we approach it at this time on too narrow a basis, we are going to run out of time. And to whatever extent we feel we can meet its demands today, simply by offering any kind of job at any kind of rate under any circumstance to these people, we are going to be wrong.

I want to make it perfectly clear what I am talking about lies very

close to the area which we have considered, some people have discussed in terms of the Government's being an employer of last resort, and others in terms of a guaranteed income. And I do not mean to reject that kind of thinking. I mean to make it perfectly clear that there is involved in some of the developments of that kind of thinking a short-cut across quicksand that still leaves the desirability of looking at those proposals for the great value which is in them, if we do not make the mistakes to which I have referred.

I say, Mr. Chairman, I will be glad to go into this further if there is interest on the part of the committee.

That concludes my statement, Mr. Chairman.

I know from previous experience you may well want to inquire about the collective bargaining picture, about the wage developments which are in prospect, in our recent past, about wage-price policy. I do not, by omitting them from the statement, mean to minimize their importance. They are very well covered in the various reports.

I will, of course, welcome whatever questions you may have in the broader area.

(The prepared statement of Secretary Wirtz follows:)

PREPARED STATEMENT OF SECRETARY OF LABOR, W. WILLARD WIRTZ

This testimony proceeds from the Economic Report of the President, from his Message of January 23rd to the Congress, and from the Annual Report of the Council of Economic Advisers; and there is little to add as further basis for the fuller development the Committee's questions will permit.

My particular interest and responsibility center on one stubborn fact—a stubborn fact which these Reports have noted: the substantial unemployment which remains after seven years of unprecedented economic expansion—at such a rate that 7½ million jobs have been added in the past four years.

The President referred to this after noting that unemployment in 1967 was at its lowest level for many years: "Yet there is no room for complacency in these achievements. The unemployment rate for Negroes, Mexican-Americans and other minorities remains distressingly high, and far too many of our teenagers look for work and fail to find it. . . . Increasingly our efforts are concentrated on the disadvantaged who have been unable to share in our prosperity."

We now know, quite clearly, that *whatever* is done to strengthen the over-all economy, consistently with the accepted views about the dangers of "overheating" it, will leave—*unless other and entirely different measures are taken*—these consequences:

An average of about 3 million people unemployed *as of any one time*—resulting in an unemployment rate (as traditionally defined—meaning those who "are looking for work and unable to find it") of between 3.5% and 4.0%.

About 10 million people unemployed *at one time or another during the year.*

A so-far-uncounted number of additional people who ought to be working but who for one reason or another are not "looking for work" and therefore are not included in the traditional "unemployment" statistics.

A heavy concentration of the remaining unemployment among particular groups (especially "minority groups" and youth) and in sharply defined areas (the urban and rural slums, especially the "ghettos").

I report to the Committee, therefore, on the development of the policy and the "manpower" programs which are the essential complement of fiscal and monetary policy—for their purpose is to meet the problems of the unemployment (call it hard-core unemployment, or sub-employment, or structural unemployment) which expansion and growth of the economy will not meet.

These are essentially problems of "unemployment" which are more "personal" than "economic"—although each of these terms is less than precise, and reflects poorly quite a lot of new understanding.

I report significant progress in this area: (a) in the development of new methods of identifying and measuring this type of "unemployment"; and (b) in the development of new operating programs to meet it.

90-191 O—68—pt. 2——13

First, about its identification and measurement:

For many years the national unemployment rate was regarded as an adequate measure of sufficiency or insufficiency of job opportunity. By this measure we have done very well indeed. The overall rate stood at 6.7 percent in 1961 and was still at 5.7 percent in 1963. It was down to 4.5 percent by 1965, to 3.8 percent in 1967. For January 1968, the rate was 3.5 percent, lowest since the Korean conflict.

For some time now we have been high lighting in our reports on employment and unemployment the situation among the groups which have shared least in the general improvement: Negro and other "minority group" workers, with unemployment still twice as great as white workers; teenagers, with unemployment averaging 12.9 percent in 1967, not much improved since 1961; nonfarm laborers, with an average rate of 7.6 percent in 1967; and so on. Moreover, it has been increasingly emphasized that while almost 3 million persons are unemployed at any one time, approximately 11 million experience joblessness at some time during the year, and that of these over a million are unemployed for a total of at least half a year.

But we have also come to realize that this traditional concept of unemployment—which includes only those who are actively searching for works and reports nothing of the frequent inadequacy of what they find—is misleading as a measure of hard-core personal economic disability. It takes little or no account of the fact that hundreds of thousands of men and women are not working because of remediable physical and emotional handicaps. Others are not looking for work because they lack the basic minimum of literacy or skill, or have been repeatedly rebuffed, or cannot find transportation to where the jobs are located, or cannot find child-care facilities. Still others have only part-time work although they need and are looking for full-time employment. Millions with full-time jobs cannot earn enough to support their families decently.

In November of 1966, we conducted a set of experimental surveys in 15 slum areas in some of the Nation's largest cities, designed to illustrate these problems of incapacity, underutilization, nonparticipation and substandard employment which lies beyond "unemployment' in the traditional sense of the term. In addition to an average "unemployment" rate of 10 percent, we found another 7 percent of involuntary part-time workers; and of those with full-time jobs, more than one-fifth were earning less than $60 per week. Outside the labor force we found a large number of men so estranged from the world of work, and of women convinced that they will be barred from work, that they were not even seeking jobs. At least one out of three residents in these slums was found to have a serious problem related to employment.

From these pilot surveys the Department has been moving into a regular and systematic program of information and analysis concerning the economic pathology of the slums. The Bureau of Labor Statistics conducted methodological work in 1967 in order to tackle special problems of communication, reduce the "undercount" of slum residents (especially young Negro males), and achieve a better understanding of job-seeking methods utilized by casual workers without good training, experience or connections. We are now activating the regular survey program by training interviewers, preparing forms and instructions, selecting neighborhood samples, and so on. In the course of this year we will be getting regular and reliable information not only describing and measuring employment problems (going beyond the traditional concept of "unemployment") in the slums but also analyzing causes and pointing to the necessary remedies. This information will be indispensable in appraising results of efforts such as the Concentrated Employment Program, the Model Cities Program, and the JOBS program.

In the meantime, we have developed a method for using reliable working estimates of the unemployment situation (largely in terms of the traditional definition of "unemployment") *on a city-by-city* basis. This is being done for the 20 largest metropolitan areas. The first complete report on these 20 areas is being released today. (A preliminary report on 15 of them was released several weeks ago.)

These reports are based on annual averages of 12 monthly surveys during 1967. They include breakdowns as between the metropolitan area as a whole and the center city (in the case of 14 of the 20 areas); on the basis of race (for all 20 areas and cities); and age and sex (for most of the individual 20 areas and 20 central cities, and for all the cities together and the areas together).

I mention here only a little of what these new compilations show, for their largest usefulness will be to the citizens and public officials in each of these areas—who have so long had to work in the dark without reliable, detailed data about their own particular unemployment situation.

The figures in fact highlight the great weakness in the law of averages—that it conceals failure with success—for these estimated unemployment rates range from 2.2 percent in Minneapolis-St. Paul and 2.3 percent in Washington to 5.6 percent in Los Angeles-Long Beach and 5.4 percent in San Francisco-Oakland.

Negro unemployment rates "average" 2.3 times as high as white rates, but here again there are important differences. The ratio between the Negro and white rates is 1.5 in New York and 1.6 in Washington, compared with 3.1 in Cleveland and 4.2 in St. Louis.

For the 20 areas as a whole, unemployment averages 4.7 percent in the central cities, 3.1 percent in the suburbs. The principal reason is that the majority of whites live in the suburbs, while over 80 percent of nonwhites are in the central cities.

These tables also make clearer the actual magnitude of unemployment, as distinguished from ratios and percentages. For example, nonwhite employment in the 20 largest areas averaged 269,000 in 1967—divided almost equally among adult men, adult women and teenagers. (This was 42 percent of total nonwhite unemployment in the Nation.) Nonwhite unemployment in a single area can be illustrated by the situation in Chicago: 9,000 adult men, 11,000 adult women and 16,000 teenagers, for a total of 36,000, of whom about 33,000 are in the city of Chicago itself.

I report, therefore, that we are now well along in a major redesigning of manpower statistics in the pattern of today's social priorities.

The President describes, in his January 23rd Message, the development and the new emphases in the operating manpower program. He prescribes there an intensification of present efforts through: (1) the further concentration of resources and facilities on those particular areas where the needs are greatest; (2) unified planning and action by the government agencies and private organizations concerned with manpower; and (3) the greatly increased involvement of private industry in overcoming hard-core disabilities.

I only summarize briefly here the three special program developments which are designed to implement the President's instruction: the Concentrated Employment Program, the manpower aspects of the Model Cities Program, and the JOBS Program presented to Congress in the January 23 Message.

The Concentrated Employment Program responds to the President's directive in his 1967 State of the Union Message that governmental measures be redeployed so as to provide concentrated assistance to those with the greatest need. The guiding principles are (1) to enlist the active cooperation of business, labor and other community interests; (2) to provide a wide range of counselling, health, education and training services as needed by the individuals being served; (3) to provide the follow-up assistance necessary to assure that a job, once obtained, will not quickly be lost; and (4) to combine in a single project contract the training and work-training components available under the various statutory authorizations and appropriations.

By the end of fiscal 1968 we expect that Concentrated Employment Programs will have been established in 76 urban slum and rural poverty areas. In 1969, we plan to have 99 urban and 47 rural areas.

The *Model Cities Program*, established under the Demonstration Cities and Metropolitan Development Act of 1966, will mount a compresensive attack on the social, economic and physical problems of blighted urban areas. The coordination of federal, State and local efforts required by this Act includes the commitment of the Department of Labor to carry out the manpower aspects within the framework established by the Department of Housing and Urban Development.

All of the 65 Model City planning grants approved by the end of 1967 have included manpower components. Substantial reduction of unemployment and underemployment through work and training opportunities for neighborhood residents will be an integral part of every Model Cities plan.

Wherever possible, CEP and Model Cities neighborhoods will be aligned. The Neighborhood Service Centers will bring together, in one installation, the services administered by the Department of Housing and Urban Development, the Department of Labor, the Office of Economic Opportunity and the Department of Health, Education, and Welfare.

The *JOBS* (Job Opportunities in the Business Sector) program for involvement of private industry in training and employing the disadvantaged is a logical growth of previous undertakings.

Of the 113,000 new OJT trainees enrolled during 1967, about two-thirds were disadvantaged. This experience taught us that in order to attract hard-core recruits and move them through training into steady employment, a broader type of program would be needed. More counselling, health assistance and other supportive services would be needed; and the additional costs incurred by employers through loss of productivity, unusual supervision needs and other extra burdens would have to be taken into account. In 1968, the OJT program is emphasizing jobs with career potential, and is providing positions in private industry for many young persons initially enrolled in the Job Corps and Neighborhood Youth Corps.

Under the JOBS program, the Government will locate and identify the hard-core unemployed. Cooperating companies will furnish jobs and bear the normal costs of training, while the Government will underwrite additional costs such as literary training, transportation, health services and counselling.

The President also announced the establishment of a National Alliance of Businessmen to help launch the program. Leading business executives are spearheading the effort in the 50 largest cities. An expenditure of $106 million from available manpower funds has been programmed for Fiscal Year 1968, with an increase to $244 million planned for Fiscal Year 1969.

The CEP and JOBS programs permit combining the resources available to meet hard-core unemployment under both the Manpower Development and Training Act and the Economic Opportunity Act—so far as the administration of the EOA programs has been delegated to the Department of Labor. These include the New Careers program, the Special Impact program, Operation Mainstream and the Neighborhood Youth Corps.

These programs funded under the Economic Opportunity Act are budgeted for $745 million in fiscal 1969. Training programs under the Manpower Training and Development Act are budgeted for $513,044,000. In addition the Department will be administering the work incentive program for AFDC recipients, with an expected enrollment of 110,000 recipients in fiscal 1969.

The grants budget for administration of state employment security agencies requests $616,573,000 for 1969. I will not take time to tell the whole story of how the employment services are redirecting their efforts to serve those in greatest need, but it is an exciting story indeed.

All in all, programs administered by the Department of Labor will provide 1,300,000 training and employment opportunities in 1969.

In summary, regarding this matter of hard-core unemployment, I suggest the importance of recognizing fully all that remains to be done—and equally what is currently being accomplished.

As well as I can advise you, not only the population of the Nation as a whole *but every group within it* has—*by any past measure*—made unparalleled gains during the past five years so far as employment opportunity is concerned. When particular statistics are picked out to buttress a contrary conclusion, it only confirms that computers can now, like the scriptures, be drawn upon selectively to support almost any proposition.

One of the significant things that is happening is that each gain which is made in increasing employment opportunity draws additional people into the work force. The development of effective training, work-training, and employment opportunities for the hard-core unemployed encourages those who had given up to try again. There is still only partial realization of the extent to which the intensification of efforts—and the increased effectiveness of the efforts—to meet the problem of hard-core unemployment in the city slums is drawing the nation's disadvantaged more rapidly into the cities.

This is not remarked in complaint. The most important thing that has happened in these past five years is probably that we have rejected, as the measure of our achievement, any standard of previous performance—substituting instead the measure of the human potential. What we were able to do before is irrelevant, any gain by that standard immaterial. If this means feeling at the end of each day like a greyhound chasing a mechanical rabbit that can never be caught, it also means starting the next morning with the ennobling realization that man has finally shaken the false ideologies of predestination and determinism and has accepted responsibility for perfecting the human ideal.

This leads to a final point.

The first stage in the development of a national policy regarding employment and unemployment accepted the non-use of people—i.e. unemployment—almost entirely as part of the product of a national economic equation. The purpose was

to increase the number of work opportunities. It was system-centered. The only measurement was in terms of a totally undifferentiated national average. The principal feature of that policy, so far as recognition of the individual was concerned, was paying him insurance benefits for a time when he lost his job—if he had contributed to the system.

The second stage has been to recognize the necessity to assist the disadvantaged individual in qualifying himself for the work opportunities which are available. This has meant significant advances—reflected in the "manpower" program which has been described here. The needs of "the system" continue to be recognized at this stage as dictating what employment is to be.

The significant character of the third stage has already emerged. It involves the quality of "employment," the circumstances of the employment relationship, the meaning of work to the individual—beyond the fact of its providing a minimal living wage. This new factor takes a variety of forms, affecting much more than the employment of the disadvantaged. It is reflected in the fact of current measurement: that we count as fully employed a person whose capacities are only half-used. It is most sharply apparent today in the increasing realization that equal employment opportunity for the previously and presently disadvantaged groups demands a good deal more than providing their members just *any* kind of work on any kind of terms. The basic human elements in the civil rights revolution would remain untouched by hollow assurances to Negroes of the chance to be "hired hands" or life time holders of public works shovels or guilt-edged Government income guarantees. What is sensible in current proposals for "last resort employment" and "guaranteed income" plans must be carefully separated out from elements which would make these disastrous short-cuts across quicksand. This is a social, not an economic, revolution.

The implications of these broader considerations go beyond the scope of this hearing. But there is reason to remind that any consideration of "economic policy" tends to assume that man lives by bread alone, and that any report on "manpower policy" tends to overlook the implications of the fact that even the phrase itself derives from "horsepower."

I realize that the Committee's inquiry of me will proceed into other entirely different areas—collective bargaining prospects, wage and price policy, and so forth. It has seemed advisable to confine this statement to a single area. I shall of course welcome your broader questions.

Chairman PROXMIRE. Thank you, Mr. Secretary. I have been listening to statements before Senate committees now for 10 years. This is—I think this ranks as one of the most powerful, eloquent, moving, and competent statements that I have heard.

Secretary WIRTZ. Thank you.

Chairman PROXMIRE. It is most impressive and most encouraging. I am delighted you put it into a perspective of progress. You are right that we tend to be pessimistic, and we tend to look at the weak spots, and overlook the progress. Your statement did a lot to give us the kind of perspective we need.

Also, it is good to get this instrument of social policy that you are giving us; the breakdown of unemployment figures by city, and by the areas surrounding cities.

I want to get to that.

Before I do, however, I would like to ask you for your own justification of the administration's proposal for a 10 percent surtax which the Council of Economic Advisers, which I should say the Chairman of the Council, Chairman Ackley, wrote me would diminish the number of jobs during this calendar year by 150,000—fiscal year 1969 by 300,000—and would hit at a time when many economists feel that the economy is likely to be softer.

Under these circumstances, it seems to me that this very well might create a situation where it is much harder to get at the hard-core unemployment—recognizing that excellent as the new programs are,

and improved as they may be, what we need above all, I think, is an economy which provides a maximum opportunity for those seeking work to find it in private employment, and good as the Government's manpower training programs are, far more important, and far more effective, by and large, are the training programs that take place in private industry.

Under these circumstances, what is the justification for a surtax that can very seriously interfere with employment opportunities for the hard-core unemployed?

Secretary WIRTZ. My response, Mr. Chairman, takes account of two inhibiting factors. One is that—the statement I am about to make has been made by so many people under so many different circumstances it will be discounted as being only the voice of a parrot. And second, my response to the question must necessarily be intuitive to a certain extent, because I recognize the significance of broad principles which I only partially understand. But my answer adds up to a complete and unqualified endorsement of the surtax proposal.

I mention it only briefly—because they have no novelty. It is with a very serious and concerned consideration of the fact to which you refer. I know that when we talk about the necessity of cooling off the economy, what that translates into as far as my most immediate concerns go is the prospect that some fewer people will be working than were before—unless we do something else about it.

Now, I am not completely clear about the additional things that we can do about it.

We are talking about some of them when we raise the training, the work training program for next year from a million to 1.3 million people. We have that problem in mind. And then the greatest consideration, Mr. Chairman, and one which I do not profess personal competence to evaluate, is in terms of the alternatives. If the figures are correct—and I assume the correctness of the figures which you have since I have not talked to Mr. Ackley in terms of the specific figure of 150,000—and if that is the job price tag of a 10-percent surcharge, my approach to it would be, first, to try to compensate for it in other ways—significantly, in the work and the work training program. And second, to say that I would not think that a very high price to avoid the alternatives which could be involved in an inflationary spiral. And that if that were the price, I would like not to have to look it in the face, because it is a tough price. But if we are talking about, as I am convinced we are, a situation in which we must avoid the dangers of inflation, I think the benefit and advantage to the working wage earner of this country—who is by statute my constituent—is very much on that side—just very much.

I said my answer would be intuitive, and it is to this extent. When I get through all my homework about the surtax, and so forth, and do not understand all of it, I still come out with a complete conviction that in this stage in the development of the prosperity of the economy we ought to pay our bills. And I know that is an oversimplification. And I know that it is not an absolute that I am talking about. But, if the prospect is for a $14, $15, $20 billion deficit, whatever it may be—when I look at our gross national product—I say it is intuition, I suppose it is upbringing—in fairness to the folks, I do not think that is total ignorance—my reaction is that we ought to pay.

Chairman PROXMIRE. Well, you see, the problem that this presents—in the first place, 300,000 jobs, I think, would be eliminated in fiscal 1969. And I think this is a conservative estimate—it could be much higher than that.

At any rate, these are not the only alternatives. Another alternative is very possible—I know that you do not approve of this at the present time, for various reasons, but it would still seem to me it is a perfectly feasible alternative—to work for a wage-price guideline figure. It is my understanding that there is a trade-off in the view of many economists between a low level of unemployment and some degree of inflation. One way of keeping that level of unemployment as low as possible, consistent with keeping prices down, is to have a wage-price guideline that is specific and definitely understood.

This worked, I think, extraordinarily well from 1962 to 1965. An excellent study by John Sheahan who is a distinguished professor at Williams, and who appeared before this committee a couple of weeks ago, together with three other top economists in this area, confirmed that we would do better if we had a precise and definite guideline figure, which we did not have last year, and we do not have again this year. It is very hard to get. It is nothing like 3.2 percent—it would have to be 4½ percent, 5 percent—but something that would help to hold down the negotiated wage increases that we are likely to get in the 6 to 7 and 8 percent range. A guideline figure of 5 percent would make it possible to keep the cost-push element of inflation under better control, make it possible, therefore, to stabilize, or come closer to stabilizing prices, while at the same time providing more jobs.

Secretary WIRTZ. I appreciate that point. I do not have much observation that is new on it. You are right—within this same forum a year ago I expressed the view which I very strongly hold, that under present circumstances the establishment of a specific adjustment point and guideline would not result in any curtailment of wage or price increases.

You will note I subscribed completely to two other propositions which are implicit or on the edges of what you have said. One, at no point am I going to support stopping inflation by what I can identify at least as a deliberate stimulation of unemployment. I know we did that for a long time. And I am against that—100 percent.

On the affirmative side, at the same time that I say I do not believe a decimal point figure guideline will help on this whole matter, you know that I think very strongly that the principle of productivity is right—not as a matter of morals, but as a matter of everybody's self-interest. Every time I see a wage increase which is higher than productivity, and every time I see a price increase which is not justified by the same principle of productivity, I know that we have lost ground. The country, as a whole, has lost ground.

Now, the particular people that got it did not. But it is going to be infectious. And I am concerned today in a very real way—we are at that point where wage increases which are above productivity, and price increases which are not required, or warranted by productivity, are having, or will have, an epidemic effect. I am very much concerned.

Chairman PROXMIRE. Aren't we much more likely to get them absent some kind of a figure that the Government will announce and fight for and make clear throughout the country?

Secretary WIRTZ. You put it in the form of a question. I know your view on it. Mine is to the contrary. I think we are not more likely to get them absent a specific figure. And I think that in a very real way.

Chairman PROXMIRE. What kind of restraint is there on a union not to try to match the Ford settlement, or not to try to exceed the Ford settlement? After all, the President says we hope you will restrain your wage demands. But, unless there is a figure, what does it mean?

Secretary WIRTZ. Well, I do not know, Mr. Chairman, whether we are talking economics or the language, because my answer would be when you say what restraint is there—if against our mutual legal background by restraint we mean something that stops a person, and says you just cannot do it, it is against the law—the answer to your question is "No."

Now, if we go to a broader area of restraint, I do not believe I am under any illusions about the inclinations of both price setters and wage setters, or price bargainers in this country, to try to get all that they can in a particular situation.

I think the answer to whatever extent there is restraint in the broader sense, as a pragmatic answer, has got to come from the pressures on the other side. In both of those cases, it is the consumers pushing the pressures on the price side, and it is the employer pressing against the wage pressures on the union side. And I believe we kid ourselves if we think that there is any accepted or recognized articulated, clearly identified concept of a public interest that any union or any seller brings to bear when he decides what the wage demands will be, or how high his prices will be set. I believe it is only the influences of the marketplace.

Now, I believe that the consumers' pressures on price—against price increases—are greatly increased by the Government saying, "Now, look, this thing is in such a situation where right now you better fight as hard as you can against price increases."

Chairman PROXMIRE. Wouldn't you agree there are circumstances under which wage-price guidelines can be effective; that they were effective from 1962 to 1965?

Secretary WIRTZ. I think they were, too, in that period.

Chairman PROXMIRE. What you are arguing for now, Mr. Secretary, is fiscal restraint and monetary restraint. But you do not provide what the wage-price guideline experts said—you should also have it if you have this—which is a restraint in the area of wage settlements and price determinations——

Secretary WIRTZ. I have never been very timid about expressing questions as to whether the experience with the decimal point guidelines was in itself much of a restraint.

Of course, the increases in violation of the productivity principle were a good deal higher on the price side during that period than they were on the wage side. The wages stayed roughly in line for the first 3 or 4 years of this decade—5 years—they stayed roughly in line with the productivity principle while prices went higher. But, as far as I can give you, what is again necessarily a subjective judgment, I do not believe that except for perhaps the steel case in 1963, 1964, and possibly the General Electric case the following year, I do not believe that the fact of the decimal point figure could be translated into the dynamics of that bargaining as I saw it.

And, so, I do believe that it is the pressure, or the information, the learning, the education which is given the country as a whole, which is translated into these forces and which has its effect.

I am very hopeful, of course, that in the working of the Cabinet Committee, which the President has established, we will find ways, working together and with representatives of unions and companies, for implementing this. But, if your next question is how that is going to be done specifically, I will realize quite quickly, and you will, too, that I am falling back on an article of faith, that that good sense can be sufficiently communicated, that it will do well, and that that good sense is not made more effective when it is put into a decimal point.

I realize it is an area of argument and disagreement, and a strongly held view.

Chairman PROXMIRE. My time is up.

Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

There are a number of points I would like to develop, but I am not going to have the time to do it.

Missing from this report, which I think is important, is the impact of war on unemployment. If we took the same 600,000 boys that are in uniform now, because of Vietnam, as well as probably a million and a half in the munitions plants, and added them to the unemployment rolls, we would have some real problems. And I think we have to think in those terms.

Also missing from the report is the impact of inflation on unemployment. Inflation is continuing. It is going to increase imports and bring about a further decline in exports. This has a serious impact on unemployment.

The impact of high interest rates on employment was brought to our attention forcibly in the homebuilding industry.

A fourth area—and there is nothing in the report on this—is the situation regarding labor-management settlements and strikes. The chairman has been examining another area which is not mentioned here—wage-price guidelines, or wages and prices with respect to our productivity increases.

So, it is very difficult to conduct an examination on a paper that does not even discuss what I think are the underlying economic conditions that this committee has to grapple with.

Now, let me go to some things that are discussed here——

Secretary WIRTZ. Mr. Chairman——

Representative CURTIS. Sure, you may respond.

Secretary WIRTZ. I have assumed, Mr. Curtis, you are familiar with the reports, the Economic Report, and with the Council of Economic Advisers' Report.

Representative CURTIS. Oh, yes.

Secretary WIRTZ. On everything you have mentioned we have tried to cover in our very detailed report from the Bureau of Labor Statistics to the Joint Economic Committee last week. And I have assumed that there is familiarity with that, and that we would be glad to answer questions on that.

Representative CURTIS. Well, let me say this:

When you appear, Mr. Secretary, as the Secretary of Labor, I

assume that you are going to stress those things that are the most significant and important—even though they are in the documents, and indeed some of this is discussed here—so that we can then direct our colloquy toward these important things.

Now, I can prepare a series of questions, and you can answer. But, I am familiar with these personal appearances of the administration. This is the occasion, I think, to point up those things that are the most significant. I think I can draw the proper conclusion that those areas, not included in your paper, are those that the administration feels are not particularly critical.

Secretary Wirtz. I think that is right. In your terms, Mr. Curtis, my statement does represent those things which I think are most important. I am really more interested today, and I think the country ought to be, in the scenery than in the garbage. I think it is more important. And that is the reason it is emphasized here.

Representative Curtis. Well, we can take our rhetoric out in another forum than this. I have listed things that are not garbage by any means. The impact of the war on the unemployment situation is not garbage. The impact of inflation on employment as I have described it, with respect to exports and imports, is hardly garbage. The impact of high interest rates on unemployment and employment, and certainly productivity increases, are hardly garbage.

But we will develop our rhetoric in other forums. And believe me, I shall.

Secretary Wirtz. I should prefer that.

Representative Curtis. Now, having said that, I would like to devote a little time to some of the things that are discussed in this report.

Referring to—in your prepared statement—the first stage in development of national policy with regard to employment and unemployment—and I am skipping: "* * * to increase the number of work opportunities." The second stage, "* * * to assist the disadvantaged individual in qualifying himself for the work opportunities which are available."

What I find missing in here is a discussion of the machinery that—to identify what work opportunities are available, because without this kind of material and data, it is very difficult for me to conceive how any of the training programs that you mentioned in your report can be fully effective. They can be partially effective.

Two of the tools are, one, updating the Dictionary of Occupational Titles. The recent updating goes back really to 1965. Where is this sitting? Is there a new revision that is about to come out?

Secretary Wirtz. I will check on the specific schedule, and we will supply it for the record. The answer to your question is that we are continually working on it. But the answer to your question is also that that work has been somewhat slowed up. That has a lower priority now under the economic pressures than it would otherwise have.

(Information below subsequently filed):

The "lower priority rate" is assigned because the current edition of the Dictionary of Occupational Titles is a comparatively recent (December 1965) publication. We are planning on a full revision every 4 to 5 years, and are contemplating the next revision (fourth edition) for 1970.

This is possible through arrangements that are underway to computerize the revision, maintenance, and printing of the DOT to make the information

more timely, accurate, and varied (depending on the need) in format. We anticipate being able to use this automated programing technique in fiscal year 1969 and we will project a new edition of the DOT for the following fiscal year (1970).

Work is continually being done to keep the information up-to-date. Parenthetically, we have, in the past, prepared and issued "supplements" to earlier editions, rather than a full revision. However, we found these to be less than satisfactory to the many users of this document, since each supplement means another volume to procure, handle and keep track of—and this frequently isn't done.

It may be of interest to note that the current edition of the DOT added some 6,000 occupations to the preceding edition; and that we anticipate adding an estimated 4,500 occupations new in the economy to the next edition of the dictionary. In addition we intend reflecting the many thousands of changes that will have taken place in the jobs currently existing in the economy.

Representative CURTIS. How can that have a low priority if the essential features of any job-training program where you are spending hundreds of millions of dollars depend on identifying the opportunities which are available. And, believe me, the opportunities that are available require new skills for new jobs which were not even in existence before.

How, can you elucidate that?

Secretary WIRTZ. I am not clear about the question. Is the question whether I think that it is important to try to keep those descriptions up to date?

Representative CURTIS. Yes.

Secretary WIRTZ. I do.

Representative CURTIS. You are saying that because of the economy pressures, that this has been slowed down. I am arguing relative priorities, saying it seems quite clear to me this is of the highest priority.

Secretary WIRTZ. Any limiting factor, as far as we are concerned on that, has come from the attempt to do just every single thing we can to pull in our belt. When the Congress says cut out 2 percent of your jobs, and cut off 10 percent of your programs, we have got to do just exactly that. And I do not object to it. But——

Representative CURTIS. In other words, what you are saying is that you do not agree that this is the highest priority. If it were the highest priority, you would not cut it—you would cut things of lower priority?

Secretary WIRTZ. You are perfectly correct.

Representative CURTIS. Then there is apparently a difference of opinion. You do not think that continuing to update the Dictionary of Occupational Titles is of this high priority that I attach to it?

Secretary WIRTZ. I do not think the further expansion of the program of keeping up the dictionary is of the priority which you apparently attach to it.

If your suggestion is that the first thing we should do in the Department of Labor is to put more people on the dictionary, we would have a point of disagreement.

Representative CURTIS. I am sure we would because I would say that it is almost inconceivable to identify the opportunities which are available if you have not constantly kept up to date the nomenclature that describes these jobs. How any of these programs can function without this essential data is incomprehensible.

So, I move to the next tool, the jobs available statistics, which, as I read the Manpower Development Training Act, was a requirement that

the Department of Labor developed. Two years ago, this committee held hearings to be sure that we were not in error about the feasibility of the jobs available statistics and the necessity of it as far as making any manpower training program work.

But, where are we on that?

Secretary WIRTZ. You know our story on that, Mr. Curtis, and how complete our agreement is on it. And, you know, too, that we have, in the 5 years that I have been Secretary of Labor, taken each year, to the Congress of the United States——

Representative CURTIS. You did not last year, and you have not this year.

Secretary WIRTZ. We have twice——

Representative CURTIS. You have not ever since then.

Secretary WIRTZ. We have twice taken to the Congress of the United States, both the full recommendations of the Secretary of Labor, the full recommendations of the Bureau of the Budget, and the strong recommendations of the President, a proposal, a line proposal, for that study, and the Appropriations Committee, or Congress has decided we should not do it.

Now, I still agree with you in your position. So, we have tried to meet that problem as much as we can.

Two years ago it seemed to us of critical essentiality that we do it, because at that point there were manpower shortages, and we thought we had to identify those as carefully as possible—not only in the interests of the individual, but in the interests of the economy. And so we did—on a draft basis—put together on a bimonthly or quarterly basis the fullest information we could on that.

We have abandoned that in the last year, because the shortages are probably not as acute as they were before.

We are also trying, in a variety of manpower development and trainin programs, to get that information in one form or another. And I believe we have it substantially. We have given up on the attempt to get from the Congress the approval, the special authorization for it. But we have tried to put it together in our own programs—I agree with you on this point, and in reality, on a great many more than the previous comments might have suggested.

I would add this:

To the extent that we can shift the program to an on-the-job training basis, as we are doing, that problem is met to a very considerable extent by seeing to it that at the training point the individuals become part of the employment relationships in which they will continue after they have completed training.

Representative CURTIS. My time is up.

I can only say—and I will come back and discuss it—these efforts are very, very feeble.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

I want to pursue, Mr. Secretary, the questions that Chairman Proxmire was directing at you—in which you have said in effect, when Chairman Proxmire communicated to you Gardner Ackley's view that the tax increase will take enough demand out of the economy to make unemployed around 300,000 people who otherwise would be employed—your answer was that that is a stiff price to pay, but that

you think it has to be met because we, in your phrase, have to pay our bills.

Secretary WIRTZ. No, Congressman. I think you left out the point that my response to that would be first to try to find, and I think we would find, ways of making up that figure. There is a coincidence between that 300,000 figure, which frankly I have not heard until today, and the expansion of the work training program, which is also being expanded this year, 300,000. So my first reaction is not that I just would pay that price. I would try to meet whatever the effect was first.

Representative REUSS. But if you cannot meet it, because—what shall it profit a Secretary of Labor to train people for jobs if there are 300,000 fewer jobs than there otherwise would have been? You just have to keep training them, but they won't get a job, as you think—passing that point, you then come to the nitty-gritty, which is that you would be willing to pay that price in order to pay the Government's bills.

Secretary WIRTZ. No. If that is a proper paraphrase of what I said, I should say it again. I am never going to settle to pay a price in unemployment to prevent overheating in the economy.

I would take into account the importance to the wage earners of this country of prices not getting way out of line. And I will take into account the desirability of paying whatever our bills are.

But I cannot support a proposition that you do any of these things at a recognized price of employing fewer people than there were before. Therefore, I try to bring these things together by making some provision—training them for better jobs—which the economy will continue to need.

I try to meet that price by some alternative method.

Representative REUSS. I tarry on this point so long because it is vitally important. And I am afraid it is one we are going to be confronted with every year for a while, until we solve the secret of the philosophers.

I am concerned, though, as you are, that here we are, unemployment still not down to the 3-percent goal which we used, at least, to say should be our goal, and here we are running a $14- or $16- or $18-billion deficit. Something is wrong with the scenario, obviously, as I have kept observing for the last couple of years. What I think is wrong with the scenario, or in part wrong with it, is that our tax system is so full of loopholes that it is not grabbing the revenues that it should, and I ask you—does it really seem like a good idea to retain those loopholes in the system, to let year after year go by without even asking the Congress to do anything about them, and then take it out on the hide of the average moderate income taxpayer, and reduce his demand-creating potential.

Frankly, it does not seem to me a very good way to run the economy.

I wonder how you account for these huge deficits that we are running, at 3.5 percent unemployment.

Secretary WIRTZ. There are several elements in the question, Mr. Reuss; when we get into the area of tax loopholes, you will realize that it is an area with respect to which my competence would be purely personal, and nothing more. But I am against them.

Representative REUSS. I know that. Everybody is, in principle. But I wonder if it is not a serious matter, that the administration has not

asked the Congress to do anything about them. Because, when you plug a tax loophole, you probably do not throw a man out of work, as you do when you grab a similar amount of revenue by an across-the-board tax increase.

Most of the money that would be brought into the Treasury by plugging tax loopholes is money that is not spent on consumption, or isn't spent on real investment in plant or equipment, but instead bids up the price of commodities, or stamps or jewelry or art works, or chases around in the stock market, or leaps overseas into foreign speculation. It does not make jobs.

Therefore, we have something grievously wrong in letting the loopholes go unplugged, because we lack the will to do anything about them—we have to throw men out of work, some 300,000 of them, in our model here, in order to, in your phrase, pay the bills.

I am for paying the bills, but why not pay the bills by getting revenues that do not tend to put people out of work?

Secretary WIRTZ. If the question were whether to pay our bills by closing tax loopholes, or putting 300,000 people out of work, I would take the closing of the loophole. I believe that is an oversimplification of it.

Representative REUSS. A little, but not entirely.

Secretary WIRTZ. It is surely not irrelevant. But I would like to suggest that I think the unemployment rate will not be larger if the surtax is imposed than if it is not imposed. I want to be very clear about that.

Representative REUSS. You reject Gardner Ackley's 300,000 figure?

Secretary WIRTZ. No. I do not think that is what he says. There are a lot of other things going on. There is a manpower training program that is covering 1,300,000 people this year. There are a lot of other things going on. I repeat, I think that if or when the surtax is imposed, the unemployment rate will be lower than it is now, or at least no higher than it is now.

I think the increase in the number of jobs this year will be as large as it was last year, or aproximately that large. I believe that is about a million six hundred thousand. So that I do not think that the surtax will reduce that.

Representative REUSS. You will have me voting for the surtax in a minute here. You really think unemployment will come down?

Secretary WIRTZ. Yes, Mr. Reuss. I think the question is whether it is legitimate to look at the surtax alone. In complete candor, perhaps even letting my guard down, I accept those figures. But I would point out there are a lot of other things going along with them. And I would urge considering two parts of the program which the President has put before the Congress—one, a surtax proposal, which you say the chairman on the Council of Economic Advisers says could in itself have an effect on reducing employment by 300,000, and a second provision of which is a manpower program expanded by half a billion dollars which will have the result of putting another 300,000 people into training.

Representative REUSS. Let me take the second part of that. I will just expand, and forget about the contracting—what is wrong with that? And pay the bills by plugging tax loopholes.

Secretary WIRTZ. I beg your pardon?

Representative REUSS. I was buying part of your package. I will buy the Labor Department part—let us increase those training programs to 1.3 million, and then let us provide jobs for those who are getting the training, by forgetting about the surtax, and instead recouping the revenues by plugging tax loopholes. Your answer, maybe, is that we should have done that a year or two ago and we would be all right. But, would you at least give me that satisfaction?

Secretary WIRTZ. I sure would—on this basis. All my life I have said in public places and as an individual, that I am opposed to a number of tax loopholes. I have not changed my mind on that. If it is a matter of expression of administration policy, obviously a statement by the Secretary of Labor about tax loopholes is not worth the back page of a paperback book. But in terms of a personal position that I have held for a lifetime about tax loopholes, I agree completely.

Representative REUSS. I was not asking you the question of morals or equity or fairness. I was asking you the question of whether we do not have to plug our tax loopholes in this country in order to get the revenues we need in the Treasury, so that at a time of close to full employment, we do not keep running disastrously large deficits.

Secretary WIRTZ. It ties the two together again. And I do not rush from that—the loopholes and the effect on employment.

I have not thought it through to an evaluation of whether the closing of the loopholes to which you are referring would have an effect on employment. I would like to try to do it.

I think your question is rather about whether the surtax could be replaced by the closing of the loopholes.

But if the question is—as I gather now it is—if the question is whether the closing of the loopholes would permit a continuation of employment at a higher level, I believe I am out of my depth. I do not believe I could honestly answer the question of the tie-in between the two.

Representative REUSS. It is a question the Secretary of Labor ought to be concerned with.

Secretary WIRTZ. The question——

Representative REUSS. You are not just concerned with structural——

Secretary WIRTZ. That is right.

Representative REUSS (continuing). With structural unemployment. You are concerned with overall demand unemployment, too.

Secretary WIRTZ. Sure, of course. And if overall demand should go down, the unemployment rate would go up. And along with everything I have said about the importance of the manpower program, I recognize that any rocking of the boat—as far as the fiscal, monetary, general economic situation is concerned—would hurt more than anything that we could possibly make up on a structural basis. I know that.

Representative REUSS. Thank you..

Chairman PROXMIRE. Congressman Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Secretary, we are always very pleased to have you before the committee. We know you have a great fund of knowledge in connection with this field.

In your statement, you said:

One of the most significant things that is happening is that each gain which is made in increasing employment opportunity draws additional people into the work force.

Now, is it not equally true that as we get inflation, the cost of living increases, additional people are drawn into the work force because they cannot meet their bills?

Secretary WIRTZ. I should think it would have some of that influence. There would be a family which would be pressed tighter by an increase in the cost of living. And if the husband's income did not go up as much as the cost of living, then there would be additional pressure for the wife to attempt to work, too. That would be true.

Representative WIDNALL. It has been my own observation that many people who thought they had acquired enough for retirement, or who were forced into compulsory retirement, with an annual income which seemed to be sufficient at the time, have now found that it is completely inadequate for their needs, and they have to go back and acquire work of some kind, somewhere within the labor force. And I think there is an equal pressure in that direction caused by inflation, and the very definite change in the cost of living for the average family.

Do you have an inventory of the number of people holding two jobs?

Secretary WIRTZ. We have tried to get—let me answer your second question first, and then just an observation on the first part.

I will supply the information that we have available on what we call moonlighting.

Our last survey of persons with two or more jobs was made in May 1966. At that time 3.6 million workers, or just under 5 percent of all employed persons, held more than one job. This proportion was somewhat lower in 1966 than in 1964 or 1965.

I submit for the record a report on moonlighting which appeared in the Monthly Labor Review in October 1967, pages 17 to 22.

(The report follows:)

MOONLIGHTING—AN ECONOMIC PHENOMENON

The Primary Motivation Appears To Be Financial Pressure, Particularly Among Young Fathers With Low Earnings

(By Harvey R. Hamel*)

Moonlighting habits of the American worker have not increased or even changed much in recent years. The most recent survey of dual jobholding shows that 3.6 million workers, just under 5 percent of all employed persons, held two jobs or more in May 1966. This proportion was somewhat smaller than those revealed by the 1964 and 1965 surveys.

The typical multiple jobholder is a comparatively young married man with children who feels a financial squeeze. He has a full-time primary job and moonlights about 13 hours a week at a different line of work. Teachers, policemen, firemen, postal workers, and farmers are most likely to moonlight. Many of them work for themselves on their extra jobs (operating farms or small businesses) while many others are sales or service workers.

One of the major subjects explored in this article is the relationship between moonlighting and weekly earnings, data on which is available for the first time. There is also an analysis of the association between moonlighting and hours of

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work, an indication of some of the possible reasons for moonlighting, and a discussion of the industries and occupations of moonlighters.[1]

A QUEST FOR HIGHER EARNINGS

Why do over 3½ million persons hold two jobs or more? The primary reason seems to be economic. Many moonlighters need, or believe they need, additional income. For some, a second job is a necessity. A second job enables others to live at a higher standard.

For still others, a second job may be the means by which they are able to maintain a standard of living that would otherwise be lost because of, for example, sudden large expenses, loss of wife's income, or a decline in earnings on the primary job.

Because financial reasons are a prime factor motivating moonlighters, the Bureau of Labor Statistics collected data on the usual weekly wage and salary earnings of dual jobholders on their primary job and of single jobholders. These data show that generally the level of a worker's earnings determines his propensity to moonlight. Multiple jobholding rates for men 25 to 54 years old are highest at the lowest earnings level—under $60 a week. As the level of earnings rises, the incidence of dual jobholding declines (see chart 1). The lowest rates were found among workers with the highest weekly earnings—$200 or more.

The close association between multiple jobholding and earnings is most evident from the data for married men 25 to 54 years old, the group for whom family financial responsibilities are usually the greatest. Among these men, the moonlighting rate for those earning less than $60 a week was 12.5 percent, more than twice as high as the 5.3 percent for men earning $200 or more a week.

Data available for the first time show that among men who are heads of households, there is a close relationship between the multiple jobholding rates, the number of young children, and usual weekly earnings. The moonlighting rate tends to increase with the number of children under age 18. The rate for men with at least five children was nearly twice that for men with no young children, as shown in the following tabulation:

Multiple jobholding rates for men who were heads of households, May 1966—Children under age 18

Children under age 18	Rate
Total	7.9
None	5.4
1 child	8.3
2 children	9.1
3 or 4 children	9.8
5 children or more	10.3

Within each of these groupings, multiple jobholding rates tended to decrease as earnings increased. For example, among men who were household heads with three or four children, the rate was 16 percent for those who earned under $60 weekly, about double that for those with earnings of $200 or more.

[1] Data in the current report are based primarily on information from supplementary questions to the May 1966 monthly survey of the labor force, conducted for the Bureau of Labor Statistics by the Bureau of the Census through its Current Population Survey. The data relate to the week of May 8 through 14.

This is the seventh in a series of reports on this subject. The most recent was published in the *Monthly Labor Review*, February 1966, pp. 147–154, and reprinted with additional tabular data and explanatory notes as Special Labor Force Report No. 63, which also includes a complete listing of earlier reports and their coverage.

For purposes of this survey, multiple jobholders are defined as those employed persons who, during the survey, (1) had jobs as wage or salary workers with two employers or more; (2) were self-employed and also held a wage or salary job; or (3) worked as an unpaid family worker, but also had a secondary wage or salary job. The primary job is the one at which the greatest number of hours were worked. Also included as multiple jobholders are persons who had two jobs during the survey week only because they were changing from one job to another. This group was measured in the December 1960 survey and was found to be very small—only 2 percent of all multiple jobholders.

Persons employed only in private households (as a maid, laundress, gardner, babysitter, etc.) who worked for two employers or more during the survey week were not counted as multiple jobholders. Working for several employers was considered an inherent characteristic of private household work rather than an indication of multiple jobholding. Also excluded were self-employed persons with additional farms or business, and persons with second jobs as unpaid family workers.

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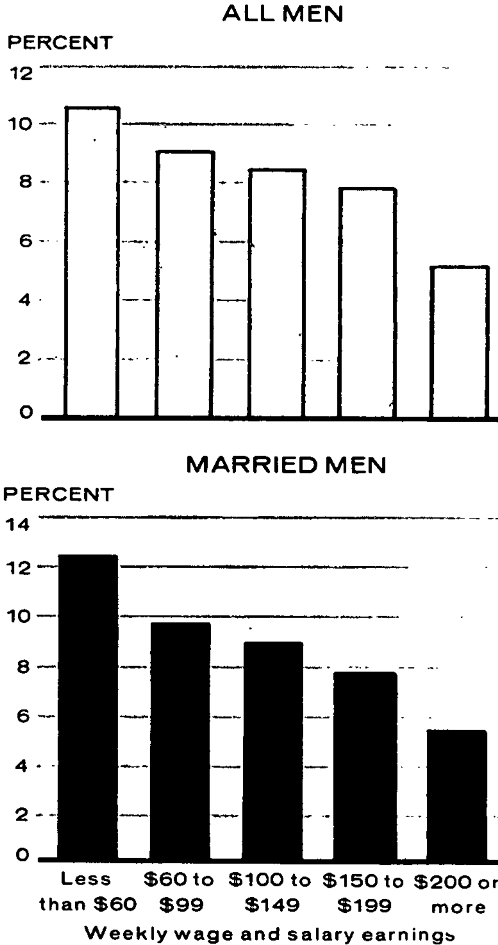
Chart 1. Multiple Jobholding Rates for Men 25 to 54 Years Old, May 1966



Financial pressure, however, is not the only reason why workers moonlight. There are several other considerations. Some workers with a regular wage or salary job want to continue or try their hand at working for themselves on a part-time basis while still maintaining their basic source of income. One-third of the multiple jobholders are self-employed on their second job. They moonlight at their own business or devote a few hours to providing some professional service in their spare time without committing large resources or all their time to the venture. Moreover, the fact that half of this self-employed group operates a farm as their second job suggests that some of these dual jobholders have chosen not to abandon the farm way of life even though economic reasons force

them to work at a full-time wage or salary job. Others may have moved to the country and taken advantage of the opportunity to do a little farming on the side.

Some persons moonlight because they are interested in another line of work. They experiment with a second job, but still maintain their primary job until they determine whether they like the work on their new job and decide whether it is feasible to make a change to this new line of work. Still others moonlight because there is a shortage of their particular skill (for example, teachers and skilled craftsmen) and they find it very easy to make extra money.

The basic characteristics of moonlighters have remained about the same in the course of several BLS surveys. The majority are men. Their multiple jobholding rate is about three times that for women workers. (See table 1.) A smaller proportion of Negro than white workers were multiple jobholders.[2]

The incidence of holding two jobs or more was highest among men 25 to 44 years old. This age group accounted for 43 percent of all employed men, but over half of all men holding more than one job. Moonlighting was least likely among the very young (14 to 19 years old), most of whom are attending school, and among workers 65 years old and over. Married men were twice as likely to be moonlighters as single men.

In sum, the data suggest that the typical moonlighter is a highly motivated and energetic young married man with a growing family, who works at two jobs or more primarily to provide additional income for his family but also for a variety of other reasons; to try his hand at working for himself; to keep busy; to obtain satisfaction; to experiment with another line of work; or to supply his skills that are in demand in his community. The moonlighter aspires to a better living and is willing to work hard to obtain his goal.

WORK-HOURS ON BOTH JOBS

Although the rate of multiple jobholding has remained substantially the same in recent years, the question still arises as to whether a shortened workweek would lead to higher moonlighting rates among workers who are affected by the cutback in hours. There is no question that when hours are shortened the opportunity to hold an extra job increase. However, an individual's decision on how to use his free time—to moonlight or do something else—involves many factors other than the number of hours worked.

One way of examining the relationship between moonlighting and the length of the workweek is to compare the dual jobholding rates of men working shorter hours with those on a longer workweek. The data show that in nonfarm industries persons who worked 35 to 40 hours on their main job were no more likely to be multiple jobholders than those who had worked 41 to 48 hours.

TABLE 1.—EMPLOYED PERSONS WITH 2 JOBS OR MORE, BY SEX, 1965–66

Month and year	Persons with two jobs or more			
	Number (thousands)	Multiple jobholding rate [1]		
		Both sexes	Men	Women
May 1966	3,636	4.9	6.4	2.2
May 1965	3,756	5.2	6.7	2.3
May 1964	3,726	5.2	6.9	2.1
May 1963	3,921	5.7	7.4	2.4
May 1962	3,342	4.9	6.4	2.0
December 1960 [2]	3,012	4.6	5.9	2.0
December 1959	2,966	4.5	5.8	2.0
July 1958	3,099	4.8	6.0	2.2
July 1957	3,570	5.3	6.6	2.5
July 1956	3,653	5.5	6.9	2.5

[1] Multiple jobholders as percent of all employed persons.
[2] Data for Alaska and Hawaii included beginning 1960.

[2] Data for nonwhites will be reported as data for Negroes, who constitute about 92 percent of all nonwhites in the United States.

Hours worked on primary job	Multiple jobholding rates for men, May 1966		
	All industries	Agriculture	Nonfarm
Total	6.5	8.7	6.3
1 to 21 hours	7.3	9.0	7.0
22 ro 34 hours	10.3	14.1	9.6
35 to 40 hours	6.8	9.7	6.7
41 to 48 hours	6.7	14.6	6.4
49 hours or more	4.5	5.8	4.3

This suggests that reducing the workweek by only a few hours would not in and of itself substantially affect the incidence of multiple jobholding provided there was no cutback in earnings. No significant inverse relationship exists between moonlighting and the length of the workweek. This finding accords with the conclusions of a recent study of rubber workers in Akron, Ohio.[3] It seems reasonable, therefore, to assume that among full-time workers, factors other than the length of the workweek determine whether a man looks for a second job.

Men working part time (22 to 34 hours) were more likely to be moonlighters than men with a full-time job (but since most men work full time, the majority of multiple jobholders are full-time workers). The rate was lowest for men working over 48 hours a week on their main job. Dual jobholding rates for men who worked less than 22 hours weekly were relatively low, reflecting the fact that men working so few hours a week are mainly students or older men unlikely to be interested in a second job.

Typically, multiple jobholders worked full time on their principal job and part time on their extra job; about one-fourth worked part time on both jobs; and 8 percent worked full time on both. On the average, they worked a total of 52 hours, only 13 of which were on their second job. The 39 hours on the primary job paralleled the 39 hours that single jobholders worked on their only job. Of all multiple jobholders, those who were farmers or factory workers on their primary jobs worked the longest total workweeks—59 and 57 hours, respectively. Men worked much longer hours than women on their extra jobs, 14 compared with 9 hours. Men who had additional wage or salary jobs worked longer at these jobs than those who were self-employed on their extra jobs, 15 hours and 12 hours, respectively.

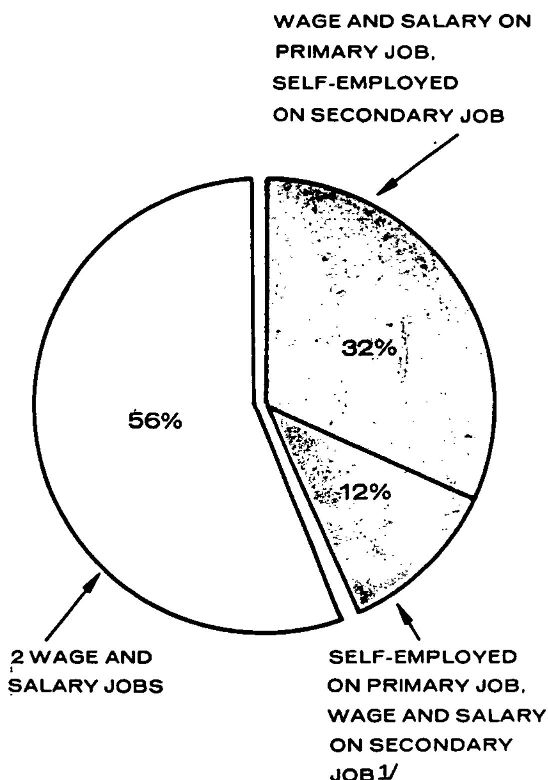
MOONLIGHT INDUSTRIES

One of the most significant aspects of moonlighting is the high incidence of self-employment. About 1.5 million or more than 2 out of 5 multiple jobholders operated their own farms or businesses or were self-employed professionals on the first or second job (chart 2). About half of them were farmers, typically holding down a regular blue-collar job and running their farms in their spare time (table 2). Workers who operated farms as their normal line of work were nearly twice as likely to have a second job as the average worker. About 25 percent of the 200,000 moonlighting farmers had second jobs as a hired hand on someone else's farm; 40 percent worked on construction or transportation jobs or in factories.

On the other hand, the multiple jobholding rate for nonfarm self-employed workers was low. This reflected both their relatively high earnings and the fact that businessmen and self-employed professional people often do not have the time for a second job. The majority of the dual jobholders had two wage or salary jobs. Of salaried employees, public administration workers were more likely to moonlight than workers in any other major nonfarm industry. The dual jobholding rate is particularly high for postal workers (1 out of 10), a proportion which has remained consistently high over the years (table 3). Other nonfarm wage or salary workers with higher than average multiple jobholding rates included those working in educational services, entertainment and recreation, transportation, construction and forestry, fisheries, and mining.

[3] John Dieter found no statistically significant difference in multiple jobholding rates for Akron workers on a 36-hour workweek and those on a 40-hour workweek. He concluded that the high incidence of moonlighting in Akron for many years may reflect an established custom of these workers, and that other factors (primary job income, number of children in the family and employment of the spouse) offered better explanations of moonlighting. See "Moonlighting and the Short Workweek," *The Southwestern Social Science Quarterly*, December 1966, pp. 309–315.

Chart 2. Class of Worker of Primary and Secondary Jobs for Multiple Jobholders, May 1966



[1] Includes a small proportion of multiple jobholders who were unpaid family workers on their primary jobs.

One-third of all the secondary jobs were in either farm or nonfarm self-employment. Another 43 percent of the moonlighters had paid jobs in the trade or service industries, which can use many part-time workers. Usually, moonlighters did not work in the same industry on their second job as they did on their primary job. Except for service and trade workers, only a small proportion had two jobs in the same industry.

There was a sharp difference in the kinds of second jobs held by white and Negro dual jobholders. About one-third of the white moonlighters were self-employed on the second job, and one-fourth worked in service industries. Among Negroes, however, fewer than 20 percent were self-employed and nearly half worked in service industries.

OCCUPATIONS OF MOONLIGHTERS

Multiple jobholding rates vary with the worker's main occupation. As in prior surveys, moonlighting rates in May 1966 were highest among men who were teachers—1 out of 5 had a second job (table 4). Some elementary and high school teachers may moonlight because they have an opportunity to take evening

TABLE 2.—TYPE OF INDUSTRY AND CLASS OF WORKER OF PRIMARY AND SECONDARY JOBS, FOR PERSONS WITH 2 JOBS OR MORE, MAY 1966

[Numbers in thousands]

Type of industry and class of worker of primary job	Total employed	Persons with 2 jobs or more		Type of industry and class of worker of secondary job					
				Agriculture			Nonagricultural industries		
		Number	Percent of total employed	Total	Wage and salary workers	Self-employed workers	Total	Wage and salary workers	Self-employed workers
Total	73,764	3,636	4.9	721	139	582	2,915	2,335	580
Agriculture	4,292	335	7.8	120	83	37	215	212	3
Wage and salary workers	1,326	88	6.6	56	19	37	32	29	3
Self-employed workers	2,253	200	8.9	49	49	(1)	151	151	(1)
Unpaid family workers	713	47	6.6	15	15	(2)	32	32	(2)
Nonagricultural industries	69,472	3,301	4.8	601	56	545	2,700	2,123	577
Wage and salary workers	62,529	3,110	5.0	599	54	545	2,511	1,934	577
Self-employed workers	6,371	177	2.8	2	2	(1)	175	175	(1)
Unpaid family workers	571	14	2.5			(2)	14	14	(2)

[1] Self-employed persons with a secondary business or farm, but no wage or salary job, were not counted as multiple jobholders.

[2] Persons whose primary job was as an unpaid family worker were counted as multiple jobholders only if they also held a wage or salary job.

Note: Because of rounding, sums of individual items may not equal totals.

TABLE 3.—INDUSTRY GROUP AND CLASS OF WORKER OF PERSONS WITH 1 JOB AND WITH 2 JOBS OR MOR MAY 1966

Industry group and class of worker	Percent distribution			Multiple jobholding rate[1]
	Persons with 1 job	Persons with 2 jobs or more		
		Primary job	Secondary job	
All industries	100.0	100.0	100.0	4.6
Agriculture	5.6	9.2	19.8	7.8
Wage and salary workers	1.8	2.4	3.8	6.6
Self-employed workers	2.9	5.5	16.0	8.9
Unpaid family workers	.9	1.3	(2)	6.6
Nonagricultural industries	94.4	90.8	80.2	4.8
Wage and salary workers	84.7	85.5	64.2	5.0
Forestry, fisheries, and mining	.8	1.0	.4	6.0
Construction	5.2	6.5	4.2	6.1
Manufacturing	27.0	23.8	6.2	4.4
Durable goods	15.7	15.4	3.0	4.9
Nondurable goods	11.3	8.4	3.2	3.7
Transportation and public utilities	6.0	7.3	5.3	5.9
Wholesale and retail trade	15.5	11.9	16.8	3.8
Wholesale	3.1	2.8	1.2	4.5
Retail	12.4	9.1	15.6	3.7
Eating and drinking places	2.6	1.4	3.9	2.8
Other retail trade	9.8	7.7	11.8	3.9
Service and finance	25.3	25.4	26.6	4.9
Finance, insurance, and real estate	4.0	3.9	4.2	4.8
Business and repair services	2.1	2.4	2.8	5.6
Private households	3.6	.7	3.2	1.0
Personal services, except private households	2.2	1.7	2.2	3.9
Entertainment and recreation	.9	1.1	3.3	6.2
Educational services	6.3	9.6	4.8	7.3
Professional services, except education	6.1	5.9	6.2	4.7
Public administration	4.9	9.5	4.7	9.2
Postal services	.8	1.7	.9	10.1
Other public administration	4.1	7.9	3.8	9.0
Self-employed workers	8.8	4.9	16.0	2.8
Unpaid family workers	.8	.4	(2)	2.5

[1] Persons with 2 jobs or more as percent of all employed persons in industry of primary job.

[2] Persons whose only extra job was as an unpaid family worker were not counted as dual jobholders.

jobs at school in some professional activity, but other evidence suggests that the most likely explanation is their comparatively low earnings of teachers.[4] The dual jobholding rate for other male professional and technical workers is high, but less than half that of teachers.

A very high proportion of men employed in protective services (policemen, firemen, and guards) had an extra job in May 1966—1 out of every 6. Their flexible work schedules make moonlighting possible and their relatively low earnings often make it necessary. Other service workers (including barbers, cosmetologists, janitors, attendants, and other workers) also had higher than average moonlighting rates. Men who were managers, officials and proprietors—an occupation group which typically works long hours and whose earnings are generally above average—were least likely to be multiple jobholders. Nonfarm laborers and retail sales workers were also unlikely to be multiple jobholders. Moonlighting rates were generally higher for white than Negro men, particularly among blue-collar and service workers.

ABLE 4.—OCCUPATIONAL DISTRIBUTION OF PERSONS WITH 2 JOBS OR MORE, AND RATE OF MULTIPLE JOBHOLDING, BY OCCUPATION AND SEX, MAY 1966

Occupation group	Persons with 2 jobs or more—			
	Percent distribution		Multiple jobholding rate[1]	
	Primary job	Secondary job	Men	Women
All occupations	100.0	100.0	6.4	2.2
Professional, technical, and kindred workers	17.8	15.1	8.9	3.5
Medical and other health workers	1.8	1.6	8.3	2.1
Teachers, except college	5.2	1.8	19.7	3.8
Other professional, technical, and kindred workers	10.8	11.6	7.4	4.1
Farmers and farm managers	5.5	16.1	9.5	2.2
Managers, officials, and proprietors, except farm	7.8	10.6	4.2	2.1
Clerical and kindred workers	10.4	7.4	6.5	2.1
Salesworkers	5.2	8.2	5.4	1.7
Retail trade	2.1	4.9	4.4	1.3
Other salesworkers	3.1	3.3	6.1	3.8
Craftsmen, foremen, and kindred workers	15.8	9.8	6.0	4.7
Operatives and kindred workers	17.0	11.4	6.0	.9
Private household workers	.7	2.2	(2)	1.1
Service workers, except private household	11.7	11.4	9.6	2.7
Protective service workers	3.8	1.3	16.8	(2)
Waiters, cooks, and bartenders	2.3	3.7	6.4	3.3
Other service workers	5.7	6.3	7.5	2.4
Farm laborers and foremen	3.2	3.0	6.7	6.2
Laborers, except farm and mine	4.9	4.7	4.8	3.1

[1] Persons with 2 jobs or more as percent of all employed persons in occupation of primary job.
[2] Percent not shown where base is less than 100,000.

A large proportion of the moonlighters (42 percent) earned their supplementary income as professional and technical workers or managers, or by operating their own farm or nonfarm businesses. Much smaller proportions of the moonlighters were craftsmen or operatives on their second than on their first job. One of the principal differences in the types of jobs held by white compared with Negro moonlighters is that a much larger proportion of Negroes work in lower paying service occupations, including private household service, while a much smaller proportion of Negro moonlighters hold white-collar jobs on either their main or their extra jobs.

The majority of second jobs were in occupations different from the moonlighter's main line of work, but usually within the same major occupation group as their first job. Half the professional and technical workers had a second job in the same occupation group, and half the farm laborers were farm workers on their second job. About one-third of the clerical and the service workers, and one-fourth of the managers and the craftsmen, had second jobs in the same broad occupation groups. On the other hand, the manual skills of farmers and blue-collar workers made a common moonlighting combination. Half the self-employed

[4] Harold W. Guthrie suggests that the teaching profession is an economically deprived one and men teachers, particularly those who are married with a nonworking wife, must moonlight to maintain a standard of living commensurate with their professional status. See "Who Moonlights and Why?" *Illinois Business Review*, March 1965, p. 8.

farmers had a second job in a blue-collar occupation and about one-fourth of the craftsmen, operatives, and laborers ran their own farm as a sideline.

Secretary WIRTZ. I think that the larger factor in older people working today is the increasing feeling that they want to continue in a meaningful function in life. As far as their financial positions are concerned, the increase in the social security benefits and in medicare a good deal more than makes up for whatever inflation there has been. Inflation unquestionably hurts the retired person. But, if your question is why more people, older people, are trying to work today, we are proceeding on the assumption which I think is completely sound—that they want to have a meaning and a function, rather than for economic reasons.

Representative WIDNALL. Compulsory retirement at a certain age comes as a real hardship to many people I am sure today. With some, they have to retire at a very early age.

Now, I have seen so many people just foundering after their compulsory retirement, and then looking around and trying to find something that their skills and ability would be adequate for, where they could fill that type of job.

Now, hasn't the number of retired people seeking jobs substantially increased in the last few years?

Secretary WIRTZ. May I ask Mr. Ross on that. I do not have the figures immediately available.

Mr. ROSS. Well, Congressman, just answering rather indirectly, there are two points. One is the number of unemployed persons over 65 is quite low compared to what it was a few years ago. Secondly, the percentage of older people in the labor force has been declining steadily. So that whereas there are certainly a great many people of the type to whom you refer, the overall statistics indicate that the trend has been generally downward.

Secretary WIRTZ. I would like to subscribe to the general point, Mr. Widnall, which your question implies.

There is no question in my mind but that we, meaning we the people, we the administration, we the economists, have done the poorest job of providing work and service opportunity for older people, of any job that we have turned to in this area. Putting it differently, I count it the least developed area of policy for the country, the economy and the administration.

Representative WIDNALL. I think it is a pretty sad state of affairs when people who are physically qualified, mentally qualified, are forced into retirement today as they are in many instances.

Secretary WIRTZ. Mr. Widnall, I suggest——

Representative WIDNALL. Let me speak about one in Government. There is compulsory retirement of a postmaster at age 70. But if that postmaster is retired at age 70, a new one can be hired at age 70, who can continue on for a number of years.

Secretary WIRTZ. I did not know that.

Representative WIDNALL. It is absolutely ridiculous.

And you have the same situation obtaining in many other areas.

I noticed so much that people who are in retirement then go and get jobs as guards in the bank, guards around factory plants, something like that. Also many union men who work a short week, 30, 35, 38 hours, to 40 hours, they get a second job. And they will get a nonunion job for the second job. They want the combination income.

We should have statistics on to what extent this is present today.

Secretary WIRTZ. A shortened workweek does not necessarily lead to higher moonlighting rates among workers who are affected by the cutback. When hours of work are shortened a worker may have the spare time to take a second job, but he has many factors to consider before he decides to look for a second job.

We have compared the relationship between length of the workweek and moonlighting by examining dual jobholding rates of men working long hours with those working short hours. In May 1966 about the same proportion of men working 35 to 40 hours (6.8 percent) as those working 41 to 48 hours (6.7 percent) were moonlighters.

Representative WIDNALL. I would like to make an observation too, about the restaurant field, for instance. I notice this in Washington—where it is quite obvious we have a rapidly shifting group of people acting as waiters in the restaurants, and most all of them have a foreign background. We are still supposed to have so much unemployment in the city. It would certainly seem to me many, many people could be trained in this particular area, to enter the work force in that area. And I just do not understand how all these people keep coming in to fill this type of job, constantly shifting—in the major restaurants here in the city.

Do you know anything about this?

Secretary WIRTZ. Yes, sir. The principal reason is that the rates are so low, that a great many people pass up that kind of work opportunity.

Representative WIDNALL. I would certainly say as far as a waiter is concerned, most of them are getting darned good salaries—total wage.

Secretary WIRTZ. The Wall Street Journal this morning carries a report that we are running out of waiters with a foreign manner, which cuts a little across what you are talking about here. But I think that there is no question about the phenomenon to which you refer. I think the largest element in it is that a great many of those jobs are paid at rates which people are passing up, whether rightly or wrongly.

Representative WIDNALL. May I pinpoint it a little bit more.

At a time when you are concerned with what is going on in the cities, very deeply involved in that, practically every new waiter I see is white in the Washington restaurants, and not Negro. Now, why is that?

Secretary WIRTZ. I do not know. I will try to get some figures on that. The problem that has concerned me more is if you go into a particular hotel or particular restaurant, they are almost always all white or all black. That has bothered me.

But I will try to get some figures, which I do not have, on the racial characteristics of people, waiters in Washington—if there is an increase in the number of white waiters, that would surprise me some.

Let me simply find out about it, because I do not know.

Our training programs in the culinary trades in Washington are highly Negro. But I will try to find out more about that.

Representative WIDNALL. I am not complaining about the service in these places. What I am trying to understand is why when we have such an emphasis on Negro unemployment today—there is supposed

to be very much higher Negro than white unemployment—why does this situation seem to prevail? I will appreciate any figures you give us.

Secretary WIRTZ. Very well, sir.

The most recent data available are from the 1960 decennial census. According to the census, there were 824,000 waiters and waitresses employed in the United States, of whom 8 percent (66,000) were Negro. In the District of Columbia in 1960, there were 7,570 waiters and waitresses, of whom 59.6 percent (4,510) were nonwhite. There are no more current or more detailed area data available.

Representative WIDNALL. Thank you.

Chairman PROXMIRE. Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Secretary, in your statement you refer to the uncounted number of additional people who ought to be working but who are not looking for work.

Granted that you have not counted them, would you be able to estimate the size of that group?

Secretary WIRTZ. It is pretty hard, Mr. Moorhead.

The thing we are talking about is suggested—if you look at table 1 in this information that has come out today—we put in here for the first time, so far as I have seen it, the current labor force participation rate in large metropolitan areas.

The participation rate subtracted from 100 gives the proportion of the population not in the labor force (that is, neither working nor seeking work). It is hard to estimate how many of these persons not in the labor force want to and should be working. I am going to give you, though, the rule that I have been working on in my own mind, and then ask Mr. Ross if he can give us a better one.

I am assuming that there is in the society today a group which ought to be working and which is not working, which is roughly the same size as the group that we are talking about as unemployed. So I think there is about that much additional potential.

Would you like to have Mr. Ross comment?

Representative MOORHEAD. Yes.

Mr. ROSS. Well, as the Secretary says, Mr. Moorhead, it is very difficult to know how many ought to be working. We know how many people are not working, we know how many of them say they would like to work—but who are not even looking.

A lot of them say they would like to work. "Why are you not looking, if you want a job?" We do have statistics which I would like to supply—I do not have them with me—the number who say they need some help with their health, the number who say they just do not have the basic training, the number who say that they have a transportation problem, they are too far from work, the number who say that they used to look but got discouraged and just gave up the search.

In the case of women, a great many say, "Well, I have young children, but I would like to work, even so." This is true, I think, of a great number of women on relief. "I have young children, but I would need child care, and I would need some training."

Now, the problem is—we know how many people are not working. To make a judgment how many of them ought to be working is more

difficult. As you know, in the case of mothers, you can argue that either way.

But we do have a good deal of information. I think it is getting better all the time. I would like to supply it for the record.

Representative MOORHEAD. Mr. Chairman, I think that would be very valuable.

Chairman PROXMIRE. Yes, indeed. Without objection, we will receive that information for the record.

(The information to be furnished for the record follows:)

On the basis of a special survey conducted in September 1966, it was found that about 10 percent of the persons not in the current labor force—some 5.3 million—wanted a regular job at the time of interview. Of these, however, 22 percent gave only a qualified affirmative answer ("maybe—it depends"), another 24 percent were negative or uncertain about their intentions to look for work in the next 12 months, and 6 percent did not reply to this question. Thus, about half of those who said they wanted jobs either qualified their responses or were indecisive about whether they would look for work in the next year. The reasons become clear when we examine why they were not looking for work. (See table 1.)

TABLE 1.—PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY REASON OF NOT LOOKING FOR WORK, SEPTEMBER 1966

[Numbers in thousands]

Reason	Both sexes		Men		Women	
	Number	Percent distribution	Number	Percent distribution	Number	Percent distribution
Total	5,292	100.0	1,641	100.0	3,651	100.0
Ill health, physical disability	1,078	20.4	480	29.3	598	16.4
In school	1,242	23.5	706	43.0	536	14.7
Family responsibilities	1,080	20.4			1,080	29.6
Inability to arrange child care	435	8.2			435	11.9
Miscellaneous personal reasons [1]	434	8.2	144	8.8	290	7.9
Expects to be working or seeking work shortly	270	5.1	44	2.7	226	6.2
Believes it would be impossible to find work [2]	754	14.2	266	16.2	488	13.4

[1] Includes old age or retirement, moving, entering or leaving Armed Forces, death in family, planning to go back to school, no need to work at present time.

[2] Includes employers think too old (or too young); couldn't find or did not believe any job (or any suitable job) was available, lacks skill, experience, education, or training, no transportation, racial discrimination, language difficulties, pay too low.

The full report on the September 1966 data entitled "Reasons for Nonparticipation in the Labor Force" is attached. Detailed information on persons not in the current labor force will be released regularly during 1968.

A Monthly Labor Review Reprint

From the July 1967 Issue

SPECIAL LABOR FORCE REPORT NO. 86

REASONS FOR NONPARTICIPATION IN THE LABOR FORCE

UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS

Reasons for Nonparticipation in the Labor Force

A Special Labor Force
Report on a Test
of Concepts and Methods

ROBERT L. STEIN*

NONPARTICIPATION in the labor force has become a major concern for manpower research and analysis. Among the important questions that need to be answered are the size and composition of the labor reserve—the groups of persons not seeking work at present, but who do move into and out of the labor force, either in response to seasonal changes or on a more irregular basis; the dimensions of the discouragement problem—its causes and the remedial steps that might help discouraged workers find their place in the job market; the number and characteristics of people who need or want work and would be able to take jobs if something were done to help them (health programs, child care, training, etc.). It is also essential to develop a method for measuring changes in these various groups over time.

The challenge to the researcher in this area is to develop objective methods for measuring what are mainly subjective phenomena. While most of our labor force concepts are based on objective, overt actions (e.g., working, having a job, seeking work in a specific way and within a specified time span) the data on reasons for nonparticipation are subjective, based on—desire for work, attitudes, perceptions, and opinions. These more elusive data require careful probing and cross-checking, to explore the depth of a reported attitude or the reality of a reported reason.

Research on nonparticipation is moving forward on several fronts: Analysis of data already collected has been published,[1] in February 1967, a very intensive questionnaire was directed to men 20 to 64 years of age, and a number of methodological studies have been designed to improve measurement techniques. This article summarizes the results of one particular attempt to measure the reasons for nonparticipation, a test survey conducted in September 1966 with a representative nationwide sample of 13,000 households. The results should be regarded as first approximations in a continuing program of experimentation and testing; however, it is believed that the test survey also provided some important substantive findings.

Approach of the Survey

The specific purpose of the September 1966 test survey, conducted with 13,000 households in the Monthly Labor Survey sample, was to try out a series of relatively simple questions which could be used on a regular basis in the household survey to measure some aspects of nonparticipation. The definitions of *employed*, *unemployed*, and *not in the labor force* were those adopted for official use in January 1967. The sampling errors were about twice the magnitude of those for the regular Current Population Survey using the 52,500-household sample of 1967.[2] The very small numbers appearing in the tables depict the results of the September 1966 test survey. Considerably more data must be compiled to assess the significance and reliability of these findings.

The first question—"Does . . . want a regular full-time or part-time job now?"—was designed to sort out those who had some "propensity" to enter or reenter the labor force. The question was not

*Of the Division of Employment and Unemployment Analysis, Bureau of Labor Statistics.

[1] "Adult Men Not in the Labor Force," *Monthly Labor Review*, March 1967, pp. 5–15.

[2] See the Technical Note in *Employment and Earnings and Monthly Report on the Labor Force*, February 1967, for a discussion of the labor force definitions and the sampling errors applicable to the CPS estimates.

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BUREAU OF LABOR STATISTICS

designed to be used alone, since affirmative answers could not be interpreted without further clarification. It was supposed to identify a subgroup of potential labor force members for further questioning. Consequently, those who reported wanting to work (either "yes" or "maybe—it depends") were asked a second question; "What are the reasons . . . is not looking for work?" A list of reasons was provided on the questionnaire, as follows: Believes no work available in line of work or area; Couldn't find any job; Lacks necessary schooling, training, skills, or experience; Employers think too young or too old; Other personal handicap in finding a job; Can't arrange for child care; Family responsibilities; In school or other training; Ill health, physical disability; and other.

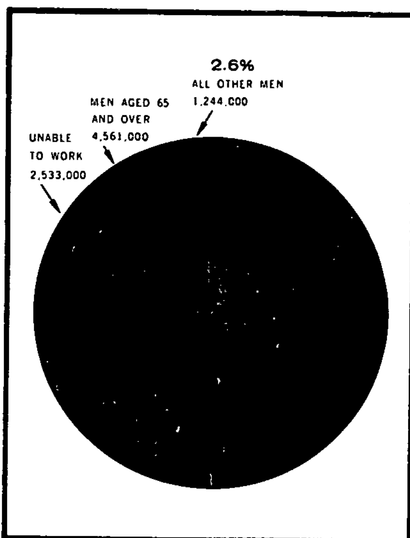
To avoid leading the respondent, the enumerator was instructed *not* to read the list, but to mark each reason mentioned. The question on reasons was an attempt to determine whether those who wanted work were also able to work and available for work. In addition, for about 55 percent of those who wanted or might want a job, the enumerator entered the respondent's verbatim comments to clarify the answers.

It was recognized that this list of possible reasons was not sufficiently detailed to yield information useful for program planning, and that some of the categories were overlapping and not mutually exclusive. However, the approach did represent a systematic effort to obtain an objective and comprehensive measure of unutilized potential manpower resources, within the limitations of a brief and highly structured interview situation. The main reason persons were not seeking work was determined on the basis of the respondent's report of the reasons, the person's major activity during the survey week, and the enumerator's comments.

A third question was asked of all persons not in the labor force, to get an additional indication of their propensity to work or seek work: "Does . . . intend to look for work of any kind in the next 12 months?"

For about half the sample, persons were reporting for themselves; for the other half, the information was based on the statements of someone else in a household. In part, therefore, the resulting statistics reflect another person's perception of the individual's attitudes toward work and work-seeking.

Composition of the Voluntary Nonparticipants, September 1966



Voluntary Nonparticipants

Altogether, 90 percent of those not in the labor force in September 1966 did not want a regular full-time or part-time job—47.5 million of the 52.8 million persons 16 years of age and over who were not employed or seeking work. They could not be considered as currently available manpower resources, since their nonparticipation was voluntary. At that time, at least, they expressed no desire for regular work. This does not necessarily mean that they had no financial hardships, or that they might not benefit from paid employment if it were made available to them. The term "voluntary" in this context simply means that such a respondent, taking into account his total situation—health, age, and other responsibilities, could not say that he wanted a regular job at the time of the survey. Undoubtedly some of these nonparticipants would be willing and able to work if certain circumstances could be changed.

Information was obtained on the age and sex of the persons who did not want to work, on their

TABLE 1. PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY REASON FOR NOT LOOKING FOR WORK, SEPTEMBER 1966

[Numbers in thousands]

Reason	Both sexes		Men		Women	
	Number	Percent distribution	Number	Percent distribution	Number	Percent distribution
Total	5,292	100.0	1,641	100.0	3,651	100.0
Ill health, physical disability	1,078	20.4	480	29.3	598	16.4
In school	1,242	23.5	706	43.0	536	14.7
Family responsibilities	1,080	20.4			1,080	29.6
Inability to arrange child care	435	8.2			435	11.9
Miscellaneous personal reasons [1]	434	8.2	144	8.8	290	7.9
Expects to be working or seeking work shortly	270	5.1	44	2.7	226	6.2
Believes it would be impossible to find work [2]	754	14.2	266	16.2	488	13.4

[1] Includes old age or retirement, moving, entering or leaving Armed Forces, death in family, planning to go back to school, no need to work at present time.

[2] Includes employers think too old (or too young); couldn't find or did not believe any job (or any suitable job) was available, lacks skill, experience, education, or training, no transportation, racial discrimination, language difficulties, pay too low.

major activity during the survey week, and on their intentions to look for work of any kind in the next 12 months. The composition of this group of 47.5 million voluntary nonparticipants is shown in the accompanying chart.

Only 2.6 percent were men between the ages of 16 and 64 who were out of school, and presumably able to work, but who did not want work at the time of interview. Half this group were past age 55, and thus undoubtedly include a sizable number of early retirees.

Evidence drawn from the National Health Interview Survey suggests that health limitations may be an important factor among men below age 65 who say they do not want to work and do not intend to look for work, even though they are not reported as totally unable to work.[3] More precise information on this point will become available with the results of the special supplementary study conducted in February 1967 of men 20–64 years of age not in the labor force. That supplement will also shed light on the major reasons for nonparticipation among other men of working age who were not in ill health or disabled, but who nevertheless responded that they currently did not want to work.

Involuntary Nonparticipants

Ten percent of those not in the current labor force were reported as wanting a regular full-time or part-time job at the time of interview. Of this 5.3 million, however, 22 percent gave only a qualified affirmative answer ("maybe—it depends"), another 24 percent were negative or uncertain about their intentions to look for work in the next 12 months, and 6 percent did not reply to this question. Thus, about half of those who said they wanted jobs either qualified their responses or were indecisive about whether they would look for work in the next year. The reasons become clear when we examine why they were not looking for work. (See table 1.)

TABLE 2. PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY REASON FOR NOT LOOKING FOR WORK, SEPTEMBER 1966–FEBRUARY 1967

[Numbers in thousands]

Reason	Sept. 1966	Nov. 1966	Dec. 1966	Jan. 1967	Feb. 1967
Men, total	1,641	1,582	1,567	1,460	1,524
Percent of total not in labor force	13.5	12.9	12.6	10.7	12.1
Reason for not looking:					
Ill health or disability	480	469	547	335	444
Going to school	706	520	512	569	650
Believes it would be impossible to find work	266	274	361	208	199
All other reasons	188	319	147	348	231
Women, total	3,651	4,509	3,775	3,425	3,780
Percent of total not in labor force	9.0	11.3	9.4	8.4	9.3
Reason for not looking:					
Ill health or disability	598	486	607	505	458
Going to school	536	605	531	516	617
Family responsibilities	1,080	1,451	1,097	995	1,090
Inability to arrange child care	435	581	453	414	473
Believes it would be impossible to find work	488	606	542	399	610
All other reasons	516	780	545	596	532

Data from the household survey samples for November and December 1966 and January and February 1967 were developed, using the same general methodology and concepts. The figures appear to be relatively stable (table 2) except for a big jump in the number of housewives who wanted work in November—probably temporary jobs for the Christmas season. There also appeared to be

[3] "Work Limitations and Chronic Health Problems," *Monthly Labor Review*, January 1967, p. 41.

a dip in the number wanting work in January, when nearly all economic activity tends to be at a seasonal lull. A considerable amount of experience with these data will have to be accumulated, however, before definite seasonal or cyclical patterns can be detected.

The number who believed it would be impossible to find work ranged between 600,000 and 900,000; on the average, women accounted for two-thirds of this group. The number of men in this category fluctuated between 200,000 and 350,000, with about half the total between the ages of 20 and 64.

A conceptual problem arises when a person reports more than one reason for not seeking work. (In September, about 25 percent of those who wanted work reported more than one reason for not looking; in subsequent months, this proportion fell to 20 percent.) For example, a person in school might also report that he was not looking for work because employers thought he was too young. A housewife with young children might also say she doesn't believe there is any work available that she could do. In the classification system used in this report, top priority is given to "ill health or disability," and those not reporting this reason were assumed to be able to work. Going to school, family obligations, and personal reasons follow in that order, under the assumption that persons who gave these reasons were really not currently available for work, and that their participation in programs to help them find work would be limited.

As table 3 shows, about a third of those reporting they believed it would be impossible to find work were not readily available for work. Of the 1.2 million who believed they would be unsuccessful in the job market, about 450,000 were also either in ill health (100,000), in school (230,000), or tied down with family responsibilities (125,000). Nearly two-thirds were women.

About 450,000 men age 16 and over who were not in the labor force wanted a job, but were not looking for work because they believed it would be impossible to find any. This included 185,000 who were also either in school or in ill health. About half of the remaining 265,000 reported that their reason for not looking for work was that employers thought they were too old.

One-third of these 450,000 men were teenagers (mainly students), one-third were in the central age groups (20–64), and one-third were age 65 and over. (See table 4.) Most of the latter said employers thought they were too old to work.

The reasons for nonparticipation given by persons who said they wanted a job at the time of the survey in September 1966 are discussed in more detail below. The qualitative analysis of reasons is based on verbatim replies recorded by the enumerators.

Ill Health or Disability

For over a million nonparticipants (500,000 men and 600,000 women), ill health or disability was given as a reason. For these persons, the desire for work tends to be highly conditional. A person may want to work, but his doctor will not permit it, or he may want only very light, sedentary work a few hours a day. Many of the responses indicated that these persons would accept a job involving a very limited amount of physical activity, but were not interested in actively seeking work. The responses also suggested that additional questions would be necessary to distinguish accurately between varying degrees of inability to work. For some persons, return to the labor

TABLE 3. PERSONS NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BUT BELIEVED NO WORK WAS AVAILABLE, BY COMBINATION OF REASONS FOR NOT SEEKING WORK AND DETAILED REASON FOR BELIEVING WORK NOT AVAILABLE, SEPTEMBER 1966

[Numbers in thousands]

Reason	Total	Employers think too young	Employers think too old	Lacks skill, experience, education or training	Could not find, or believe no job available	No transportation	Other handicaps or barriers [1]
Total	1,203	39	257	84	619	147	57
Ill health, disability	95		28		45	22	
In school	229	28			167	34	
Family responsibilities	74				57	17	
Inability to arrange for child care	51				28	23	
No other reason	754	11	229	84	322	51	57

[1] Includes racial discrimination, language difficulties, unsatisfactory pay scale for type of work sought.

90–191 O—68—pt. 2——15

TABLE 4. MEN NOT IN THE LABOR FORCE WHO WANTED A REGULAR JOB, BY COMBINATION OF REASONS FOR NOT LOOKING FOR WORK AND AGE, SEPTEMBER 1966

[Numbers in thousands]

Reason	Age in years							
	Total, 16 and over	16 to 19	20 to 64					65 and over
			Total	20 to 24	25 to 54	55 to 59	60 to 64	
Total	1,641	673	664	122	376	61	105	305
Ill health, disability	429	11	308	11	198	33	66	110
In school	573	468	105	66	39			
Miscellaneous personal reasons	144	22	77	28	33	11	5	45
Expect to be working or seeking work shortly	44	17	27		27			
Believed it would be impossible to find work	450	155	146	17	78	17	34	150
No other reason	266	22	123	17	61	11	34	122
Also in ill health	51		23		17	6		28
Also going to school	133	133						

force depended on recovery from accidents or from operations, on the outcome of scheduled surgery, on the healing of disfiguring conditions, or general improvement in health. With more precise inquiries, it might be possible to identify those with minor disabilities or illnesses, who expected to be in the labor force within a month or two.

About a tenth of this group indicated that they anticipated that finding work would be impossible, mainly because of their health and disability problems.

Persons in School

In one sense, going to school is not a full explanation for not looking for work. Part-time jobs are available to millions of students who do work weekends or evenings. The responses indicate that many students were uncertain about whether or not they really wanted work. They were available only for those jobs that would fit in with their school programs. In September, also, some of them did not yet have a clear idea whether they could handle their school work and a regular job. Some expected to start looking for work in the next week or two. Replies from about a fifth of the students indicated actual or expected difficulties in finding a job.

Family Responsibilities

Of the persons citing family responsibilities (1.1 million) all were women, and 90 percent were between the ages of 20 and 54. (See table 5.) The vast majority were married and had children at home.

The verbatim replies point up the problems women face in reconciling their desire for work with their family responsibilities. Some husbands will not permit their wives to accept employment. In other cases, responsibilities to their children prevent women from working. This may be true even when the children are grown: Typical examples are the mother who was too busy getting her daughter ready to go overseas, the mother who has a diabetic daughter requiring special care, and the mother who was waiting until her son returned to his Armed Forces station.

A closely related group are those women who specifically mention inability to arrange for child care as their reason for not seeking work. Presumably this latter group of women would be available for work if they could solve the specific problem of finding someone to care for their children during working hours, whereas those who report "family responsibilities" are unlikely to enter the labor force until their children grow older or their family situation changes so that they have more freedom. Admittedly the distinction is conjectural.

TABLE 5. PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE OF FAMILY RESPONSIBILITIES OR INABILITY TO ARRANGE FOR CHILD CARE, SEPTEMBER 1966

[Numbers in thousands]

Age and reason	Family responsibilities	Inability to arrange for child care
Total	1,080	435
16 to 19 years	51	51
20 to 24 years	102	96
25 to 54 years	854	282
55 years and over	74	6
Total	1,080	435
No other comment	740	350
Husband won't permit work	62	
Job, pay, hours, location have to be right	175	17
Expects to be working or seeking work shortly	17	
No transportation	17	23
Couldn't find or believe no job available	57	28
All other (moving; going back to school)	11	17

Miscellaneous Reasons

This relatively small group of about 150,000 men and 300,000 women consisted of women who, at the time of interview, did not need (or really did not want) to work; men and women who were retired or semiretired, but said they might take some light part-time work if it came their way; persons who were getting ready to move, were just getting settled after a move, or were uncertain when or whether to move; persons who were taking care of personal business (e.g., after a death in the family); and young persons who were entering or leaving the Armed Forces or getting ready to go back tc school. By and large, it could be said of these persons that at the time of the survey in mid-September 1966 they really did not want to work, or that their desire for work was relatively weak.

Expect to Work or Look Soon

Some 270,000 persons expect to be in the labor force shortly. This group was right on the fringe of the labor force, but did not meet the strict definitions (i.e., working or having a job last week, seeking work in the last 4 weeks, having definite instructions to report to a new job in 30 days, or being on layoff from a job with definite expectation of being called back). For example, there were some who had just quit or been discharged from one job, but had not yet started to look for another. A sizable number of women were waiting to be called to a job (and some of them possibly should have been counted as unemployed), but it was not clear when they last looked, when they expected to report, or even if they had definite instructions to report. Still others said that they planned to start looking for work soon—this week, next week, or within a month or two. A small number of persons actually started working at seasonal farm jobs during the interview week (the week following the survey week), but had not been seeking work in the previous 4 weeks and had not known just when the work would become available.

The Discouraged

An estimated three-fourths of a million persons wanting jobs at the time of the survey, were willing and able to work, were available for work (in the sense that health, school, or personal or family obligations did not stand in the way), but had not looked for work in the past 4 weeks. The reasons they gave reflected discouragement or disappointment in the job market, or at least a negative attitude toward their own job prospects. (See table 6.) Two-thirds of this group were 20 to 64 years of age—125,000 men and 375,000 women.

For 430,000 of the three-quarters of a million—110,000 men and 320,000 women—training or placement assistance appeared to be a possible help. These individuals reported that they couldn't find a job or believed jobs weren't available, that they lacked education or training, or that language was a problem.

This group of 750,000 was less educated than the total not in the labor force (only a third were high school graduates, compared with about 45 percent of all nonworkers) and also disproportionately nonwhite (23 percent compared with only 10 percent of all nonparticipants).

TABLE 6. SELECTED CHARACTERISTICS OF PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE THEY BELIEVED IT IMPOSSIBLE TO FIND, BY SEX, SEPTEMBER 1966

[Numbers in thousands]

Characteristic	Total	Men	Women
REASON			
Total	754	266	488
Employers think too young	11	-----	11
Employers think too old	229	138	91
Lacks necessary schooling, training, skills, or experience	84	22	62
Could not find or believes no job (or no suitable job) availabl	322	84	238
No transportation	51	11	40
Language difficulties	23	6	17
Pay too low	11	-----	11
Other personal handicaps [1]	23	6	17
AGE			
Total	754	266	488
16 to 19 years	56	22	34
16 to 17 years	28	22	6
18 and 19 years	28	-----	28
20 to 64 years	497	123	374
20 to 24 years	34	17	17
25 to 54 years	343	61	283
55 to 59 years	45	11	34
60 to 64 years	74	34	40
65 years and over	201	122	79
COLOR			
Total	754	266	488
White	581	211	370
Nonwhite	173	55	118
Educational level			
Total	754	266	488
Less than 8 years of schooling	195	99	96
Elementary school graduate	123	50	73
Some high school	182	39	143
High school graduate	188	50	138
Some college	66	28	38

[1] Includes racial discrimination; excludes mental or physical disabilities.

Supplementary Tables

TABLE A. PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE OF ILL HEALTH OR PHYSICAL OR MENTAL DISABILITIES

[Numbers in thousands]

Age and reason	Total	Men	Women
Total	1,078	480	598
16 to 24 years	90	22	68
25 to 44 years	358	138	220
45 to 54 years	173	77	96
55 to 59 years	101	39	62
60 to 64 years	111	66	45
65 years and over	245	138	107
Total	1,078	480	598
No other comment	533	221	312
Would take part-time or light work	94	66	28
Will work or seek work when health improves	279	138	141
Has family responsibilities	79	6	73
No transportation	22	11	11
Employers think too old	28	22	6
Couldn't find or believed no job available	45	17	28

TABLE B. PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE THEY WERE IN SCHOOL

[Numbers in thousands]

Age and reason	Total	Men	Women
Total	1,242	705	537
16 and 17 years	741	396	345
18 and 19 years	317	204	113
20 to 24 years	94	66	28
25 years and over	90	39	51
Total	1,242	705	537
No other comment	635	369	266
Job would have to fit in with school program	217	110	107
No transportation	34	6	28
Employers think too young	28	17	11
Couldn't find or believed no job available	167	110	57
All other (family responsibilities; expect to enter Armed Forces)	79	51	28

TABLE C. PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE OF MISCELLANEOUS PERSONAL REASONS

[Numbers in thousands]

Reason	Total	Men	Women
Total	434	144	290
No strong need to work	107	11	96
Old age or retirement	107	45	62
In process of moving	57	6	51
Entering or leaving Armed Forces	22	22	------
Death in family or other personal business	45	22	23
Planning to go back to school	39	11	28
All other	57	27	30

TABLE D. PERSONS WANTING WORK WHO WERE NOT LOOKING FOR WORK BECAUSE THEY EXPECTED TO BE WORKING OR SEEKING WORK IN THE NEAR FUTURE

[Numbers in thousands]

Reason	Total	Men	Women
Total	270	[illegible]	[illegible]
Has job lined up or planning to start business in own home	107	11	96
Plans to start loo ing for work shortly	85	[illegible]	[illegible]
Is in between jobs; hasn't started looking for a new one yet	28	22	6
Waiting to hear the results of applications or examinations [1]	51	6	45

[1] Includes waiting to enter Job Corps or MDTA.

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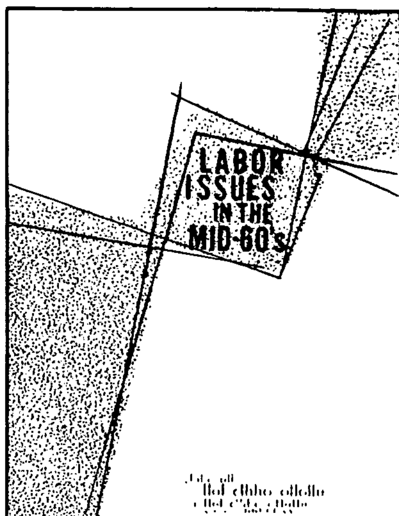

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Number

44 Geographic Mobility and Employment Status, March 1962–March 1963
45 Unemployment Among Full-Time and Part-Time Workers
46 Out-of-School Youth, February 1963
47 Out-of-School Youth, February 1963—Part II
48 Work Experience of the Population in 1963
49 Labor Force Projections for 1970–80
50 Marital and Family Characteristics of Workers in March 1964
51 Multiple Jobholders in May 1964
52 Labor Force and Employment in 1964
53 Educational Attainment of Workers, March 1964
54 Employment of High School Graduates and Dropouts in 1964
55 Employment of School Age Youth, October 1964
56 Labor Force Status of Youth, 1964
57 Long Hours and Premium Pay
58 Long-Term Unemployment in the 1960's
59 Why Women Start and Stop Working: A Study in Mobility
60 The Unemployed: Why They Started Looking for Work
61 A Portrait of the Unemployed
62 Work Experience of the Population in 1964
63 Multiple Jobholders in May 1965
64 Marital and Family Characteristics of Workers in March 1965
65 Educational Attainment of Workers in March 1965
66 Employment of High School Graduates and Dropouts in 1965
67 An Experimental Study of Repeated Unemployment
68 Employment of School Age Youth in October 1965
69 Labor Force and Employment in 1965 (Did not appear in the *Review*)
70 The Effects of Employment Redistribution on Earnings
71 Out-of-School Youth—2 Years Later
72 Overtime Hours and Premium Pay
73 Labor Force Projections by Color, 1970–80
74 Labor Force Projections by State, 1970 and 1980
75 Poverty Areas of Our Major Cities
76 Work Experience of the Population in 1965
77 Job Tenure of Workers in January 1966
78 Why the Unemployed Looked for Work
79 Adult Men Not in the Labor Force
80 Marital and Family Characteristics of Workers, March 1966
81 Overtime Hours and Premium Pay
82 Low Earners and Their Incomes
83 Educational Attainment of Workers, March 1966
84 Occupational Mobility of Employed Workers
85 Employment of High School Graduates and Dropouts in 1966

Secretary WIRTZ. I think the undercount figure, Mr. Moorhead, in the 1960 census, which bears on this same problem, was almost six million. In percentage terms, the undercount was greatest for Negro males, especially those in the 16–44 age groups.

We will supply those figures specifically. But it is in that range. And that suggests to you how difficult it is, both for us—it suggests both how difficult it is to get at this, and that it is probably a figure of significant size. Because those people just do not show up in any statistics. I think Mr. Ross feels they show up in some of ours better than they do in the cenus. But there is a large undercount factor there.

I make two points. First, the undercount is hard to compile specifically. Second, it is large.

The Census Bureau estimates an undercount in 1960 census of 5.8 million—2.9 percent of the estimated "true" population figure. The undercount estimate is much larger for the nonwhite population—9.7 percent for males and 7.3 percent for females. The proportion was highest for nonwhite men aged 25 to 34 (18.9 percent). The percentages undercounted were also high for nonwhite men 16–24 and 35–44 years of age—14.9 percent and 13.6 percent, respectively.

The attached table shows the extent of the population and labor force undercount in 1966. The above data are only estimates because it is difficult to get at this problem exactly, but it is clear that the problem of population undercount is large, especially for Negro men.

TABLE 1.—TOTAL POPULATION AND CIVILIAN LABOR FORCE, BY AGE, SEX, AND COLOR, AS PUBLISHED AND AS ADJUSTED FOR ESTIMATED 1960 CENSUS UNDERCOUNT, 1966

[Number in thousands]

Age, sex, and color	Published [1]	Adjusted	Difference [2]	
			Number	Percent
WHITE MALE				
Total population, July 1, 1966:				
Total, all ages	85,432	87,711	2,279	2.6
Under 16	27,642	28,106	464	1.6
16 and over	57,790	59,605	1,815	3.0
16 to 24	12,578	13,113	535	4.1
25 to 34	9,926	10,335	409	4.0
35 to 44	10,629	10,942	313	2.9
45 to 64	17,305	17,539	234	1.3
65 and over	6,908	7,676	324	4.2
Civilian labor force (annual average, 1966):				
16 and over	43,572	44,823	1,256	2.8
16 to 24	7,454	7,774	320	4.1
25 to 34	8,859	9,219	360	3.9
35 to 44	9,892	10,187	295	2.9
45 to 64	15,439	15,637	198	1.3
65 and over	1,928	2,011	83	4.1
WHITE FEMALE				
Total population, July 1, 1966:				
Total, all ages	87,820	89,160	1,339	1.5
Under 16	26,510	26,782	271	1.0
16 and over	61,310	62,378	1,068	1.7
16 to 24	12,257	12,564	307	2.4
25 to 34	9,941	10,071	130	1.3
35 to 44	10,929	10,972	43	.4
45 to 64	18,513	18,859	346	1.8
65 and over	9,670	9,912	242	2.4
Civilian labor force (annual average, 1966):				
16 and over	23,702	24,070	368	1.5
16 to 24	5,697	5,842	145	2.5
25 to 34	3,732	3,777	45	1.2
35 to 44	4,894	4,915	21	.4
45 to 64	8,514	8,654	140	1.6
65 and over	865	882	17	1.9
NONWHITE MALE				
Total population, July 1, 1966:				
Total, all ages	11,468	12,707	1,237	9.7
Under 16	4,760	4,947	185	3.7
16 and over	6,708	7,760	1,052	13.6
16 to 24	1,747	2,054	307	14.9
25 to 34	1,273	1,570	297	18.9
35 to 44	1,237	1,432	195	13.6
45 to 64	1,799	2,040	241	11.8
65 and over	652	664	12	1.8
Civilian labor force (annual average 1966):				
16 and over	4,901	5,728	827	14.5
16 to 24	1,051	1,244	193	15.5
25 to 34	1,089	1,342	253	18.9
35 to 44	1,090	1,262	172	13.6
45 to 64	1,509	1,715	206	12.0
65 and over	162	165	3	1.8
NONWHITE FEMALE				
Total population, July 1, 1966:				
Total, all ages	12,121	13,071	951	7.3
Under 16	4,740	4,888	149	3.0
16 and over	7,381	8,183	802	9.8
16 to 24	1,766	1,960	194	9.9
25 to 34	1,427	1,541	114	7.4
35 to 44	1,430	1,526	96	6.3
45 to 64	1,975	2,263	288	12.7
65 and over	783	893	110	12.3
Civilian labor force (annual average 1966):				
16 and over	3,599	3,976	377	9.5
16 to 24	764	848	84	9.9
25 to 34	777	838	61	7.3
35 to 44	863	920	57	6.2
45 to 64	1,096	1,257	161	12.8
65 and over	99	113	14	12.4

[1] Published totals are the sum of the rounded components shown here and may, therefore, differ somewhat from totals published elsewhere.
[2] Difference is adjusted minus published. Percent difference is based on adjusted.

Representative MOORHEAD. You point out, Mr. Secretary, that some of those people have remediable physical handicaps. Is there any program to bring remedies to them?

Secretary WIRTZ. As far as the formal Government program is concerned, it includes most specifically the vocational rehabilitation program, which is in the Department of Health, Education, and Welfare, and administered through the State agencies. So, it falls further outside my jurisdiction than would permit a clear answer.

As far as our own people are concerned, the formal Department of Labor training program, so far as it goes, includes very few of the physically and mentally handicapped. I have qualified both answers, because as we both know, there is a great deal of private work going on in this interest. A good deal of this centers around the President's Committee on Mental Retardation, and the President's Committee on the Employment of the Handicapped. But a very large part of what is being done, as far as the physically and mentally handicapped are concerned, falls today outside the Government program. and I say this as—well, a confession of inadequacy as far as our training program is concerned.

Representative MOORHEAD. Mr. Secretary, referring to your statement you refer to the 110 recipients of Aid for Dependent Children who are in your work incentive program.

Secretary WIRTZ. 110,000.

Representative MOORHEAD. Thank you—110,000. Do you include those people as people who ought to be working?

Secretary WIRTZ. Yes. That, of course, involves several very complicated controversial questions.

You perhaps noticed a report about a week ago, in which an interview I believe in New York had indicated that 80 percent of those women wanted to work, wanted to take training.

Now, I am not just sure about that. I suppose if anybody is asked whether she wants to take training, the inclination is to answer, "Of course." So I am not sure about that.

We are proceeding on the assumption that in most cases the action of the Congress, last year, will not present a problem, and that we will find a receptivity to training, so it is not going to be a serious problem. But I am not sure what we are going to find on that. That program starts with us on April 1.

Representative MOORHEAD. It would seem clear to me that in some situations it would be much better for the mother to be with her children rather than on a job, or in an on-the-job training program; it would seem to be clear in other situations it would be much better for the mother to have the work incentive, and the pride of a job, income, and so forth.

Secretary WIRTZ. I agree.

Representative MOORHEAD. How do you make this determination in the 110,000 work-incentive enrollees that you will have this year?

Secretary WIRTZ. Two pieces in the answer.

First, in our advanced thinking about it, the identification of that fact is going to be made in every case. And second, that the——

Representative MOORHEAD. Who makes that identification?

Secretary WIRTZ. Through the State employment service officers working with the Manpower Administration. But a very important

point, Mr. Moorhead, is that until we supply large day care centers of one kind or another, we will have to go awfully easy about pressing that point. So, as an affirmative part of the answer, we, and by "we" I mean the Government and the country and particularly HEW, are just going all out right now on the development of child care centers. Without that development—I think we figure the need is only about 20 percent met so far—without the development of child care centers, to press that requirement would be cruel, thoughtless, and a mistake.

Representative MOORHEAD. But as the situation stands now, because of the statistics, you would not be cruel and oppressive; is that right?

Secretary WIRTZ. That is correct.

Representative MOORHEAD. Mr. Secretary, at the conclusion of your statement you invited inquiries on a broader base.

I would like to have you give us a brief statement as to what you see in the next year as far as collective-bargaining agreements are concerned—where we might look for trouble spots, where there would not likely be trouble.

Secretary WIRTZ. Yes, sir. Very quickly, and summarizing what we have set out in fuller form in the document transmitted to the committee last week, the situation is this:

We have known that 1968 was going to be a hard year as far as major contracts are concerned. As part of the answer to your question, about 4 million people are covered by collective-bargaining agreements which will come up for consideration this year. That is a slightly lower figure than last year. So it is not the total number. But, in terms of major disputes, this is a tight year. We enter it with the sobering realization that the copper strike today is now starting its eighth month, and that is a failure of collective bargaining, which there would be no point in minimizing. We balance against that the fact that there have so far this year been three or four quite significant private agreements which encourage us. There have been two agreements, the Railway Clerks, at the end of the last calendar year, and now the Brotherhood of Railroad Trainmen, which give us renewed confidence that the railroad people have found new strengths of private collective bargaining which is very important.

We are encouraged by the fact that the can settlement came and was passed so quickly on a private basis there is hardly any notice given it.

In terms of the problems ahead, there are quite a few of them, but they include most specifically steel, longshore, and aerospace. And I should mention telephones, which is likely to come to a head in perhaps fairly serious form next month. Those are the ones which stand out. But there are a number of others.

It is just best to take a dour view of it right now, I guess. And I do. I have a feeling that we are going to be surprised in finding that there is more strength in private collective bargaining than our recent comments on it have shown.

It is not our business, but this matter of strikes of public employees, State and local, is obviously very much on the country's mind, and should be included in the kind of list to which you refer.

Representative MOORHEAD. Thank you, Mr. Secretary.

My time has expired.

Chairman PROXMIRE. Congressman Rumsfeld?

Representative RUMSFELD. Mr. Secretary, I found your remarks this morning very interesting.

Reviewing your statement, and recalling your remarks in answer to questions, you have said that the United States has seen 7 years of unprecedented economic expansion. You have referred to it as extraordinary.

And I suppose it could be described that way.

But, what disturbs me is that I question whether it can be described that way if it is put in the context of a war economy.

Is it correct that at no place in your statement do you relate what is going on in this country economically to the war, and in no place in your statement do you adjust any of your figures to reflect the impact of the war?

Secretary WIRTZ. There is no—so far as I can think of—no reference to that.

Mr. RUMSFELD. For example, where you mention the national unemployment rate, and say by this measure we have done very well indeed—referring to the fact that the rate—in percent—stood at 6.7 in 1961, went to 5.7 in 1963, 4.5 in 1965, 3.5—3.8 in 1967, and 3.5 in 1968.

The lowest since the Korean conflict.

The Korean conflict represented a war economy, just as the economy today does.

Taking the last five words of your statement, it would seem to me, rather than saying we have done very well indeed, that just the reverse would be true—that if one compared the economy today with the last comparable war economy, we find that this is the benchmark, and that in fact we have a higher rate of unemployment today in a similar economy than we did during the last war economy. And, certainly, the dates that are indicated here reflecting the downturn in the rate of unemployment also reflect precisely the increase in the effort with respect to the war in Vietnam.

Now, not mentioning that seems to me to throw a very interesting statement—had it been put in perspective, a very useful statement—it seems to me it throws it right out as far as usefulness goes.

Secretary WIRTZ. I perhaps mistakenly assumed the reading by all the members of the committee of the report on which these hearings were based, and that matter is covered in detail on pages 89 to 91. I have gotten allergic to statistical comparisons, I feel almost self-conscious when I use them.

But we could perhaps advisedly take the period to which you refer. We ought to consider it on all its points.

For instance, we ought to consider that during that period prices rose—I will correct the specific times and figures for the record—but what I am about to say is very close—prices rose in a 9-month period by, I think, 8 percent. That was the situation then.

Now, we have avoided that this time. I realize this is a different point from the one you are making. And I want to come to the one you are making.

If we were to go back over a historical period—incidentally, we had to go to direct wage and price controls then—we would take

a look at 1958 and 1957, in which unemployment went to nearly 7 percent, and prices went up those years about 5 percent.

Representative RUMSFELD. Mr. Secretary, you say by this measure we have done very well. And, it seems to me, by your own statistics, by the very measure you have selected in the presentation you have made this morning, we have not done very well—once you plug in the fact that the economy is benefiting, if you want to use the word, from some very extraordinary circumstances.

Secretary WIRTZ. I don't think benefiting in any way. I love to think of the things we would have done——

Representative RUMSFELD. Don't we all.

Secretary WIRTZ. There is no question about it. Let us be plain about it. The test of whether you and I have a difference would lie in the answer to the question as to whether I think these figures are going to get worse upon the ending of the war in Vietnam. And I do not think they are. I think it will take us about 60 days to recover stride. There will be some readjustments, and in some particular areas it will take somewhat longer than that.

Representative RUMSFELD. In other words, if you subtract the impact of the Vietnam war from these statistics, you are saying you still feel we have done——

Secretary WIRTZ. Mr. Rumsfeld, if I thought different, I would resign from the human race. If I thought at this stage in the development of our economy, our fiscal, monetary policy, manpower—if I thought at this stage we were dependent for employment on a war, I would quit from the race. And so I feel very strongly.

Representative RUMSFELD. I am not suggesting either one.

Secretary WIRTZ. No. But it is——

Representative RUMSFELD. I don't want to lose a good constituent.

Secretary WIRTZ. It is directly on the point you are raising, because the implication of the question is that everything we have done depends upon the war factor.

Representative RUMSFELD. No; that is not my implication.

Secretary WIRTZ. Then I misunderstood.

Representative RUMSFELD. My questions relate to your statement—the paragraphs which begin "For many years," in which you say, "we have now arrived at the lowest rate since the Korean conflict." That means that it is a higher rate compared with the Korean conflict?

Secretary WIRTZ. Let's see.

Representative RUMSFELD. It must.

Secretary WIRTZ. That is correct.

On an annual average basis, the total unemployment rate was 3 percent in 1952, and 2.9 percent in 1953. Those are the lowest rates on record since World War II. On a monthly basis, the lowest rate was 2.5 percent, recorded in both May and June 1953.

Representative RUMSFELD. Maybe I am not asking a question, but rather, making a statement. I am challenging your statement that we have done very well indeed by the use of the very statistics you are using. And, if that is inaccurate, perhaps you can clarify it for me.

Secretary WIRTZ. I do not know whether it is inaccurate. Because of the reaction that there is to it here—I guess if I had to say it again—I would say it is the lowest rate since 1953. I thought by the

implication of the question that there was a suggestion that this accomplishment is a result of the military effort and the war activity. That is not my judgment of it. But, I think, by making the reference date, the Korean conflict, there is that implication. And it is that that makes me say that I think this record does not depend on what you call the plugging in of the military, and would be just as good without it, and will be just as good.

Mr. ROSS. Mr. Secretary, the unemployment rate in 1952 averaged 3 percent, and in 1953 it averaged 2.9 percent.

Representative RUMSFELD. So, we are comparing 3.5 today with 3 to 2.9?

Secretary WIRTZ. If you take just those two periods. We would be glad to set out that whole stretch.

In general—there were the two sets of ups and downs in the later 1950's, and then we came into our responsibility on it in a purely political sense at a rate of about—let us see—it went to 6.8 percent in 1958—but I know you did not have the political implications in mind.

Let me just take the key dates, and the record for the last 18 years is that in the early 1950's it went down to 2.9 or 3 percent. It then went up and down during the 1950's, went to a high of nearly 7 percent in 1958, went down again, but went up to nearly 7 percent again in 1961—the average for the year was 6.7. It went down nearly steadily until 2 years ago and for the last 2 years it has leveled out. I do not believe that the war factors have been a serious factor.

Representative RUMSFELD. Well, I am very interested to hear that, because that has not been my impression. And if I had to speculate, I would think that the curve for the next 5 to 10 years, assuming there is a termination of the conflict in Vietnam, would more closely follow the previous curves than what you are suggesting.

Secretary WIRTZ. I think the significant thing, Mr. Rumsfeld—and there is nothing partisan about this—I think the significant thing is that the country, the Congress and the administration have learned in the last—and I make it 10 years, or whatever period—have learned how to make the economy its servant instead of its master. And I believe that there would be complete bipartisan support for turning whatever energies are released in Vietnam to the improvement of the human race at home. And I believe it would be done right quickly. And I believe it would be done within 60 to 90 days.

We are quite clear about those things which we would like to get on to faster.

So, in a very very sincere way, I say to you that I think—well, I cannot wait, and neither can you.

Representative RUMSFELD. I am afraid we have absorbed my 10 minutes——

Secretary WIRTZ. I am sorry.

Representative RUMSFELD (continuing). With one question.

Chairman PROXMIRE. I would like to pursue with you, Mr. Secretary, the notion that this economy is moving too fast, expanding too fast, and that our main danger is inflationary pressure.

This may or may not be your impression. It is the impression I have gotten from other administration witnesses, and many of the independent economists who have appeared.

Let us take a look at the economy. Because you are close to the statistical heart of our Government, I think your comments would be very helpful.

It seems to me that at best we have a mixed bag on the basis of the January statistics—it is awfully hard to argue that this is an economy that is booming too fast, that we need more restraint, that unless we slow down we are going to be in trouble.

It is true unemployment went to a 15-year low in January. But you know far better than anyone in Government perhaps what was concealed in those unemployment figures.

Number one, you had the fact that something like 500,000 women left the job market and were no longer seeking work.

Number two, the hours of work per week in the factories actually declined from 40.8 to 40.5, indicating less pressure on manpower resources; 40.5 is a figure as low as it has been since 1962. So, this indicates the pressure on manpower is not very great.

The rate at which our plant capacity was utilized is still only about 85 percent—15 percent idle. And, back in 1964, one of the arguments for reducing taxes was that our plants were operating at only 85 percent of capacity.

Industrial production, which was very disappointing last year, grew very little—only a little better than 1 percent—dropped in January; it did not increase, but it fell. Housing starts were disappointing. Inventories grew $9.2 billion, and the expectations are they will continue to grow over the next 4 or 5 months because of the steel situation, and then decline, which will tend to slow down the economy.

Retail sales were up, it is true, but personal income was up far less than expected, and far less than it has been for a number of months.

There is no indication in consumer intentions that we can get that we can expect a boom from less saving and more spending.

The business investment in plant and equipment is expected to increase somewhat in this quarter, but then level off and we will get very little stimulation from that source.

So, under those circumstances, I would like to ask you this question.

You said that you were quite sure that with the surtax we would have less unemployment than we have now—at least I understood you to say that.

Secretary WIRTZ. Yes.

Chairman PROXMIRE. If in June or July when we vote on the surtax unemployment is higher, significantly higher than it is now, will you still feel it would be a good idea for us to vote for this kind of restraint in the economy?

Secretary WIRTZ. I would reply just as honestly as I can to the question. Every factor you have mentioned squares with the information that I have, and contributes to making this what I think of as a complex question and complex problem. The things you mention drive me to what I admit as a kind of intuitive judgment that I am clearest about this whole thing in terms of paying bills.

Now, with respect to the statement that unemployment will be lower—Mr. Ross advises me just here as we talk that he thinks that is a dangerous statement to make, because we do not know what is going to happen even as far as the work force is concerned, as far as these various things go.

I am in effect confirming what I understand to be the basis of your statement, that there are elements of doubt, specially when we move to the second quarter.

Now, you asked me whether I would recommend to the Congress that there be a vote in favor of the surtax if by the middle of the year the unemployment rate seems to be heading up. I have two or three difficulties about that. First, the postponement of that vote presents me with what I think is a serious question.

I think it ought to be done now. I have some trouble evaluating that problem as it might exist then. I want to know what happened to the cost of living. If the cost of living keeps going up another 0.3 percent or 0.4 percent every month, as it has been for the last 6 or 7 months, then it resolves a lot of what would otherwise be, to me, economic doubts.

Chairman PROXMIRE. But that is the problem: In 1958, for example, we had almost 7 percent unemployment and serious inflation. We could have something like—not that bad, we hope—but something like that again. Where do you make your decision?

Secretary WIRTZ. I do not know. The last time I was through this, which was in the Korean period, the thing went up so fast we had to turn to wage and price controls. I do not think the country wants to do that right now.

As far as I am concerned, it is a matter of looking at a very hard equation, which I understand only partly, which includes the factors to which you refer. It also includes this factor of the inflationary developments to which Mr. Curtis, Mr. Widnall, and Mr. Rumsfeld referred. I think all those things have got to be balanced. And I come out with an affirmative answer to your question. But I have extended my answer out of respect for the elements which you mentioned, because I think they complicate it.

Chairman PROXMIRE. Well, now, I would like to get back just a minute to your argument with Congressman Reuss—or your response to Congressman Reuss—when you said that one answer to the difficulty created by the increased surtax is that there will be more people working because of the manpower training programs which you have. This seems to me to make the argument even stronger against what I would consider excessive restraint.

If you have 1,300,000 people trained who would not be otherwise trained, you are going to have more people seeking work who are trained and able to fill the jobs. You need more demand, not less.

This is an argument against the surtax, not for it. If you are not going to train these people—these people are consumers but not producers. But, if, in addition to being consumers they become producers, you need more demand in the economy. Your manpower training program is one eloquent argument against the surtax. We could go down to 3.2 percent or 3 percent unemployment without inflation.

Secretary WIRTZ. It is so complex that the point I am about to make will seem to you evasive. It is not. A large number of the people we are talking about are under 20, a large number of the 1,300,000 are under 20. A large number of the jobs we are talking about are part-time jobs which will enable them to stay in school. In my own thinking we will meet the problems you and I are both interested in when we move toward the point where a person under 20 is not unemployed—he is either in or out of school.

My point is, by programs of the kind we are talking about here, we could increase the number staying in education. It becomes that much more complex.

We can also, by these training programs, push these people into those areas in which there are still—Mr. Curtis suggested—some skill shortages, which are slowing up productivity.

I do not mean to discount the point you made. I think it is a more complex point. And I think a properly administered, directed manpower program, will see at least another 300,000 people, I believe more, moved into activity which will not compete.

Chairman PROXMIRE. This gets back to the problem that has been troubling you the most, and we have not answered in our questions, or in our statements up here.

As far as paying the bill is concerned, the best way to pay the bill, it seems to me, is have our economy as fully utilized as possible, with earnings as high and jobs as numerous as possible.

We all know that the 1964 tax cut—everybody says—asserts that it increased revenues. Taxes were lower, but revenues were higher, because the economy was stimulated. It is perfectly possible that the 1968 tax increase might reduce revenues, make it harder to pay the bill.

Secretary WIRTZ. The other side is that the manufacturing workers' real weekly earnings have not increased in the last 2 years. That gives us pause, necessarily—both of us sharing this view.

Chairman PROXMIRE. It certainly won't increase if we pass the surtax.

Secretary WIRTZ. I am not sure about that. If the surtax will avoid—as I think it will—will avoid that spiraling of costs, which has taken money out of his billfold every time it has gone in, then it does.

Chairman PROXMIRE. If it will; yes. Of course, that is something that is very hard to say.

Secretary WIRTZ. I am banking on its doing it. I think it is just too bad that you add almost 4 million jobs to an economy, and you have production of the kind we are having, and real weekly earnings in manufacturing stay almost level for 2 years, as they did between December of 1965 and December of 1967. That makes me think we have to do more than talk about the number of jobs. That is a serious matter, that spiraling.

Chairman PROXMIRE. The staff has called to my attention the last study you made on labor shortages. This was September 10, 1967, entitled "Labor Shortage Continues To Ease."

In view of the serious problem we have here—the economic policy problem this committee has in recommending policies to Congress—would it be possible to get a more recent updated study? Usually this comes every quarter. We have not had one for 6 months.

Secretary WIRTZ. They have stopped. That is what Mr. Curtis refers to as feeble. If it is the judgment of this committee that that series ought to be continued, I say to you right now we will reinstate it.

Representative CURTIS. Oh, yes.

Chairman PROXMIRE. It would be most helpful to us. It goes right to the heart of the matter.

Thank you, my time is up.

Mr. Curtis?

Representative CURTIS. That was a nice note to end on.

I am coming back now to my last remarks that the efforts of the administration to implement the jobs available statistics were feeble.

Isn't the real reason the administration has not pushed the jobs available statistics because of the opposition we have from the AFL–CIO?

Secretary WIRTZ. No. I make no bones about it. I have pushed those in complete disregard of and because I disagree with their position, and so has the administration. What the influence has been on the Congress, I do not know.

Representative CURTIS. Mr. Secretary, this, then comes around to the definition of what you interpret to be push, and what I would interpret to be push.

When the administration really wants something, we in the Congress have learned what happens.

Now, I do not think the President has ever spoken out personally on the importance of jobs available statistics, nor do I recall that you have ever made any public statement—except under cross-examination. But, can you direct me to one of your speeches where you talked about the need for jobs available statistics?

Secretary WIRTZ. Public speeches—I will try to find those. It is not the kind of thing that most audiences care about.

Representative CURTIS. Mr. Secretary, I am interrupting so that we will be sure you get the gist of my question. I am now talking about what you mean by pushing.

Secretary WIRTZ. I have argued myself black in the face with the Appropriations Committee, and the President's budget that——

Representative CURTIS. But you did not even submit a bill or request——

Secretary WIRTZ. Not this year.

Representative CURTIS. No; nor the previous year. As a matter of fact, the chairman of the Subcommittee on Appropriations, a very good friend of mine, John Fogarty——

Secretary WIRTZ. He was against it.

Representative CURTIS. Yes. And the AFL–CIO is the only organization that spoke before our subcommittee against the jobs available statistics. They are opposed to it, and frankly, this is what I identify as the reason the administration has not been forceful in getting this through.

We are talking about $2½ million, I think. And you are already talking about half a billion dollars that you are planning to spend for job training and so forth.

This is how ridiculous it really is. This is a vital part of job training—not just manpower development training, but what might be done by the private sector.

That is the context in which I have been raising this.

Secretary WIRTZ. I understand.

Representative CURTIS. Well, now let me ask whether or not the Department of Labor has issued a report on the Human Investment Act, which is a bill that has been introduced by many Congressmen and Senators. The first question is: Has the Department made a report to the committee on this?

Secretary WIRTZ. I do not recognize the legislation.

Representative CURTIS. Well, the legislation is to try to encourage

90-191 O—68—pt. 2——16

private employers to train and retrain and gives a 10-percent tax credit for doing it. The first question is, Has the Department made a report?

Secretary WIRTZ. Yes; we have.

Representative CURTIS. The second question is, What is the report, or the position, or if a report has not been made, why hasn't it?

Secretary WIRTZ. The report has been made. We have testified to that. I have taken, specifically, the position to the use of a tax credit to stimulate training.

Representative CURTIS. Why?

Let me first put it in context.

You see, the administration did promote and had enacted into law a 7-percent investment credit to corporations for investment in new machinery. The point is that, if we are going to do this for new machinery, certainly, that which, to a degree, competes against new machinery ought to be equalized. And this is the significance now. You have a report I have not seen, this official report to the Ways and Means Committee, Mr. Secretary.

Secretary WIRTZ. The report to which I refer is testimony, is in the form of formal testimony before several committees.

Representative CURTIS. This is before the Ways and Means Committee. And, of course, you know our procedures—when a bill is introduced, we ask the various departments affected to submit their official reports on it.

Do you know whether——

Secretary WIRTZ. I will check to see.

Representative CURTIS. Please do. And if not, let us put in the record—so it won't be redundant—whatever testimony you think would relate to that.

Now, there is another act I am interested in—the Employment Incentive Act—H.R. 13777—which was introduced October 31, 1967. I introduced it; others have, too. Incidentally, Senator Percy has introduced the bill here in the Senate, with some cosponsors. And on page H14264 of the Record there is an explanation of this.

This is an attempt to gear in the minimum wage laws with these training programs.

Has the Department made a report on that?

(The bill referred to by Representative Curtis is reprinted below:)

[H.R. 13777, 90th Cong., first sess.]

A BILL To increase employment opportunities for individuals whose lack of skills and education acts as a barrier to their employment at or above the Federal minimum wage, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Employment Incentive Act of 1967".

STATEMENT OF PURPOSE

SEC. 2. The purpose of this Act is to increase employment opportunities for individuals whose lack of skills and adequate education acts as a barrier to employment at or above the Federal minimum wage, and thus to help provide useful employment and training opportunities for individuals who might otherwise be trapped in the cycle of poverty by persistent and recurrent unemployment or underemployment.

MINIMUM WAGE EQUIVALENCY REFUND

SEC. 3. Certified employers who employ certified workers at not less than the minimum wage applicable under section 6 of the Fair Labor Standards Act

of 1938 shall receive, in accordance with the provisions of this Act, a minimum wage equivalency refund (hereafter in this Act referred to as the "refund") consisting of a portion of the wages paid.

PAYMENT OF REFUND

SEC. 4. (a) The refund shall be paid quarterly to those employers who—

(1) have applied for and been issued employer certificates, as provided in section 8 of this Act;

(2) employ workers holding employee certificates, as provided in section 6 of this Act, at least forty hours per week;

(3) pay certified employees the minimum wage applicable under section 6 of the Fair Labor Standards Act of 1938 in addition to fringe benefits received by comparable noncertified employees; and

(4) report quarterly to the Administrator of the Wage and Hour and Public Contracts Division of the Department of Labor (hereafter in this Act referred to as the "Administrator") on the status, number, and total hours worked of employees holding employee certificates.

(b) The refund shall be an amount equal to—

(1) 40 per centum of the wages paid at the rate referred to in section 4(a)(3) to all employees certified pursuant to sections 5 and 6 for the first half of the period of such certification for each such employee; and

(2) 20 percentum of the wages paid at the rate referred to in section 4(a)(3) to all employees certified pursuant to sections 5 and 6 for the remainder of the period of certification for each such employee.

DETERMINATION OF ELIGIBILITY FOR EMPLOYEE CERTIFICATE

SEC. 5. An individual shall be eligible to receive an employee certificate if—

(1) his skill, training, education, or job experience is below that normally required for steady employment at or above the minimum wage, as determined by his local United States Employment Service office, and

(2) if unemployed, he or she has sought but has not been able to obtain employment at the minimum wage or above after a period of unemployment of five weeks or longer.

EMPLOYEE CERTIFICATE

SEC. 6. Upon application, the appropriate local office of the United States Employment Service may issue an employee certificate to any individual who meets the requirements set forth in section 5. The form of such certificate shall be prescribed by the Director.

DETERMINATION OF EMPLOYER ELIGIBILITY FOR CERTIFICATE

SEC. 7. An employer shall receive a certificate of eligibility to receive the refund for the employment of employees certified under sections 5 and 6 upon application, if the Administrator determines that—

(1) the employer is covered by the provisions of section 6 of the Fair Labor Standards Act of 1938;

(2) the employer applying for a certificate has not raised his hiring requirements following or in expectation of the enactment of this Act;

(3) an adequate supply of qualified workers is not available despite reasonable efforts by the employer to recruit them;

(4) the refund will not have the effect of impairing or depressing the wages, working standards, or opportunities for full employment of existing employees;

(5) abnormal labor conditions, such as a strike, lockout, or similar condition, do not exist at the firm;

(6) the employer will afford certified employees full opportunity for continued employment at the minimum wage or above after the expiration of the employee's certificate; and

(7) the employer has a formal or on-the-job training program to upgrade the skills and enhance the productivity of certified employees.

EMPLOYER CERTIFICATE

SEC. 8. (a) An employer may apply for a certificate as soon as it decides to hire an individual eligible to be a certified employee under this Act. If the employer hires such an individual before its application is accepted, and the

application is subsequently accepted, the refund shall be retroactive to the date the employee was placed on the employer's payroll.

(b) An employer certificate, if issued, shall specify—

(1) the number of certified employees authorized to be employed at any one time, which shall not exceed 25 per centum of an employer's total labor force; and

(2) the effective date and the expiration date of the certificate.

Such certificate shall be in the form prescribed by the Administrator.

DURATION OF CERTIFICATES

SEC. 9. (a) The duration of employer certificates shall be one year, renewable upon finding of continued eligibility by the Administrator. In the event an employer chooses not to renew a certificate, he shall continue in the program until all employees hired under the previously existing certificate have completed the duration of their certificates.

(b) There shall be the following two classes of employee certificates:

(1) A six-month certificate for nonskilled occupations.

(2) A one-year certificate for skilled occupations.

The local office of the United States Employment Service shall issue a qualified individual a certificate of eligibility prior to his employment. After the certified individual is employed, the local office shall determine on the basis of his occupation whether his certificate shall have a duration of six months or one year.

(c) Not more than one employee certificate shall be issued under this Act to any individual and such certificate shall be nonrenewable.

EQUAL OPPORTUNITY

SEC. 10. No certified employer shall discriminate on account of race, color, religion, or national origin in the employment of certified employees.

ENFORCEMENT

SEC. 11. (a) The provisions of this Act relating to employer certificates and the distribution of the refund and all regulations pertaining thereto shall be enforced by the Administrator. He shall conduct investigations of possible violations of employer certificates upon—

(1) a complaint by either an employee or an employer under a certificate, or

(2) a complaint by a competitor of a certified employer, or of an experienced worker who claims to have lost employment or to be unable to obtain employment because of competition from certified employees.

(b) The provsions of this Act relating to employee certificates, their issuance, and all regulations adopted under these provisions shall be enforced by the Director of the United States Employment Service (hereafter in this Act referred to as the "Director"). He shall conduct investigations of possible violations of employee certificates upon—

(1) a complaint by either a certified employee or employer, or

(2) a complaint by an experienced worker who claims to have lost employment or to be unable to obtain employment because of competition from certified workers.

(c) If after notice and hearing the Administrator or Director finds that there has been a violation of the provisions of this Act, or regulations thereunder, the Administrator, in the case of an employer, and the Director, in the case of an employee, shall cancel the certificate issued under this Act, and deny the privilege of obtaining a new certificate for such period as the Administrator or the Director, as the case may be, shall determine.

ADMINISTRATION

SEC. 12. (a) The Administrator shall administer the provisions of this Act relating to employer certificates and payment of the refund.

(b) The Director shall administer the provisions of this Act relating to employee certificates.

(c) The Administrator and the Director are authorized to establish such rules and regulations as are necessary and appropriate to carry out their respective functions under this Act.

CRIMINAL PENALTY

SEC. 13. A certified employer who knowingly violates the conditions of an employer certificate or the other provisions of this Act shall be deemed to have committed a misdemeanor, and shall be subject to a fine of not to exceed $1,000.

RECONSIDERATION AND REVIEW

SEC. 14. (a) (1) Any person aggrieved by the action of an authorized representative of the Administrator in denying or granting an employer certificate may, within fifteen days after such action, (A) file a written request for reconsideration thereof with the authorized representative of the Administrator who made the decision in the first instance, or (B) file a written request for review of the decision with the Administrator or an authorized representative who has taken no part in the action which is the subject of review.

(2) Any person aggrieved by the action of an authorized representative of the Administrator in denying a request for reconsideration may, within fifteen days thereafter, file with the Administrator a written request for review.

(3) Any person aggrieved by the determination upon reconsideration of an authorized representative of the Administrator may, within fifteen days thereafter, file with the Administrator a written request for review.

(b) (1) Any person aggrieved by the action of a local United States Employment Service office in denying or granting an employee certificate may, within fifteen days after such action, (A) file a written request for reconsideration thereof by the local United States Employment Service office which made the decision in the first instance, or (B) file a written request for review of the decision by the Director, or (C) file a written request for review of the decision by an authorized representative of the Director who is not attached to the local office making the decision in the first instance.

(2) Any person aggrieved by the action of a local United States Employment Service office, or of an authorized representative of the Director in denying a request for reconsideration may, within fifteen days after such determination, file with the Director a written request for review.

(3) Any person aggrieved by the determination upon reconsideration of a local office, or of an authorized representative may, within fifteen days thereafter, file with the Director a written request for review.

(c) A request for reconsideration shall be accompanied by a statement of the additional evidence which the applicant believes may materially affect the decision together with a showing that there were reasonable grounds for failure to present such evidence in the original proceedings.

(d) A request for review shall be granted where reasonable grounds for the review are set forth in the request.

(e) If a request for reconsideration or review is granted, the Administrator, the Director, their authorized representative, or a local United States Employment Service office may, to the extent he deems it appropriate, afford other interested persons an opportunity to present data and views.

SECRETARY'S EVALUATION AND REPORT

SEC. 15. Prior to March 1, 1969, and again prior to March 1, 1970, the Secretary of Labor shall make a report to Congress. Such report shall contain an evaluation of the program authorized in this Act, enclosing the number of persons employed and trained, the employment experience of individuals who have completed the program, the response of employers to the program and recommendations for improvement.

AUTHORIZATION OF APPROPRIATIONS

SEC. 16. There is hereby authorized to be appropriated $72,000,000 for the fiscal year ending June 30, 1969, for payment of the refund for the employment of not more than one hundred thousand certified employees; and $144,000,000 for the fiscal year ending June 30, 1970, for payment of the refund for the employment of not more than two hundred thousand certified employees. There is authorized to be appropriated such sums as may be necessary for administrative expenses for the fiscal year ending June 30, 1970. Such sums may be appropriated for each fiscal year thereafter as the Congress may hereafter authorize by law.

Secretary WIRTZ. I will have to check that particular piece of legislation. I would like to, before answering. I think we have not made a

formal report on it. And, so, I do not have it clearly enough in mind to know how broadly it raises a question to which we have given a good deal of attention; namely, the application, or the use of minimum wage rates in the training programs.

Representative CURTIS. It is hitting along that line. Let us leave the record open for your response.

(The information furnished for the record follows:)

SUPPLEMENTAL STATEMENT OF SECRETARY OF LABOR WIRTZ IN REPLY TO QUESTIONS BY REPRESENTATIVE CURTIS

First, I will respond with regard to the tax credit for the expenses of employee training programs which would be provided under the Human Investment Act bills (H.R. 4574, 4578). Last year, at the request of Senator Percy, I submitted material for inclusion in the record of the hearings of this committee on this subject. (February 2, 1967, part 2 of the hearing record, p. 307). I indicated there that the Department of Labor was actively pursuing the subject independently and with representatives of the Treasury Department, but that all plans which had been considered had such serious defects that they could not be supported. Shortly thereafter in the Manpower Report of the President dated April, 1967, the President directed creation of a Task Force on Occupational Training with members drawn from business, labor, agriculture, and the general public. This Task Force now is engaged in a survey of training programs operated by private industry and will make recommendations as to how the Federal Government should promote and assist private training programs. The possible use of tax credits as one method of promotion and assistance is being considered by that Task Force. My own final conclusions on this subject will not be made before receipt of the Task Force report.

Second, with regard to the direct wage subsidy plan contained in H.R. 13777, the Employment Incentive Act bill, introduced last October. In principle this is the same as the direct wage subsidy proposal on which I testified last June in the hearings before the House Education and Labor Committee on the Economic Opportunity Amendments of 1967. (June 22, 1967, part 2 of the hearing record, pp. 1203–1208 and 1214–1215) A direct wage subsidy is not, in my opinion, the answer to our present problem. The views expressed there remain my views, and are reinforced by the strong support and response which private industry is giving to the Job Opportunities in the Business Sector (JOBS) Program announced by the President in his January 23, 1968 message to Congress, "To Earn a Living: the Right of Every American." This program will devote $350 million to a new partnership between government and private industry to train and hire the hard core unemployed.

Representative CURTIS. In essence, it recognizes that certain people, at some stage of their development, probably are not economically worth the full minimum wage. Therefore, the employer pays that which they are worth, and you make up the difference in minimum wage through, frankly, Government subsidy. But then it phases out.

This would be a comment on my part, rather than a question. During the development of the social security bill last year, I was very concerned that we gear this in with the minimum wage laws and other laws, like child labor and so on. The Health, Education, and Welfare Department officials, including Mr. Cohen, were the witnesses. I kept asking to have the Department of Labor people come in, because I thought you were most familiar with it. Mr. Cohen reported to us that he had had discussions with someone in the Department of Labor and reported back that they felt, as we did amend it in certain ways, that it was properly geared in.

For the record, later, would you comment on how well you think we did or did not do a job in the social security legislation?

Am I coming clear to you with what I am asking?

Secretary WIRTZ. Yes; sure. There is a big problem as to the relationship of the minimum wage to the expansion of the educational program when it gets into that in-between area which we call work training. I do recognize the problem. It is a complicated problem.

Representative CURTIS. All I have is an indirect report as to what the Labor Department views are. But, I would apperciate, for the record, your comments on how well you think that we did do the job, or where you might suggest that we need to improve it.

We made great strides forward, I think, in trying to relate welfare to getting people onto their economic feet, as opposed to just keeping them in a constant position of welfare.

Secretary WIRTZ. That is right; it was a good job. We will, of course, know more in the next 2 or 3 years as to how well the new work-training program of title IV of the recently enacted Social Security Act amendments work, and will report back to you then, as the act calls for.

Representative CURTIS. I have—when I come back again—some specific questions for your response later.

I have had over a period of years a series of tax reforms which I think are most essential in trying to improve the mobility of labor. I think our tax laws are structured really in a way that they impede this.

One law, for example, is the deduction from gross income of going to summer school, night school, vocational training.

The laws are so archaic. They apply to a schoolteacher. She goes to summer school. She cannot deduct that as business expense unless the school board has told her she is going to be fired if she does not. In other words, "Are you holding your job or are you trying to improve yourself?" If you are trying to improve yourself, they won't give you a deduction. Yet, I would argue, in this day and age of automation, where skills become obsolete in 5 or 10 years, that the need for constant training and retraining is so important that our tax laws should not be an impediment here.

We have the same problem in moving costs, and the same thing on costs to maintain two residences. When the Chrysler plant moved from Evansville, Ind., to St. Louis, there was a depressed real estate market. A lot of people could follow their jobs to St. Louis, but they commuted back and forth. And yet, they were not given, as a business expense, the cost of maintaining two residences, because the archaic law says a man's residence is where his job is. I argue that today it is where his home and his family are. And then, there are the problems of the handicapped, where they have to have special vehicles, and all sorts of things.

I would like to have some help in these areas in getting our tax laws revised.

We just are not seeming to move forward at all.

Secretary WIRTZ. If you will add one more—and that is this. If I were to take my staff to lunch, for purely business reasons, I would first have to pay for it myself, and second would not be allowed the deduction as a business expense.

Representative CURTIS. I would be happy to work on that one, too.

Secretary WIRTZ. I would be glad to file a statement.

Let me be sure we have the area.

Those matters of tax practice involving and related particularly to business expense deductions which we feel might appropriately be

considered in connection with the fairness and the increase of employment, and particularly the employment of people to whom this would make a very real difference.

Representative CURTIS. It is the mobility of labor. A great deal of this is not the businessman. A great deal of it is the individuals themselves, Mr. Secretary. And, let this argument deter you, what good does it do to give an income tax deduction to a person who might be unemployed. I think our difficult problem in this training and retraining is the escalation that a person with a good job, if he will train for a higher skill, leaves his job open for someone. So, it is very meaningful, I would argue, to remove these impediments in our tax laws.

Secretary WIRTZ. We would be glad to file such a statement.

(Representative Curtis' bill for tax deductions for the above purposes, H.R. 5045, has been forwarded to the Department of Labor by the House Ways and Means Committee for expression of the Department's views. The report will be forwarded when completed.)

Chairman PROXMIRE. Congressman Widnall.

Representative WIDNALL. Thank you, Mr. Chairman.

Several prominent economists, particularly Professor Brozen of Chicago, and Professor Campbell of Dartmouth, have made studies that indicate the minimum wage has reduced employment opportunities for young, inexperienced workers.

What do your studies show?

Secretary WIRTZ. They do not show that. It is required under section 4(d) we make annually, and file with the Congress the first of each year, a report on the effects of the minimum wage law. And in the most practical terms I can identify, every study that we have made so far does not support the conclusion that the minimum wage has a depressing effect on employment.

But I want to make this clear, Mr. Widnall.

This is a limited, careful, guarded statement that I have made.

There is no evidence in any of these studies to show affirmatively that kind of thing.

But I want to make this clear.

If the minimum wage for youngsters or for any other group in this country were, let us say, 50 cents an hour—as it is, for instance, in Japan—there cannot be any question but that there would be larger employment of that group which was given that exemption.

Now, the problem would be that it would have a depressing effect on our local standard of living all the way up and down, as it does in Japan.

And so I am trying to say in answer to your question that I do not think that there has been a reduction in youth employment because of the minimum wage law. And that is the point they make.

I do not recognize that if we had an entirely different approach to this problem, as indeed is true in a number of other countries, where there is a youth differential, it would affect that matter.

Representative WIDNALL. Have you considered recommending legislation to amend the minimum wage law, to permit a lower minimum wage for trainees, perhaps with a Government subsidy to make up the difference between the actual wage paid and the minimum wage?

Secretary WIRTZ. We have considered it, and have reached affirmatively the conclusion not to make the recommendation in that form.

I will tell you the area in which it seems to me most pointed. It is in the area of the handicapped worker, to whom there has been reference here before.

We presently have under serious consideration the question of whether we are taking the right approach to that. We now give sheltered workshops an exemption on one kind or another. We are seriously considering whether we should make recommendations which would say that is the wrong approach, that a handicapped person who works his head off all day is as much entitled to the minimum wage as somebody else that we are talking about here.

Now, if there is a noneconomic element in that situation, maybe we ought to make it up. And, so, my answer to your question is that we have considered the problem; we would not at this point recommend a differential on the age basis as they have in Holland and a number of European countries, the Scandinavian countries. We would not make that. But we have—we recognize a real question here.

Representative WIDNALL. The Monthly Labor Review last September indicated that in fiscal 1967 about 1 million jobs could be attributed to Vietnam.

Has the Department an up-to-date statement of the number of jobs that could be contributed to Vietnam military expenditures today?

Secretary WIRTZ. I would file a separate statement on that. If it is felt there is additional information beyond what is supplied in the Council of Economic Advisers' Report on that.

They do make some—they do have some discussion of that. And, if it will satisfy your point, Mr. Widnall, we will review that, and see if we have any additional information bearing on that point.

At the present time the Department of Labor does not have any later estimates of the employment impact of the Vietnam buildup than those through fiscal 1967 shown in the September 1967 Monthly Labor Review. The Bureau of Labor Statistics is presently trying to extend the estimates through fiscal 1968. However, essential data on contract awards for the entire fiscal year 1968 will not be available from the Department of Defense until later this spring. When this material is available, we will be able to complete the work and should have the information ready during the summer.

Representative WIDNALL. You undoubtedly have very up-to-date figures on that, because I am very much aware of the fact that some of the Government contracts are awarded on the basis of labor impact. And, where there seems to be a sloughing off in employment, aren't some of the contracts channeled into those areas?

Secretary WIRTZ. There is very little of that. There is a rider to the Department of Defense Appropriation Act which precludes directing a contract to meet the point you have in mind if it results in a higher cost.

Now, there are some limited advantages under the Small Business Act, and so on. But there is comparatively little—some of us have felt too little—of what you suggest.

But I would be glad to identify that.

Representative WIDNALL. Just one further question.

Last September a Federal compulsory arbitration panel awarded a 5.5-percent package to six railroad shop craft unions.

Do you feel the Federal Government itself is contributing to the wage price spiral by such action?

Secretary WIRTZ. I believe the form of the question, Mr. Widnall, implies administrative action to the exclusion of legislative action.

I think it was unfortunate that Congress has finally, on the recommendation of the administration, sent that case to that settlement.

If the question is whether I think that kind of answer to labor issues is a good thing, the answer is "No; I do not."

If your question is, Do I think that the administration contributed to inflation by the taking of that action. The answer is "No." The settlement which was finally reached was so close to what everybody knew would have been the settlement if the parties had settled it themselves, that all we did was to make up for their failure to discharge their responsibility.

But I do not count that settlement a material factor as far as inflation is concerned.

Representative WIDNALL. What bothers me a great deal is that for several years there was a firm effort on the part of the administration to have management and labor adhere to a 3.2-percent guideline. And all of a sudden that guideline was abandoned, and there does not seem to be any real guideline now. An appeal is made to a voluntary effort on the part of labor and management to hold increases and changes in benefits within reason.

Now, isn't there some goal, isn't there some maximum that the administration has in mind that would be beneficial to the economy, and really noninflationary?

There must be something that is reasonable.

Secretary WIRTZ. You are talking only about wages—because the breakdown was on the price side first.

Do I properly interpret your question as meaning there should be a specific rule for prices as well as for wages? Because if——

Representative WIDNALL. There is the same reason existing today that I take was in existence at the time the 3.2 percent guidelines was issued.

Secretary WIRTZ. My partial answer is this.

The reason for departing from the 3.2 percent was that the departure from the productivity, especially on the price side, made that no longer a tenable figure—because it meant when productivity went up 3.2 percent, and when wages went up by the same amount, there was no gain, because the prices had gotten out of hand. And, so, I have got to answer you that because there is apparently—there proved to be no way to keep the price factors in line—that 3.2 productivity thing did not work, in fact. Therefore, I would have to answer you that absent any way of keeping prices in line, I do not believe that we can fairly or effectively, either way, attach ourselves to a decimal point reflex of the productivity.

So, it is a long answer, but the answer is "No," I do not think we can.

Representative WIDNALL. Isn't it true, in recent months, productivity has not gone up?

Secretary WIRTZ. That is right. Prices have.

Representative WIDNALL. In comparison to prices?

Secretary WIRTZ. That is right. You say it has not gone up. It has

gone up much less, I think. Well, in the last quarter of 1967 it started to go up a deal more again. Early 1967 very little. And for the year, some place between 1½ and 2 percent, for the total private economy.

Representative WIDNALL. And this left inflation unattached.

Secretary WIRTZ. The wage increases and the price increases both, in disregard of the productivity principle, surely did, in 1967, contribute to inflation—both of them.

Representative WIDNALL. But there is no firm guideline now being provided by the Government. It is just voluntary submission to so-called standards, as to what is reasonable.

Secretary WIRTZ. It is true that neither the Economic Report of the President nor the Council of Economic Advisers named a specific figure this year. It did not last year.

It appears originally in 1962, in the Council of Economic Advisers' Report. It was in there up until 1967, and is not in the report as of now.

That is the only place that figure has ever been developed.

Representative WIDNALL. Thank you, Mr. Secretary.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Secretary Wirtz, I have just returned from 9 days of Lincoln Day speeches in your State and my State, Illinois. I spent a great deal of time in southern Illinois because of our economic problems down there.

The migration of our agricultural workers and people out of the mines continues.

We are turning out fine educated young people at Southern Illinois University, with no place to go to work. They are moving to St. Louis, Pittsburgh, and Chicago, to find jobs, separating families. And this is a problem that many States are experiencing.

Could we think about some of the programs that we might work on to solve some of this problem?

For instance, tax incentives to encourage establishment of businesses in rural communities have been proposed to stop the concentration of industry in our urban areas. I wonder whether it is not well to think in terms of providing special inducements for businesses that will go where we need them, such as where we have large pools of unemployment, where we need to hold people, to keep a community going and alive. We simply cannot keep crowding our urban areas at the present rates.

Secretary WIRTZ. The general problem or question is important.

The desirability of action of one kind or another which would have that effect would have our complete support. I would agree with you completely. I would question only one part, and that is whether the tax incentive is the most effective way of doing that. But aside from that, I know of no larger problem today than to try some way to reverse the tendencies that prompt people to pile on top of one another in the cities. More specifically, we will do everything we can to move in the other direction.

Senator PERCY. Would this also apply to the other areas where industry is going—the suburban areas, outside the city?

Would the same thing hold true for industries locating inside the inner city, where we also have large pools of unemployment, especially Negro workers?

Secretary WIRTZ. I am much less clear about moving, if I under-

stand your question—much less clear about this second point, which if I understood you, would involve moving businesses into the ghetto areas themselves.

I hope we are not going to become a country in which the cities are black and the countryside is white. And the whole problem, I mean as far as the population is concerned—the tendency is in that direction.

There is a good deal of illusion in some of the suggestions that the way to meet the problems in the slums and the ghettos is to bring businesses in there. In a very pragmatic way, one of the difficulties is that it takes a lot of time.

It probably makes much more sense to attempt to meet the transportation needs that are involved, and to prevent those steps which have led some people to describe the prospect to which you refer as being a gilded ghetto. I believe if we simply move into the ghettos those businesses which would supply the kind of work which can be done there, there would be some serious consequences. We have got to do some of that, and we are doing some of that. But I do not believe that is a long-term answer.

Senator PERCY. I was wondering about an area like the stockyards in Chicago, where, I think, in the last 8 years employment has dropped from about 17,000 to 2,500; 75 percent of that employment was Negro employment. They were paid very good wages. The decentralization and dispersal of the meatpacking industry has left the stockyards a pretty vacant area, without employment opportunities.

What can we do together in some sort of alliance for progress, Federal, State, local government, private industry, business organizations, to utilize that land area there, where several million people are close at hand, several hundred thousand available for employment. Nothing seems about to be done about it.

Secretary WIRTZ. We are hoping, of course, that the model city recommendation from Chicago will meet precisely that problem.

One of the important points of what you are saying is that we have to recognize this as more than an employment problem. It is housing, it is education, it is employment, and health—all four together. And any suggestion that we approach it as one or the other is going to be wrong.

So my answer to your question would be that we can—that the Congress has now provided in the model cities approach what seems to me the best answer, the best presently available answer to that kind of problem. Except for this.

There is a certain amount we can do through Government, and the rest of the answers ought to come from a coordination of private interests of one sort or another, and I think some of the emergences of that kind of thing is all to the good.

Senator PERCY. I am convinced, as I am sure you are, that we must involve private enterprise in this job of hiring the hard-core unemployed. The Job Corps simply is not enough, and it sometimes trains people for jobs that do not exist. Somehow we must pull in the whole forces of our employment process into this. I think industry has to do some of this kind of work, to start attracting the young people, who see in business a broader commitment than we used to see. There is more excitement in VISTA programs, Peace Corps programs, and yet, in this area there is exciting work to be done.

Has the Department of Labor developed any kind of pilot studies where we could see what the effect on industry could be? For instance, have you developed a project and experimented to see what impact it has on the social conscience of a given company? An example might be taking on and hiring a certain number of hard-core unemployed. I think Henry Ford is trying to do this; I think Eastman Kodak is trying to do it.

Has the Department of Labor—can it see itself as a catalyst to spread information on these programs to more businesses?

Secretary WIRTZ. It goes a good deal beyond that.

In the JOBS program—jobs opportunities in the business sector—the President, in his January 23 message, outlined a program, price tag $350 million for the next 2 years—it is administered as far as the program part of it is concerned through the Department of Labor— that has been done. We hope that that will mean the employment of 500,000 hard-core unemployed in the 50 largest cities in the next 3 years. And I think it will.

In general response to your question, both the concentrated employment program, and the JOBS program rely very very strongly on the proposition that the right answer is private employment, and that the right way to reach that answer is through a combined participation by Government and the private employers in the working out of these programs.

Senator PERCY. My last question—I look upon labor leadership as responsible, patriotic and so forth. We have a crisis, a balance-of-payments crisis in this country. Tourists are asked not to travel. We have industry being asked not to invest abroad, even though they know that in the long range this will operate to the detriment of our economy.

Has any thought been given to having labor have a strike moratorium in industries that affect us in balance of payments, just as if it is a war problem. The copper industry, for instance, certainly is creating a tremendous drain now on us in our balance-of-payments problem. What is being done about this, to bring this forcibly to the attention of the American public and labor leadership, the detriment of that kind of continued strike?

Secretary WIRTZ. There has been thought. Two questions that I would have to include in answer to it.

When you say a strike moratorium, do you imply arbitration by law, or in some form as a part of that?

Senator PERCY. Something—just to bring about a settlement in a crisis.

Secretary WIRTZ. It cannot just be a strike moratorium. There would have to be the substitution of some method of determination.

I think you would find the most significant approach to this—in the attempt that was made in the steel industry to do just exactly this kind of thing. We were all encouraged in December that there was a possibility that they would voluntarily work out some kind of arbitration arrangement. It did not work out. But it reflects exactly the point you are talking about, because the interest of both the company and the union was in making some arrangement which would mean there was not a lot of offshore buying of steel.

So there has been that serious kind of conversation there.

I wish that had worked out. It was entirely private. We did not get into it. If the question is whether I think the circumstances warrant our doing it by law, my answer is "No." But if the question is whether it is a matter of good, sound development, my answer is "Yes."

You take into account, Senator, at this point, another thing that bothers us a good deal, and that is that a good many of the settlements which have been arrived at in collective bargaining have not been ratified by the membership. That point, too, would have to be considered. My general answer to your question is that the development is one which should be given strong consideration—I think not by law.

Senator PERCY. I would hope we could do as much in the area of getting advance assurances now from labor. As long as business is being asked not to invest for the next couple of years, since people are asked not to travel—is it possible to get assurances from labor for a couple of years now they are not going to strike those industries which would cripple our balance-of-payments problem.

Secretary WIRTZ. Or that the employers should not be adamant on their part. It cannot just be to stop the strikes. We have to substitute some method of settlement.

Senator PERCY. Thank you.

Chairman PROXMIRE. Senator Javits?

Senator JAVITS. Mr. Secretary, I would like to ask one further question based upon what Senator Percy has opened in his last question.

As I understand it, there is about a billion dollars in foreign exchange involved in copper, and possibly with the addition of steel, which is being piled up too in contemplation of a possible strike. Now, why can't the President, on your recommendation, call in the leaders of industry and labor in copper and in steel, and say as a patriotic gesture they should agree to what George Meany calls voluntary arbitration in the national interest?

Secretary WIRTZ. Why can't he?

Senator JAVITS. Yes.

Secretary WIRTZ. My own reaction is that this matter should not at this point be subject to that kind of direct White House participation which has, on previous occasions, met with severe criticism, and I think properly, as far as the country is concerned.

On the desirability of doing all we can effectively and consistent with our system to try to accomplish the results to which you refer, I am a firm believer in that, as you know, and I answer with reservation only when you talk about putting the President directly into the dispute at that point. That I do not consider wise. I am humbled, of course, by the fact that the procedures on which Secretary Trowbridge and I have been working are at, least, yet not successful. But, I have no question about the good sense of what you are talking about, except as it injects the President as an individual.

Senator JAVITS. Mr. Secretary, is my figure correct? I understand it costs, roughly, $80 million a month to bring in copper?

Secretary WIRTZ. Yes; that is about right. The trade balance effect of the copper strike—I have it in the daily figure, but it coincides with yours—is between $3 million and $4 million a day.

Senator JAVITS. And I am correct about the fact that that represents one-quarter of the whole imbalance in our interest payments?

Secretary WIRTZ. I would be out of my depth.

Senator JAVITS. To that must be added some figure for steel imports. It is true that they have risen materially through fear of a possible steel strike?

Secretary WIRTZ. Yes, sir.

Senator JAVITS. Nonetheless, you feel, notwithstanding the Vietnam war, it would be inopportune for the President to intervene on the manner I have suggested?

Secretary WIRTZ. I already answered. I am obviously in an area where the question of propriety and the degree of my comment on what the President ought to do in that situation has been about reached. But, I would say quite frankly, I would have the feeling that that personal participation would not at this point be a good idea.

Senator JAVITS. Now, on another crisis front, to wit the cities, do you see, Mr. Secretary, any need for another emergency job program, like we had in 1967, when we appropriated 75 million special dollars for the purpose?

Secretary WIRTZ. I cannot place the program as a separate program to which you refer. We have discussed earlier this morning the desirability of expanding the manpower program as a whole, as it is expanded in the President's recommendation, and I do support that. But I am not sure if you have reference to some particular program.

Senator JAVITS. May I just refresh you on it.

Last year the President sent a special message to the Congress asking for $75 million for summer jobs. We voted the $75 million upon the express request of the administration.

Now, I ask you, What about this year?

Secretary WIRTZ. I am not in a position to answer that.

Senator JAVITS. As yet?

Secretary WIRTZ. That is correct.

Senator JAVITS. I do not want to press you, Mr. Secretary. You know I have great respect for you.

Will you be prepared to testify at this time as to need on that score?

Secretary WIRTZ. I will be glad to testify as to the situation.

Senator JAVITS. Now?

Secretary WIRTZ. At any time.

Senator JAVITS. I am asking you, Do you see a need for summer jobs this year?

Secretary WIRTZ. I beg your pardon. I thought you meant on the basis of some further preparation. What I can say to you now is in pretty general terms, and would not go to the point of whether I think there ought to be a separate appropriation. I will say this to you. I think it is the heart of—meets the heart of your question.

There is no question but that—I mean it is a fact that a large part of that supplemental appropriation last year went into programs in the larger cities in the country. And that is not possible under the allocation formula as far as the general programs are concerned. The numbers are quite significant in the larger cities, and present a problem that is very important. And I could give you, or I could supply for the record—I do not have it immediately at hand—the effect, or—

yes, the effect of the supplemental appropriation last year in the major cities, which could not be matched without a supplemental appropriation. That is about the closest I could come to it.

Senator JAVITS. I think that is excellent, Mr. Secretary. I am very pleased you should be helpful to that extent.

Would you be kind enough to supply for the record the statistical substantiation for this statement?

Secretary WIRTZ. Very well.

Senator JAVITS. I ask unanimous consent.

Chairman PROXMIRE. Without objection.

(The statistical information referred to follows:)

NEIGHBORHOOD YOUTH CORPS SUMMER JOBS FUNDED IN 50 SELECTED CITIES, FISCAL YEAR 1967

City [1]	Final total (including supplemental appropriation)	Total [2] (before supplemental appropriation)
U.S. total	[3] 294,269	[3] 194,581
Total, selected cities	121,860	71,552
Akron	350	305
Atlanta	1,340	1,061
Baltimore [4]	3,000	1,937
Birmingham	700	437
Boston	1,150	872
Buffalo	1,635	634
Chicago	18,500	13,992
Cincinnati	1,260	985
Cleveland	3,900	1,589
Columbus	625	513
Dade County (Miami)	1,250	1,120
Dallas	1,454	880
Dayton	420	357
Denver	450	294
Detroit	5,550	4,992
El Paso	398	308
Fort Worth	465	391
Honolulu	925	550
Houston	1,622	1,004
Indianapolis	875	875
Jersey City	750	103
Kansas City, Mo	817	759
Los Angeles [5]	9,644	5,732
Louisville	1,380	736
Memphis	850	652
Milwaukee	1,100	662
Minneapolis	1,000	623
Newark	2,610	1,444
New Orleans	990	697
New York	23,900	11,197
Norfolk	1,000	----------
Oakland	[3] 2,047	[3] 635
Oklahoma City	790	434
Omaha	830	308
Philadelphia	3,215	2,417
Phoenix [4]	3,680	966
Pittsburgh	3,700	2,164
Portland, Oreg	510	416
Rochester	1,042	172
St. Louis	1,080	795
St. Paul	300	218
San Antonio	2,142	886
San Diego	1,539	1,098
San Francisco	[3] 1,450	[3] 242
Seattle	845	596
Tampa	1,100	1,027
Toledo	420	398
Tulsa	240	161
Washington, D.C	7,020	[3] 2,918

[1] Cities represent the sponsor's location as shown on the BWTP contract.
[2] Estimated.
[3] Represents corrected figures.
[4] Includes statewide programs.
[5] Includes data for Long Beach.

Senator JAVITS. I might say, Mr. Secretary, as you know, my burning interest is—I think one of the reasons we avoided so far the dire eventualities in my city, New York, that were compounded in other major cities like Detroit, is the fact that our mayor was ready with a summer program when he got it funded, and gave a very considerable number of jobs. And I think it is critically important this year as it was last.

We have not yet come abreast of the basic problems of slums and ghettos adequately to dispense with this kind of emergency treatment. But, I will not press you further. I understand the limitations perfectly upon you as a Cabinet officer.

I have just one other line of questions I would like to ask you.

We are told that a number of programs must be undertaken to deal

with the present monetary crisis. One, tax surcharge, credit restraint by the Federal Reserve Board, various restrictions in investment, lending, travel, in order to correct our balance of international payments.

Now, two questions immediately arise there.

One, what unemployment are we to expect from—what addition to unemployment are we to expect from this program of retrenchment? We have a right to know what we have to pay for it—not only in dollars, in taxes, but also in the human terms—to wit, does the Department believe that if we go through with this program, there will be an inevitable increase in unemployment?

Secretary WIRTZ. No, sir; we do not.

We have discussed this some, earlier this morning. I would simply summarize the views expressed there. The chairman has advised me of Mr. Ackley's report to the committee, that a surtax could be identified with—the effect of a surtax could be identified with 300,000 unemployed.

My reaction to that is this. I do not argue with that—if that is what has been done. But I would have to rely, because I refuse to compromise with the idea of meeting inflation with unemployment—refuse to compromise with it one bit. My position would be that in other programs, in the training programs, programs of one kind or another, we can do what would be necessary to meet that impact.

I hope and I think we can.

Senator JAVITS. So that really it would be Government that would fill in to the employment diminution which would inevitably occur from credit and other restraints?

Secretary WIRTZ. I do not think it is that simple. How much we can accomplish, for example, with this jobs program, in which we rely upon a combination of Government resources and private resources, I do not know.

But I think perhaps quite significantly that can be done.

We indicated our willingness to pick up the full amount of the training costs in this kind of program.

I think, from my conversation with American businessmen, a good many of them are going to find enough self-interest, in terms of their customer power, of these individual employees and so on and so forth, to make some contribution, too.

But if the question is whether it depends upon an alternative expansion in which Government does have a part, the answer is "Yes."

Senator JAVITS. Mr. Chairman, I have one other question—because my time is up.

Mr. Secretary, the other corollary point which occurs immediately, when you discuss restraint of this kind, is, What about wages and prices? Are any controls contemplated—standby or otherwise—or is the administration satisfied to leave that as it is?

Secretary WIRTZ. The answer to the first part of the question is, "They are not contemplated." The answer to the second part is, "I think there is not satisfaction," and that that is reflected in the President's designation of a Cabinet committee to proceed with the representatives of labor and management, to try to find some further—some more effective form of an expression of not only the public interest, but of the principle of productivity.

Senator JAVITS. I thank the chairman.

Chairman PROXMIRE. Mr. Secretary, 25 minutes from now, the Senate will be called upon to vote on cloture on an open housing amendment. The President made his position emphatically clear. He hopes we will pass fair housing, or open housing.

I would like to ask you to address yourself to the effect such an open housing law would have on hard-core unemployment.

The principal statement you made this morning, which I thought was very excellent, was directed at this hard-core-unemployment problem. How important is this open-housing provision to the solution?

Secretary WIRTZ. My answer is, of course, unqualified. My only difficulty is in breaking it down.

If there are direct economic factors involved in terms of increased employment—one as against the other, I am not familiar with those. But my answer is not covered a bit by that. Because my point was, without meeting the kind of need that the open-housing provision meets, we will not be meeting the unemployment problem which we face. Or putting it affirmatively, the meeting of that problem is absolutely essential to what I define—to meeting what I define as the hard-core-unemployment problem.

Chairman PROXMIRE. Is there a clear convincing economic argument that jobs have moved to the suburbs much more rapidly than people? And many of the kind of jobs that the hard-core unemployed can fill are in the suburbs, that transportation is a seriously disqualifying problem for them?

Secretary WIRTZ. Yes, sir.

Senator PROXMIRE. I understand, in Washington, some women have to travel 4 hours a day on buses to get to and from their jobs. I am sure in many areas, many places people with jobs far away, many are too discouraged to commute these long distances, and to move, because they just cannot do it.

Secretary WIRTZ. On all of those points—I have no reservation. I meant to include all of those in my answer. And the meeting of those points is essential to meeting both the quantitative and qualitative unemployment problem that we have—more significantly, this qualitative point to which I was referring. My answer ought to be, I think, that that kind of legislation is absolutely essential to the meeting of the hard-core-unemployment problem.

Chairman PROXMIRE. Last year you gave us a very encouraging report on the benefit-cost ratio for manpower training programs. As I recall, I think you said that there was a payoff in saved social welfare costs in a period of a couple of years. In some of these programs, there was a payoff in terms of savings just from increased taxes paid by people who were not employed before, and now have jobs and are employed. This was in a matter of 4 years.

I know you are continuing to study it. Can you give us an updated picture of this?

Secretary WIRTZ. Yes. To whatever extent there has been any change, the savings factor has increased. I was interested in the fact—I noted last night, in the February 24 issue of the Saturday Review, there is a very interesting article on the urban crisis, by General Gavin and

Arthur Hadley. It is an interesting article. I must say that it combines imagination with—which I respect—with some arithmetic which I deplore.

But, on the point that you asked, they put a price tag of $4,000 a head, per year, on a person——

Chairman PROXMIRE. The payoff?

Secretary WIRTZ. The cost, if we do not train them, is $4,000 a head. Our figures on training them are going up now, incidentally, because we are moving further and further into the hard core. And our figure—I forget the figures I gave you last year—but we are talking now in a range—where a year ago we were talking in a range between $1,500 and $2,500, we are now talking in the range of between $1,500 and $3,500. And, if we were not, we would be wrong, because what this means is, we are moving on the hard core.

So, the cost, to whatever extent, what I gave you last year, has been refined—it points in the direction of larger costs per year if we do not do it, as illustrated by General Gavin's $4,000 a year, and if I had to pinpoint, taking all the programs into account, our costs when we do it, the salvation cost now is between $2,500 and $3,000 once, or the alternative is that you lose $4,000 a year the rest of their lives.

Chairman PROXMIRE. To the extent you can supplement this and break it down, and give us more information for the record, I wish you would. I anticipate that on this program, which asks an increase in appropriations, if Congress is called upon to spend more money, there may well be a serious fight in the Appropriations Committee on the floor. It would be very helpful to this committee to be able to make this kind of finding—because, obviously, if there is a rapid payoff from our spending more on manpower training, it is just bad from the standpoint of good banker-mentality arithmetic—it is bad not to fund this, and not to increase this, this is a superlative investment. It will pay back in a period of a very few years from increased revenues, and from reducing the deficit.

So, from the most conservative principles, it seems to me this is an expenditure which can be justified, and we would like to have the ammunition to do it.

Secretary WIRTZ. I would like to add to the record a careful statement of the fullest amount of the information we have.

(The information subsequently furnished for the record follows:)

REPLY TO QUESTIONS CONCERNING COST-EFFECTIVENESS STUDY OF MANPOWER TRAINING PROGRAMS AND ANTICIPATED INCREASE IN PER CAPITA TRAINING COSTS FOR SEVERELY DISADVANTAGED PERSONS

An unemployed individual with a family on welfare can cost the country roughly $4,000 a year—and that is the only dollar cost. The cost in human terms—a wasted natural resource—is far higher. The same human being, trained, given the opportunity for rewarding work, and decently housed, may in five years be earning more than twice this amount. Not only would the Government save $4,000 per year after a moderate initial investment in training and supportive services over a relatively brief period; it would then over a short span of years be directly and fully reimbursed through taxes collected from the individual. More importantly, the individual would contribute to society values that multiply his own pride and worth.

The Department of Labor is engaged in a cost-benefit analysis program in which preliminary studies indicate that approximately one-third of every Federal dollar invested in MDTA training is recouped within two years in savings from unemployment compensation, public assistance, and other Government expenditures.

This does not take into account the additional income accruing to the Government from taxes received as a result of the individual's productive employment. From an overall point of view the average net Federal benefit-cost ratio, defined as direct and indirect benefits to society (again exclusive of increased taxes paid) compared to the Federal investment per trainee, is 3.28 to 1 for on-the-job training, 1.78 to 1 for institutional training, in *one* year after training.

It must be recognized, however, that these results have been achieved with a relatively select, albeit disadvantaged, group of trainees, and with a substantial sharing of the OJT costs on the part of private industry. The best estimates we currently have available suggest that the employer dollar investment in training has been nearly triple that of the Government. Total estimated cost (Federal plus private) per individual completing OJT (including related instruction) exceeded $2,800 of which approximately $800 represented the Federal investment.

The training and job resources of the private sector are essential to the success of the manpower programs. If private industry is to share in the more difficult tasks now confronting us in aiding the most severely disadvantaged, a larger proportionate Federal investment is required. To ask industry to assume increased risks and expenditures concomitant with employment and training of severely disadvantaged persons in view of present employee productivity-profit ratios would be unreasonable.

That costs per trainee will increase as the severely disadvantaged are enrolled has been demonstrated many times. Research and experimental and demonstration programs under the Manpower Development and Training Act in many areas of the country, experience under the poverty programs, such as the Job Corps and Neighborhood Youth Corps, have reaffirmed the need of the most disadvantaged for extended and comprehensive training programs and related services if they are to succeed in breaking through the barriers to success whether self-imposed or resulting from a combination of social, educational, economic, and related factors.

As the Committee is aware, the Department of Labor is just now launching the President's JOBS Program which will enlist full industry support in hiring, training, and retaining in employment the hardest of the hard-core unemployed. Within the next few months, the Department expects to gain further insight into what industry considers to be a realistic estimate of the extra costs to an employer in endeavoring to restore these persons to employability.

Chairman PROXMIRE. One final point. Will you give us a breakdown of unemployment by city—you referred to it earlier; some of the members of the press here, I understand, have been asking for it; they do not have it. If you have it with you, it would be most helpful. We would like to have it. Do you have it duplicated?

Secretary WIRTZ. Yes; it is. I do not know about the matter of mechanics.

Chairman PROXMIRE. We will have our staff distribute it to the press.

Secretary WIRTZ. We will; yes.

Chairman PROXMIRE. Congressman Curtis?

Representative CURTIS. I want to second the remark just made, and say education has economic returns. Yet, our tax laws do not treat it as a capital investment; they treat it as current. And, in this business of so-called economy and establishing priorities, this would be of such high priority that we won't touch it. But I can identify the areas where, at least in my judgment, our expenditures could be cut effectively.

In September, the Monthly Labor Review said:

> Independently conducted surveys of the cost effectiveness of the War on Poverty Program show there is little to justify optimism about the value of educational expenditures in general in ameliorating poverty and its conditions. However, expenditures on vocational training are thought to constitute an exception to this rule.

Does the Department agree with this evaluation, and if so, what changes are being recommended in the poverty program?

Secretary WIRTZ. Where does the statement appear?

Representative CURTIS. In the September Monthly Labor Review.

Mr. ROSS. Mr. Curtis, am I correct in my recollection that this was from an article which was a kind of symposium of different views express by private individuals?

Representative CURTIS. That is true.

Secretary WIRTZ. The answer to your question is: I do not agree.

Representative CURTIS. Of course, I have felt that we did the proper thing in amending the Manpower Development Training Act to permit general education, as it were. But, that still had the discipline of tying it in with vocational training. You had to teach people to read and write in order for them to take vocational training. With the discipline of having a job in sight, the education was there. But, inasmuch as you do not agree, then——

Secretary WIRTZ. I agree with the second part, and would make the same statement about the first part.

Representative CURTIS. Another article in the Monthly Labor Review, September, said that the application of a minimum wage to agricultural work "will only speed the process of labor displacement."

Do you believe that the agricultural minimum wage will speed the movement of workers from farms to cities, and is this an objective of the Department of Labor?

Mr. ROSS. Mr Curtis, I would like to say again—is it not correct, this is not an expression by the Monthly Labor Review? Was this not merely reporting on an economics meeting, in which a private individual made that statement?

Representative CURTIS. I am sure this is so. There are all sorts of statements in the Monthly Labor Review, just as there are in the Congressional Record. I simply am identifying where the statement was made. I think your Labor Review does very well in presenting all sorts of views.

No; this is only identifying the source—

Chairman PROXMIRE. If the Congressman would yield. I appreciate his sentiment. But, I must say, I got the impression, since it came from the Monthly Labor Review, it might very well have been an official statement by the Department.

Representative CURTIS. No. Actually it is the third question—in September.

Secretary WIRTZ. Our view of that, set out in the report filed with the Congress, the so-called section 4(d) report, filed last month—our view is contrary on that point, and is to the effect that the minimum wage law does not result in a reduction in employment.

Representative CURTIS. Let me clarify something. The Monthly Labor Review is not a review which presents the official view point of the Department of Labor; is it? It is simply a series of articles. You might have a statement by the Secretary of Labor, and you might have other things by top officials. But, as I have read it for years—and I again give it a very high mark—it has all sorts of authors.

In fact, I once wrote a little bit for it.

Secretary WIRTZ. On your side or mine?

Representative CURTIS. I have forgotten what it was, even.

Mr. Ross. I think I would say this, Mr. Curtis: The bulk of the articles are written by our staff members, so that insofar as statements of fact are included, we would represent this to be the fact, and that the Department of Labor considers it to be a fact.

Now, occasionally we do have a report of the type that you quoted from, where a meeting of the American Economic Association or some other conference might be reported on. We would state it as a fact that Professor So-and-So has this judgment. But I think that is a little different from the implication that statements of fact made by our own staff members are correct.

Representative Curtis. Yes, Well, I am glad to have this clarified, because I was not reading that at all in that sense. That is the very reason I asked the question whether there was an agreement with that point of view.

Mr. Ross. Yes. If some article by one of our staff members made that statement, I would either think it was a bad article or else at least I would say I would take the responsibility for the veracity of it.

Representative Curtis. Yes. Well, I use this material all along. One final question, Mr. Secretary.

I asked, before, about activities of the Manpower Utilization Board, which has now been supplanted under the new draft law by a new board.

Are you a member of this new group?

Secretary Wirtz. No, sir.

Representative Curtis. How does the Labor Department get its viewpoints into the consideration of the manpower utilization vis-a-vis the draft?

Secretary Wirtz. We did on the the most recent occasion—simply addressed by memorandum that group with our views. You will know that under previous practice there had been the identification by the Department of Commerce, Department of Labor of a list of critical occupations and critical industries. That has now been, at our recommendation, stopped, because it was in my judgment a poor list. I am opposed to occupational deferments in general, with a few exceptions. And, furthermore, the local draft boards were making those decisions without regard to ——

Representative Curtis. The draft order says that from now on the local draft boards are going to make these decisions of occupational deferments. Now, how in the name of Heaven can the local draft boards have judgment over the overall manpower skills needed in the society? This is where we are. The Department of Labor then has no way of expressing judgment.

Secretary Wirtz. We have expressed a judgment by the position we have taken, and that is that, except as there may be particular factors, there should not be occupational or industrial deferments.

Representative Curtis. I think I would tend to agree with that. But that is not what the draft authorities have said. They have simply said, instead of anything being done in a central place, apparently these local boards had the power to give occupational deferments, on their judgment of what might be needed.

Secretary Wirtz. Put it this way, Mr. Curtis. To whatever extent there has been a change, it has been a change which will have a marked effect in reducing occupational deferments. Because there

have been deferments before on an almost automatic basis, because they were covered in these lists. Now we have stopped that. There would still be some of what you are talking about. I think there will be less.

Representative CURTIS. I think I would come to a different conclusion on the use of occupational deferments: that this was not an automatic thing that we can both look at and see.

Secretary WIRTZ. I just do not like them—period.

Representative CURTIS. I am so distressed about the failure to do a rational job on manpower utilization by the military, and the draft laws. It is hard to discuss it. What position did the Department take on the latest rule on draft deferment?

Secretary WIRTZ. It was the joint recommendation of the Secretary of Commerce, HEW, Labor—I do not know whether it has been formally released or not—it was in complete support of the action taken.

Representative CURTIS. There was a limitation of the health service field, as I recall.

Secretary WIRTZ. That is right.

Representative CURTIS. Is that because your study showed there was a shortage in this field?

Secretary WIRTZ. No; I am a little out of my jurisdiction on this.

The consideration, as far as doctors and dentists are concerned, is that almost all of them go in anyway.

Representative CURTIS. I was going to mention that. But I thought the coverage was the broad field. Here is the reason I am asking you as Secretary of Labor.

This does deal with, of course, manpower utilization. I think that is essentially Department of Labor. Of course, HEW has a very close affinity to this.

Secretary WIRTZ. We have advised, at these points, Mr. Curtis—at the point of the Marshall Committee, in testimony before several congressional committees, that from the—from our standpoint, the economy presents no needs which have to be served at the price of what I think of as unfair differentiation. There is no manpower consideration which enters into that balance.

Representative CURTIS. I think I share that. I only wish that we could develop a rational system, which I think we could.

Mr. Chairman, I would like to ask unanimous consent that at the point where I was asking the Secretary about the Employment Incentive Act, that the act itself be put in the record. It is not too long.

Chairman PROXMIRE. Without objection.

(See p. 576.)

I would like to ask just one question for the record, before we adjourn.

Mr. Ross, you would be most helpful in this respect.

I have asked witnesses who have appeared from the Council of Economic Advisers, the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve Board—to indicate what specific prices are going to be affected by the surtax. They never come up with an answer. I start off listing some of them—food, no. Automobiles, no, probably not. Steel—no.

They cannot find any.

And I think it would be very helpful for you, as the man in charge

of the Consumer Price Index, if you could give us some indication of the effect of the 10-percent surtax on prices. If you can do so, and show us any indication of when you think the effect might be over a period of a year or so. And could you also give us the assumptions that you make with regard to the impact of the surtax on income—the result that you conclude we could expect on the surtax.

Mr. Ross. I would be glad to do whatever I can on that, Senator.

Chairman PROXMIRE. I know it is a big order. Maybe it is an impossible request. But I think unless we get some specific analysis of the effect on particular prices, we are spinning our wheels—we just do not know what we are talking about.

Mr. Ross. Yes, sir.

(The following information was later supplied:)

The effect of the surtax upon personal income depends, of course, on the assumptions that are used in making this analysis. In general, it can be said that disposable personal income would be higher without a surtax than with one—by the amount of the surtax plus some multiplier effect.

However, since prices would be rising more rapidly in an economy not subject to increased taxes, the increase in real income without the proposed surtax is likely to be significantly smaller than the surtax. Moreover, if the realistic assumption is made that new monetary restraints would be necessary if the surtax is not enacted, these restraints could seriously reduce activity in the fields of housing and business investment, thereby cutting back (on an inequitable basis) some of the expected increase in personal income.

Without the proposed income tax surcharge, we would expect the 1968 price increase (GNP deflator) to be as much as half a percentage point greater than with it. This would place the rise close to 4 percent, compared with current projections of about 3¼ percent assuming passage of the tax. It is difficult to project beyond the end of this year, but it is quite possible that price increases in the neighborhood of 4 percent during 1968 would influence consumers' expectations and result in further rises subsequently. If that happens, the effects of not passing the tax surcharge would begin to show up clearly during the last half of this year, and probably would cause an acceleration of price increases early next year.

The prices that would advance the most if the surcharge were not passed are those for products that have high income elasticities. These comprise commodities and services for which the consumer has considerable discretionary power to spend or not spend. In this category it would seem applicable to place such items as home purchase, restaurant meals, new and used cars, recreational goods and services, some clothing items, furniture, appliances, and floor coverings. These goods constitute about 25 percent of the total weight of the consumer price index.

Chairman PROXMIRE. Thank you very much.

Thank you, Mr. Secretary, and Mr. Ross, for an excellent presentation. It has been a most enlightening morning.

Secretary WIRTZ. Could I, Mr. Chairman, add to the record, at this point, an expression of what I know is a regret, shared by the members of this committee and by myself, about Mr. Ross leaving the Government to go back to the university world, and to take this opportunity to express just a very deep gratitude for what he has brought in the last 2½ to 3 years to the kind of Government discussion which is illustrated here this morning, and which I think is so imperative to our being a Government instead of just a bunch of administrators. I am sorry to see him leave.

Chairman PROXMIRE. I am delighted that you brought that up, Mr. Secretary. I have the greatest admiration and respect for Mr. Ross. He has done a superlative job. He has certainly won the confidence of

the Congress and the country. We are going to miss him very, very much. We just wish he were going to stay on here.

The committee will supply additional questions to you which we trust you will respond to in sufficient time for incorporation into the record.

Secretary WIRTZ. We will be happy to do so, Mr. Chairman.

Chairman PROXMIRE. Thank you very much.

We will reconvene at 10 o'clock tomorrow morning, and 2 o'clock tomorrow afternoon, for our final session.

(Whereupon, at 1 p.m., the committee was recessed, to reconvene at 10 a.m., Wednesday, Feb. 21, 1968.)

(The material which follows was subsequently supplied for the record:)

PRICES, COSTS, AND INCOMES

Question 1. What proportions of the overall rise in the Consumer Price Index were accounted for by its major components? (This type of information for 1966 was supplied for last year's record, appearing on page 295.)

Answer: Information is supplied by the attached table.

PERCENT CHANGE AND CONTRIBUTION TO TOTAL CHANGE, SELECTED CONSUMER PRICE INDEX COMPONENTS, DECEMBER 1966 TO DECEMBER 1967

Component	Percent change	Percent of total
All items	3.1	100.0
Food	1.2	9.3
Food at home	.3	1.7
Food away from home	4.8	7.6
Housing	2.7	29.2
Shelter	3.0	20.6
Rent	2.0	3.5
Hotel and motel room rates	4.8	.6
Homeownership	3.4	16.5
Purchase, taxes, and insurance	3.6	10.0
Mortgage interest	1.5	1.5
Maintenance and repairs	4.6	4.9
Commodities	2.3	.7
Services	5.7	4.2
Fuel and utilities	.8	1.3
Fuel oil and coal	2.6	.6
Gas and electricity	.7	.6
Telephone, water, and sewer	.2	.1
Household furnishings and operation	2.8	7.2
Textile housefurnishings	2.0	.4
Furniture	3.3	1.6
Floor coverings	.4	.1
Appliances	1.0	.4
Other housefurnishings	2.4	.7
Housekeeping supplies	1.3	.6
Housekeeping services	6.3	3.5
Apparel and upkeep	4.0	14.2
Men's and boys'	3.7	3.6
Women's and girls'	5.1	6.8
Footwear	4.1	2.2
Other apparel	2.4	1.7
Commodities	2.0	.4
Services	2.5	1.3
Transportation	3.6	16.9
Private	3.7	15.2
New cars	2.7	2.2
Used cars	9.3	6.7
Gasoline and motor oil	1.5	1.7
Tires	4.5	1.1
Auto repairs	4.2	1.4
Other auto expense	2 3	2.2
Public	3.9	1.7
Health and recreation	4.6	30.0
Medical care	6.4	12.9
Drugs and prescriptions	-.2	-.1
Professional services	5.5	5.0
Hospital services and health insurance overhead	11.0	8.0
Personal care	3.1	2.8
Toilet goods	2.0	.9
Barber and beauty shops	4.2	1.8
Reading and recreation	3.2	6.3
Recreation goods	0	0
Recreational services	6.1	3.4
Reading and education	5.1	2.9
Other goods and services	4.7	8.0
Tobacco products	6.3	4.2
Alcoholic beverage	3.5	3.1
Personal expense	4.2	.7
Financing charges	3.0	.4
Commodities	2.5	54.3
Nondurables	2.3	36.8
Durables	2.9	17.5
Services	3.9	45.7
Commodities less food	3.2	45.0
Nondurables less food	3.4	27.5
Apparel commodities	4.2	13.0
Apparel less footwear	4.3	10.8
Nondurables less food and apparel	2.8	14.5
New cars	2.7	2.2
Used cars	9.3	6.7
Household durables	1.4	2.4
Housefurnishings	2.1	3.1
Services less rent	4.3	42.2
Household services less rent	3.4	15.8
Transportation services	3.1	5.3
Medical care services	7.9	13.0
Other services	4.2	8.2

Source: U.S. Department of Labor, Bureau of Labor Statistics, Office of Prices and Living Conditions.

Question 2. The Council compared consumer price increases in major OECD countries. Are data available for a comparison of wholesale prices and prices of commodities important in international trade?

Answer: Data comparing wholesale price indexes of the United States and other major industrial nations are given in the attached table.

Most countries use foreign trade statistics to construct average value indexes of imports and exports which are used as deflators for the foreign trade sector of the national accounts. Indexes based on trade values do not ordinarily constitute reliable indicators of commodity price changes for use in balance-of-payments analysis, however, because the value categories are sometimes broad enough to include a large number of heterogeneous commodities. In the case of manufactured commodities especially, changes in unit value indexes often result from shifts in product mix rather than from changes in commodity prices.

Accordingly, the Bureau of Labor Statistics is developing a new program designed to obtain prices suitable for comparing price trends and, in some cases, price levels for important durable manufactured commodities sold by the United States and other major trading nations. Conceptual research for the program has been accomplished, plans for price collection have been developed and cooperative arrangements for the international exchange of information within the OECD framework have been discussed with other major exporting countries. Funds have been requested of the Congress to initiate the necessary comprehensive price collection program.

WHOLESALE PRICE INDEXES IN THE UNITED STATES AND OTHER MAJOR INDUSTRIAL COUNTRIES, 1955-67

[1960=100]

Period	United States [1]	Canada	France [2]	Germany [3]	Netherlands	United Kingdom [4]	Japan [5]
1955	91.4	92.7	77.9	91.1	99	89.0	(6)
1956	95.0	95.6	80.8	93.7	99	93.1	(6)
1957	97.9	98.2	84.7	96.7	101	96.6	(6)
1958	99.0	98.4	90.3	98.6	100	97.8	(6)
1959	99.8	99.8	96.4	98.5	100	98.5	(6)
1960	100.0	100.0	100.0	100.0	100	100.0	100.0
1961	99.6	101.0	103.0	103.1	100	102.7	(6)
1962	99.7	102.8	104.1	107.2	101	104.0	(6)
1963	99.5	105.0	107.2	108.1	103	104.7	102.9
1964	100.0	105.9	109.8	110.2	109	107.5	102.7
1965	101.7	107.9	110.4	113.5	112	111.6	105.2
1966	104.5	111.1	113.6	116.4	117	114.7	107.9
I	103.7	110.0	112.5	114.9	117	113.2	107.4
II	104.3	110.8	114.5	116.7	117	114.7	107.5
III	105.1	111.7	113.7	117.2	118	115.3	107.8
IV	105.0	111.6	113.5	116.6	119	115.1	108.7
1967	105.5						
I	105.2	112.2	113.2	116.6	119	115.2	108.9
II	105.2	112.8	112.0	116.3	118	115.2	109.0
III	105.7	113.4	112.6	115.9	119	116.1	109.8
IV	106.1						

[1] Total manufactures excluding farm products and other raw or slightly processed goods.
[2] Intermediate goods excluding food and fuel.
[3] Investment goods.
[4] Manufactured goods, excluding food.
[5] Manufactured goods, total; component indexes are available for years prior to 1963.
[6] Not available.

Sources: U.S. Bureau of Labor Statistics and Organization for Economic Cooperation and Development, Main Economic Indicators, various issues.

Question 3. What are the possibilities that the exceptionally low increase in productivity in 1967 will be followed by exceptionally rapid advances in 1968?

Answer: We expect a more rapid increase in productivity in 1968, reflecting the anticipated acceleration in the growth of real output, and the concomitant more efficient utilization of manpower resources in the production process.

If output grows at approximately a 4 percent annual rate, we would expect productivity in the private economy to advance by about 2½ to 3 percent. The better balance between production and unemployment should pave the way for a gradual return to the 1947-67 trend rate of productivity growth of 3.2 percent.

Question 4. What factors accounted for the plateau of real compensation and spendable earnings of production and nonsupervisory workers? How importat

were such factors as changes in the industry mix, changes in sex or skill mix, consumer price changes, and social security tax?

Answer: The plateau of real compensation and spendable earnings of production and nonsupervisory workers was due to a combination of factors which offset the rise in hourly earnings.

The most important factor was the 3.1 percent rise in the CPI between December 1966 and December 1967. Next most important was a decline of about half an hour (1 percent) in the number of hours worked.

Two other factors affected spendable earnings. (1) As earnings rise the percent withheld for income taxes rises and, hence spendable earnings rise less rapidly than gross earnings. (2) Social security withholding taxes were increased 0.2 percent effective in January 1967.

Shifts of employment among industries were not a factor in the leveling off.

The effect of these factors on the various series was as follows:

Gross hourly earnings rose 5.0 percent between December 1966 and December 1967. The decline in hours reduced this to a 3.9 percent rise in *gross weekly earnings*. The rise in social security taxes and in income taxes with the advance in earnings cut the gain in *gross spendable earnings* to 3.3 percent.

The rise in the CPI cut the gain in *real gross weekly earnings* to 0.8 percent and the gain in *real spendable weekly earnings* (i.e., for a worker with three dependents after Federal taxes) to 0.2 percent.

MANPOWER POLICIES AND PROGRAMS

Question 1. How does the level of the unemployment rate in the United States during the past two years compare to the rates in other advanced industrial nations of the free world—after adjustment for differences in concepts and methodologies?

Answer: The table below shows unemployment rates of eight industrial countries, adjusted to U.S. concepts. With the exception of Great Britain, all of the adjusted rates are based primarily on data derived from labor force surveys similar to the United States monthly labor force survey. The adjusted rates for Great Britain, which has not conducted a labor force survey, are based on a comprehensive 1962 comparative study of British and the United States unemployment rates.

Although the data have been adjusted for all known major definitional differences, it should be recognized that it has been possible to achieve only approximate comparability among countries. Nevertheless, the adjusted figures provide a better basis for international comparisons than the usually published figures which are based on labor force and unemployment definitions that differ from country to country and dissimilar methods of computing unemployment rates.

With the exception of the United States and Canada, most 1966 and 1967 figures and 1965 figures for Germany and France are preliminary estimates because all of the data necessary for the adjustment purposes are not yet available.

UNEMPLOYMENT RATES OF EIGHT INDUSTRIAL COUNTRIES ADJUSTED TO U.S. CONCEPTS, 1965–67

	Percent unemployed		
	1965	1966	1967
United States	4.5	3.8	3.8
Canada	3.9	3.6	4.1
France	2.3	2.4	3.2
Germany (Federal Republic)	.3	.3	.9
Great Britain	2.1	2.3	3.3
Italy	4.0	4.2	3.7
Japan	1.0	1.1	1.1
Sweden	1.2	1.6	2.2

Source: U.S. Department of Labor, Bureau of Labor Statistics, Office of Foreign Labor and Trade.

Question 2. We used to hear the theory expressed that if only the unemployment rate could be held below 4 percent for a few years, the inflationary pressures would diminish as employers adjusted their recruitment and training practices and workers were trained, migrated, and searched more efficiently for jobs.

Do we have much concrete evidence to indicate whether and to what extent this may be correct?

Answer: In late 1965, the unemployment rate began to fall sharply, giving rise to fears that a general labor shortage and its resulting inflationary pressures were imminent. Through the first half of 1966 the Nation's job market was very tight, with manpower shortages appearing in some areas, occupations, and industries. In the summer of 1966 the tight situation stabilized, and by the fall it had eased considerably.

Although the easing in part reflected a more moderate growth of the economy, it also resulted from improved employer practices of various kinds as well as an expanded government training effort. Additional training programs were established and existing ones expanded, jobs were redesigned, new methods of recruiting were instituted, and in many cases unnecessarily high hiring specifications—age, sex, race, education, and experience—were relaxed. Combined, these actions served to ease the Nation's manpower stringencies.

Information regarding these developments comes to the Labor Department through a variety of methods. In general, the evidence has been fairly clear and unambiguous where employer training and recruitment practices are concerned. The Bureau of Employment Security and the affiliated State Employment Services are closely in touch with employers' manpower needs and hiring practices The Department's various manpower training programs involve special efforts to meet existing or incipient shortage situations. In addition, the information from the continuing reports on employment, turnover, and job placements confirm the easing of the employment situation since 1966.

Question 3. Where are the labor shortages in the economy and to what extent are they general? Has there been any progress within the last year in the measurement of different dimensions of labor shortages—for example, in the detailed measurement of job vacancies?

Answer: In early 1968 the manpower situation appears to be much the same as it was during the last half of 1967, a time when the job market had loosened from the tight situation of late 1965 and early 1966. Occupational stringencies are being partially offset by increased numbers of available applicants. Demand for production workers in particular is well below 1966 levels, although unmet needs for professional and technical workers remain relatively high. Among the occupations most in demand are engineers, electronics technicians, registered and licensed practical nurses and social workers.

The easing of the job market has been geographically widespread. The number of areas classified by the Bureau of Employment Security as having low unemployment—one indicator of the geographic impact of labor shortages—has fallen from 66 in December 1966 to 51 at the end of 1967.

There has been only limited progress within the past year in improving the measurement of labor shortages. No comprehensive statistical program to measure job vacancies is currently in effect. Funds for such a program were twice recommended to the Congress in recent years, but the appropriations request was not approved. In light of the continuing need for information on job opportunities, the Department has been working to develop a limited program within its current resources. It may prove possible in the next few months to initiate a program to measure more completely the availability of current job opportunities. Such a program would provide some important insights into job vacancies and labor shortages.

Question 4. How advanced is the clearance system for matching job openings with available workers? How long will it be before Project LINCS, or the application of automatic data processing systems to placement operations, becomes operational on a broad scale?

Answer: (*a*) The present clearance system requires a local employment office to distribute employer orders and applicant qualifications by mail through State headquarters clearance section channels to other local offices throughout the country. Except for the LINCS experiment all matching of job requirements and applicant qualifications is done by manual search.

An *interim* clearance procedure designed to improve the present manual search system, pending nationwide adaptation of an ADP system, is about to be released to the field. It will permit local offices to deal with each other directly regardless of State lines, and eliminates the practice of referring applicants to the order-holding office for rescreening.

The interim procedures also require offices within large metropolitan urban areas to share orders by telephone or other electronic means of communication if available. This revision will eliminate the paper shuffling between offices in the same job market area and will result in a saving of staff and applicant time.

(*b*) Project LINCS, the experimental use of computers to match applicant characteristics with individual job requirements, is now installed in professional placement offices in Sacramento, San Francisco, and Los Angeles. Since July 1966, this experiment has been an integral part of a much more comprehensive, contractor-assisted effort to develop model data systems meeting management, operations, and research information requirements throughout the Federal-State employment security community.

The first phase of this study was completed in May 1967 when systems concepts were approved. The second phase, development and implementation of prototype systems, is now underway. This will be followed by a third and final phase involving evaluation of these systems and their implementation nationwide.

Current major undertakings include the development and subsequent implementation of: (1) compatible automated data systems in each of three model State agencies; (2) a model Area Manpower Data System to support human resources development and manpower training operations in the tri-State New York City metropolitan area; (3) modifications of the experimental California LINCS system; and (4) the Wisconsin agency's tests of worker-trait profiles as screening devices in computer-assisted placement.

The Project LINCS and Wisconsin efforts are tests of file indexing, computer-oriented screening techniques, and other methodologies designed to meet discrete systems requirements in the area of bringing worker and job together. Results of these experiments will have significant impact upon model systems design and on computer-screening approaches to be introduced nationally.

Integration of existing computer applications in the model States will begin in September 1968. Implementation of the tri-State New York area Manpower Data System will begin the following month. An interim automated Federal reporting system will be implemented by January 1, 1969 to ease the considerable reporting burden of State employment security agencies. The three model State Systems are expected to become fully operational during 1970. Following their evaluation and the preparation of an orderly plan for nationwide implementation, exportation of these model systems or selected subsystems thereof to other States will begin within a reasonable period. Uncertainties with regard to financial resource availability and other variables such as equipment procurement cycles preclude precise assessment as to when these system will be operational throughout the States.

Question 5. With the post-World War II "baby boom" coming into the labor force, how rapidly will the labor force expand this year and the next few years? How rapid must be economic growth to absorb the growth in the labor force over the next few years?

Answer: Based on increasing population and trends in labor force activity, the anticipated increase in the labor force over the next few years is as follows:

	Anticipated net growth (in millions)	Percent increase over the previous year
1967–68	1.4	1.7
1968–69	1.4	1.7
1969–70	1.4	1.7
1970–71	1.5	1.7
1971–72	1.5	1.7

Assuming no change in average hours of work, the rate of economic growth necessary to absorb the increase in the labor force would be 1.7 percent plus the gains in productivity.

Question 6. How much information do we have on the migratory characteristics of ghetto dwellers For example, how many are displaced from agriculture?

Answer: Little information is available about the former occupation of ghetto dwellers who are migrants to the city. We know that about half of large-city

Negro residents were not born there, although most have lived in the city more than 5 years.[1]

Negro ghetto dwellers in the North originate chiefly from the South. The Southern distribution of Negroes by occupation for earlier decades suggests that Negro adults presently living in large cities were not overwhelmingly in agriculture.

In 1950, about one-fifth (23 percent) of Negro workers in the South were nonfarm laborers and about one-fifth were farmers or farm managers (19 percent). Almost one-fifth (18 percent) were production workers (operatives or kindred) and 6 percent were craftsmen. Only 15 percent were farm laborers; 10 percent were service workers. From 1950 to 1960 the proportion of Negro farm managers and operators declined by more than half, and the ratio of farm laborers by only a little. The number working in industry in the South rose appreciably.[2]

Most studies of Negro migrants to cities conclude that although those migrating are lower in status than their counterparts already in the city, they are drawn from a segment that is higher in status than the general population in the place of origin.[3]

A study of *Hard-Core Unemployment and Poverty in Los Angeles*, issued by the U.S. Department of Commerce in 1965 and prepared by staff of the Institute of Industrial Relations of the University of California at Los Angeles, provides information about unemployed migrants' last job before moving to California. About 15 percent of the Negro and Mexican-American men and women had been in agriculture before migrating. More than one-third had been in semiskilled work. One-third had been in unskilled jobs outside of agriculture. The remainder had been in service work (12 percent) or skilled occupations (7 percent).

One may therefore conclude tentatively that given the distribution and change in the occupational structure among Negroes in the South, and the characteristics of migrants, a substantial number of the migrants to cities had nonfarm occupations.

A few special sample surveys have recently been made from which data may be derived later. The Federal Government's 1967 Survey of Economic Opportunity will show the origin and occupation of persons living in poverty areas, but the tabulations are not yet run.

A study of households in Detroit following last summer's riots was made under the direction of Professor Ferman of the Institute of Labor and Industrial Relations at Ann Arbor. Questions about origin and previous occupations were asked and data might be obtained from this source. The study results have not yet been released.

A sample study now under way in Cleveland will provide data on the origin and characteristics of white and nonwhite migrants. This survey is being made by the Bureau of Social Science Research, Inc., located in Washington, D.C. Results will be available within the next several months.

Question 7. Given appropriate monetary and fiscal policies, what percentage of the labor force would be—

(*a*) frictionally unemployed,

(*b*) structurally unemployed but retrainable for employment in private industry,

(*c*) structurally unemployed, retrainable, and capable of holding useful, but subsidized or government-provided employment,

(*d*) employed full-time but earning less than $3,000 a year?

Answer: There can be no precise indication of the percentage of the labor force that could be termed frictionally or structurally unemployed given appropriate monetary and fiscal policies. However, there have been some estimates that frictional unemployment—an irreducible minimum of unemployment covering normal labor turnover and seasonal fluctuations—might be reached in the range of 2 to 2.5 percent overall unemployment. Under present conditions of unemployment hovering around 3¾ percent, the balance of about 1½ percent might be termed structurally unemployed.

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[1] Concluded from data on the mobility status of populations in lower-income neighborhoods of Cleveland and Los Angeles, 1960–65, and from annual reports on mobility of the population, by color. (See Census Bureau studies P–20, No. 156 and Series P–23, No. 18 and 21.)

[2] Table II–B–4 in *The Negroes in the United States*, BLS Bulletin No. 1511.

[3] See Karl and Alma Taeubers' study *Negroes in Cities*, Chicago, Aldine Publishing Company, 1965. (Chapter 6.)

In addition to those included in the unemployment count, there are many others who are either underemployed (working part-time although available for full-time work, or working below their abilities), or who have not counted as being in the labor force because they have ceased looking for work. Many of these individuals find themselves disadvantaged in the same way as the structurally unemployed.

As regards the structurally unemployed but retrainable—whether for industry or for government—there are few practical limits. Nearly everyone is trainable or retrainable.

Data are available indicating the number of full-time workers who earn less than $3,000 a year. In 1966, there were 6.5 million persons (8.6 percent of the labor force) who worked at full-time jobs and had incomes of $3,000 a year or less. Some of these were unattached individuals or members of a family with other bread-winners, so not all could be characterized as "poor." It can be anticipated that with the appropriate manpower development programs, monetary and fiscal policies would provide an economic climate in which every full-time worker could be earning more than poverty level wages.

THE 1968 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 21, 1968

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

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

Present: Senators Proxmire, Javits, Jordon, and Miller; and Representatives Bolling, Reuss, Moorhead, and Brock.

Also present: William H. Moore, senior economist.

Chairman PROXMIRE. The committee will come to order.

We expect other members to be along shortly.

We are honored this morning to have three of the Nation's most eminent economists. All of you are highly reputable. You are well-known to the Congress and to the country for your ability—representing one of the Nation's outstanding banks, and one of the Nation's outstanding firms in the area of forecasting and economic advice in general, and, of course, one of the great universities.

I suggest we begin with Mr. Olsen. I would also suggest, since there are three witnesses and there will be other members who will want to question in some detail, that if you gentlemen would want to abbreviate your statement at any point, try and make your comments in 15 minutes, if you could. We will insert the entire statement in the record as if read, and it will be available to all members of the committee.

We will start off with Mr. Olsen, and then Mr. O'Leary, and then Mr. Hart.

STATEMENT OF LEIF OLSEN, SENIOR VICE PRESIDENT AND ECONOMIST, THE FIRST NATIONAL CITY BANK, NEW YORK

Mr. OLSEN. Mr. Chairman, I would like to thank the committee for this opportunity to speak on the Economic Report of the President and the Annual Report of the Council of Economic Advisers. While I will touch on a number of aspects of these reports, my major thesis is that the Council's economic strategy continues to underestimate the ability of monetary policy to influence changes in economic activity. This has contributed to the higher rates of inflation and interest we have today.

It is my hope that my remarks on monetary policy will add to those of others who have testified in earlier years before this committee. I have in mind here particularly those submitted last year by John M. Culbertson, professor of economics at the University of Wisconsin, and by Beryl W. Sprinkel, vice president and economist, Harris Trust & Savings Bank, Chicago, Ill. Hopefully, this growing body of

90-191—68—pt. 2——18

testimony will help to encourage a more penetrating look into monetary factors by Congress and the Council of Economic Advisers.

As this committee knows from past testimony, economists differ sharply over the relative merits of using fiscal policy (i.e., changes in tax rates) or monetary policy in influencing business conditions. The Council of Economic Advisers has assigned primary importance to changes in tax rates and placed monetary policy in a subordinate role at best. Because our national economic policies are being influenced so one-sidedly by fiscal theory, the debate has sharpened in recent years.

The Council's economic strategy seeks to fulfill the goals of the Employment Act of 1946: "Maximum employment, production, and purchasing power." We now have full employment. To maximize purchasing power we must restrain the pace of expansion. Here the Council maintains that monetary policy can do this only by pushing interest rates to excessive levels, disruptive to housing and falling generally with an uneven impact on the economy. The Council prefers to seek economic stability through higher tax rates rather than higher interest rates.

I do not quarrel with the desirability of a tax increase at the present time, given the Vietnamese war and the helpfulness of bringing fiscal needs to the attention of every taxpayer. But, I do question the validity of the Council's fiscal-monetary strategy for economic stability. Monetary policy can smoothly slow the pace of economic expansion if properly executed. The great danger is that monetary policy may become a captive of fiscal policy, thus seriously hampering its execution.

If it is to be effective in stabilizing the economy, monetary policy must not be made dependent on the requirements of fiscal policy or Treasury borrowing. If it is, we will continue to experience what we have had over the past 2 years—wide swings in credit conditions, high interest rates and high rates of inflation.

The Council credits monetary policy with the ability to stimulate the economy but not by itself, only in conjunction with fiscal policy. As its report states: "Through nearly 5 years of economic expansion, monetary policy reinforced expansionary fiscal measures * * * it made a major contribution to the advance of the economy by accommodating growing credit demands at remarkably stable interest rates."

A view that harkens back to the thirties holds that at low interest rates banks will not lend and the public will not spend additional cash; thus Federal budget deficits are needed to stimulate spending and the demand for credit. Today, interest rates are high and monetary policy has demonstrated its ability alone to increase bank lending, money supply and public spending. But a significant increase in demands in the economy can be realized only by an increase in money supply, or a faster turnover of money.

Monetary Policy as an Instrument for Restraint

But the primary problem facing the country today is to restrain the economy. The Council notes in its report: "The ability of tight money to restrain the economy was clearly demonstrated in 1966, but so were its uneven impact and the troublesome side effects of a financial

squeeze." The events of 1966 have been used to discredit monetary policy as the primary instrument of restraint. But the 1966 credit squeeze was largely a matter of poor policy execution. Monetary policy not only should be used to restrain excessive demand but it must be used—tax increase or no tax increase—if we are to avoid still higher rates of inflation and still higher rates of interest.

Against the background of these two theoretical views, let us examine the experiences of 1966 and 1967. I know that much has already been said about the 1966 experience and I will be as brief as possible.

You must recall that during the second half of 1965 heavy defense orders were superimposed on a capital goods boom—a combination of events without precedent in recent economic history. This combination alone was sufficient to push the demand for credit sharply higher, but other stimulants to borrowing were introduced.

The 1964 program to speed up corporate income tax payments was accelerated further in early 1966. In addition, social security taxes were increased January 1 of that year. Corporations were also required, beginning in the second quarter, to speed up their payments to the Treasury of withholding and other taxes for which they act as collectors.

At the same time, monetary authorities began to move in late 1965 toward a less-expansive policy. Nevertheless, total bank reserves and money supply continued to grow at a relatively rapid rate in the first quarter of 1966. Beginning in the second quarter, Federal Reserve policy shifted abruptly toward a policy of severe restraint, which was, in retrospect, too sudden and too severe. Public statements made by monetary authorities made it clear that the Federal Reserve was trying hard to produce a sudden and sharp slowdown in commercial bank loans to business. However, considering the degree to which monetary expansion had just previously been stimulating growth of incomes, spending and credit demands, and considering the leadtime of corporate financial plans, it was unreasonable for monetary authorities to expect a prompt drop in bank loans to business.

Corporations had been hit, in a sense, by a temporary tax increase in the form of accelerated tax payments in the first half of 1966. This shows up in the marked increase in business borrowing over the tax payment dates in April and June of that year. (See table A.)

In effect, corporations were forced to borrow on behalf of the U.S. Treasury. The Federal Reserve did not accommodate this borrowing as it would have had the borrowing been done directly by the Treasury.

We had a situation in which American business was being asked by the Defense Department to tool up and staff for heavy defense needs at the same time that it was heavily committed to capital goods orders. It was also asked to help meet the Treasury Department's financing requirements. Yet the Federal Reserve aggressively sought, and expected, a prompt slowdown in business borrowing.

So hard did monetary policy squeeze in, trying to stop business borrowing, that it seemed to many to overlook the damage it was doing to the housing industry. It was, in my opinion, clearly a case of excessive restraint, of poor execution of monetary policy. Less obvious was the damage to the overall economy. Long historical experience demon-

TABLE A.—CHANGES IN BUSINESS LOANS AT WEEKLY REPORTING MEMBER BANKS OVER TAX DATE PERIODS

Period	Change
1964:	
March 11	−92
March 18	+630
Total	+538
April 15	+288
April 22	−237
Total	+51
June 10	−9
June 17	+651
Total	+642
September 9	−60
September 16	+771
Total	+711
December 9	−85
December 16	+754
Total	+669
1965:	
March 10	−180
March 17	+1,171
Total	+991
April 14	+85
April 21	+77
Total	+162
June 9	−12
June 16	+1,215
Total	+1,203
September 15	+926
September 22	+278
Total	+1,204
December 15	+991
December 22	+544
Total	+1,535
1966:	
March 9	−167
March 16	+1,309
Total	+1,142
April 13	+150
April 20	+158
Total	+308
June 15	+1,253
June 22	+641
Total	+1,894
September 14	+336
September 21	+762
Total	+1,098
December 14	+345
December 21	+745
Total	+1,090
1967:	
March 15	+1,110
March 22	+160
Total	+1,261
April 12	−102
April 19	+646
Total	+554
June 14	+905
June 21	+1,477
Total	+2,382
September 13	+47
September 20	+864
Total	+911
December 13	+11
December 20	+1,417
Total	+1,428

Source: Board of Governors, Federal Reserve System.

strates that persistent monetary restraint leads, sooner or later, to a business recession.

Once the tax payments were out of the way in June, business demands for credit did slow down. Beginning in August, in fact, commercial bank loans to business virtually stopped growing altogether, on a seasonally adjusted basis. The ultimate result of monetary restraint in 1966 was the minirecession of the first half of 1967. Indeed, the lag between cause and effect was unusually short in this period. A more patient monetary posture should have been undertaken, considering the kind of impetus behind business borrowing needs.

It is clear that severe credit restraint depressed housing in 1966. But we may be assigning too much of the blame to monetary policy if we fail to look at some of the earlier events. In 1962 and 1963, the Federal Home Loan Bank System expanded the flow of credit to the savings and loan industry.

This heavy, short-term indebtedness to the Federal Home Loan Bank System was carried forward into 1966 and limited the ability of the home loan banks to supply additional relief during that critical

year when such credit should have been available. The rollover of the excessive debt and new cash borrowings in a period of rising short-term rates added to the costs of savings and loan associations and restricted their ability to acquire mortgages. The liquidity breakdown is well explained in "A Study of Mortgage Credit" prepared last year at the request of the Subcommittee on Housing and Urban Affairs of the Senate Committee on Banking and Currency.

So the depressed housing market of 1966 had some legacies from earlier years which made the situation worse than it might otherwise have been. I offer this analysis because I believe that monetary policy, while at fault, may have been excessively condemned.

The implication that monetary policy succeeded in slowing down the pace of economic expansion only by causing a sharp decline in home-building and other areas of construction is an oversimplification. Monetary policy has a much more pervasive influence. The effects of a sharp slowdown or a cessation of the growth of money supply can be found in consumer spending and the demand for financial assets—stocks and bonds—as well as plant and equipment outlays. In any event, monetary policy has been generally credited with the moderation of the rate of economic expansion in the first half of 1967.

The Contrary Behavior of Interest Rates in 1967

Many economists have long held that monetary policy influences the economy primarily through interest rates. In other words, rising interest rates gradually deter economic growth and falling interest rates encourage it. It is generally believed that the Federal Reserve can readily control the level of interest rates by adjusting the supply of credit. In 1967—and not for the first time—these views were disproved. The Federal Reserve became increasingly expansive, yet interest rates rose higher and higher. Moreover, the rise in interest rates did not harm business conditions; instead economic expansion speeded up in the course of the year. One important lesson we should learn from this is that monetary authorities do not have as much control over interest rates as they once assumed.

Expectations of borrowers and lenders play an important role in changing the structure of interest rates. In the spring of 1967, even after the Federal Reserve reduced the discount rate from 4½ to 4 percent, long-term rates continued the rise that began in late February. In the course of the year some rates reached the highest levels since the Civil War.

The rising volume of new corporate issues in the first half of 1967 was not unusual. In recessions—and the first half of last year has been tagged a minirecession—corporate treasurers generally seek to strengthen their debt structures. However, in the past, long-term interest rates have continued to edge lower despite the enlarged volume of new capital issues.

I would suggest that the sudden, unusual acceleration in the volume of new capital issues in the second quarter of 1967 was not so much a legacy of 1966 as it was the expectation of extraordinarily large Government financing requirements in the second half of last year and in 1968.

The original budget figures released by the administration in Janu-

ary projected a fiscal 1968 deficit of only $4.3 billion on a cash budget basis. Consequently, in the early months of last year there was little awareness that the deficit in reality would be many times larger. The administration proposed enactment of the tax surcharge to become effective at midyear. However, by mid-March, word began to spread through the investment banking community that the Federal budget deficit was rapidly worsening and that Federal borrowing in the second half of the year would be staggering.

Corporate borrowers with long-term requirements were told to get in and get their money early before the Federal Government got to the market. This was a major factor in altering the expectations of both borrowers and lenders. Inflationary expectations were also enhanced by news of a worsening in the deficit. This, too, contributed to rising rates as lenders demanded higher yields to offset the effects of inflation on income.

The early assessment by the market of the Government's money needs proved accurate. Net issues of U.S. Government securities acquired by the public in the second half of 1967 totaled $19 billion, a sharp contrast with the $4 to $5 billion in the second half of the 2 preceding years. (See table B.)

TABLE B.—NET ISSUES OF U.S. GOVERNMENT SECURITIES, 1965–67

[Billions of dollars; not seasonally adjusted]

	1st half	2d half	Year
Total securities issued:[1]			
1965	–2.4	6.1	3.6
1966	–.7	7.0	6.3
1967	–8.3	21.0	12.7
Acquired by Federal Reserve:			
1965	2.0	1.7	3.7
1966	1.4	2.1	3.5
1967	2.4	2.4	4.8
Acquired by public:			
1965	–4.4	4.4	–.1
1966	–2.1	4.9	2.8
1967	–10.7	18.6	7.9
Commercial banks:			
1965	–6.8	4.4	–2.4
1966	–5.5	2.2	–3.4
1967	–1.6	10.2	8.7
Nonbank financial institutions:			
1965	–.2	–.7	–.8
1966	–.6	1.5	.9
1967	–2.9	3.1	.2
Nonfinancial corporations:			
1965	–2.7	.6	–2.1
1966	–1.4	.2	–1.2
1967	–3.9	1.1	–2.7
Households:			
1965	2.4	.6	3.0
1966	4.7	3.2	7.9
1967	–2.0	3.4	1.3
Foreign investors:			
1965	–.8	.7	–.1
1966	–1.5	–1.1	–2.6
1967	.8	.7	1.4

[1] Excludes securities acquired by Federal trust funds, etc. Includes Federal agency issues and participation certificates.

Sources: Federal Reserve Board, flow of funds data.

Monetary Policy Becomes a Captive of Fiscal Policy

The theoretical view that assigns little importance to monetary policy as a stimulant in the economy led to a great paradox in 1967.

During the year, administration economists were warning that impending inflationary pressures and overheating in the economy would require a tax increase. Nevertheless, monetary authorities pursued the most expansive policy since World War II without any word of caution from administration economists. It would certainly see that in the face of repeated warnings of an overheating in the economy monetary authorities would have followed a more cautious policy. The fact is, they did not.

While there are many considerations that go into the making of monetary policy, there is one I believe which deserves special attention. This is the extent to which the Federal Reserve seeks to create favorable market conditions for Treasury borrowing.

In the minutes of the Federal Open Market Committee meeting of July 18, 1967, we find the following:

> In the course of the committee's discussion, considerable concern was expressed about the recent high rates of growth of bank credit and the money supply, particularly in view of the prospects for more rapid economic expansion later in the year. It was generally agreed, however, that the Treasury's forthcoming financing militated against seeking a change in money market conditions at present. Moreover, even apart from the Treasury financing, most members felt that it would be premature to seek firmer money market conditions at a time when resumption of expansion in overall economic activity was in a fairly early stage; and some also referred in this connection to the growing expectations that the administration would press for measures of fiscal restraint. In addition, some members expressed concern about the possibility that any significant further increases in market interest rates might reduce the flows of funds into mortgages and slow the recovery under way in residential construction activity.

Here we see—at a time when administration economists were warning of impending inflationary pressures and at a time when inflationary expectations were strengthening—a move toward a less expansive policy was inhibited by the need to support growing Federal deficit financing. It comes up repeatedly in the 1967 minutes of the Open Market Committee. A possible shift in policy was also postponed by hopes for a tax increase that never came and by fear of rising long-term interest rates, which continued to rise despite the maintenance of a liberal credit policy.

I would like to emphasize that it is not unusual for the monetary authorities to maintain "an even keel" in the money markets during Treasury financing operations. However, in 1967, the original budget deficit figures proved unusually inaccurate and the ballooning requirements of the U.S. Treasury had the effect of promoting a more expansive monetary policy than might otherwise have been the case.

I might add that this committee in its Joint Economic Report last year urged the monetary authorities to adopt "the policy of moderate and relatively steady increases in the money supply, avoiding the disruptive effects of wide swings in the rate of increase or decrease." The general range suggested by the committee was 3 to 5 percent with the minority recommending 2 to 4 percent for 1967. It was further pointed out that: "Sudden changes in the money supply give rise to instabilities in the economy."

From January through August of last year, monetary authorities permitted money supply to grow at a 9-percent annual rate; if time deposits are included the annual rate of growth was 13.4 percent. That came on the heels of a decline of 1 percent and a rise of only 3.2 percent,

respectively, from April 1966 through January 1967. We went from one excess to another.

It is apparent that the Federal Reserve tried hard to keep interest rates from rising last year. It is ironic, however, that the resulting increase in money supply and incomes is leading to more inflation and consequently higher interest rates. Given the lag effect of monetary policy, we are now feeling, and will continue to feel, the inflationary effect of last year's large increase in money supply.

I am aware of the fact that a good deal of the increase in Federal financing last year was required because of expenditures related to the Vietnamese war. But there has also been a considerable debate about the necessity to reduce nondefense expenditures to ease the pressures on the money market. A tax increase as well as reduced expenditures would, of course, have been helpful in reducing growing inflationary pressures. But the tax action would only have made this contribution if the monetary authorities—faced with less Federal financing to support—had shifted more freely to a less-expansive credit policy.

The widespread opinion was that a tax increase would by itself dampen demands sufficiently so that monetary policy could become more expansive and thus reduce interest rates. But a tax increase merely shifts purchasing power from the public to the Federal Government. The consumer buys fewer cars but the Government has more revenue to build more highways.

I would like to mention here an oftrepeated fact that a Federal deficit is not inflationary if it is financed in the National's pool of savings in competition with other private borrowers. It does become inflationary, however, when it is financed by the central bank, as was the case last year. When we run a substantial deficit at the same time that the money supply increases rapidly, we have evidence of the inflationary financing of the Federal deficit.

The notion that interest rates can be reduced by simply making more and more money available is not supported by the evidence of 1967. Rates may decline for a short time but they soon begin rising. People are not interested in money as such but rather in what it will buy. Consequently, more money turns into more demand for goods and services. Excess demand means price inflation. Price inflation enlarges demands for credit.

If the monetary authorities seek to meet the surge in credit demand with no interest rates increase, it means an even more rapid growth in money and more inflation. Even then, lenders cannot be expected to ignore the effects of inflation on a fixed income return.

To induce lenders to lend on fixed income obligations, interest rates must rise to offset the effects of inflation. Monetary authorities do not have to accommodate the Treasury, and they do not always. But if the Government is forced to borrow in competition with others as it often does, interest rates will rise and they may rise a good deal if the Federal Reserve maintains a neutral position. But the increase may be short lived if inflationary pressures are curbed in the process.

A moderately restrictive monetary policy may cause rates to rise for a time, but by reducing money supply and demands generally, it leads to lower interest rates. It reduces inflation. There are plenty of examples in the world showing that high rates of inflation court high

rates of interest. I make this point because the Federal Reserve has often, and in my opinion erroneously, been charged with making interest rates too high through a tight money policy. If there was anything the tight money policy of 1966 achieved it was a marked lessening of inflationary pressures and finally a reduction in interest rates. They peaked out in September, more than a month before the official shift toward less restraint.

The Economy Ahead

In the last few months there has been evidence that the growth of money supply is beginning to slow down and that monetary authorities are pursuing a cautious policy of moderating the rate of monetary expansion. This contrasts sharply with the execution of policy in 1966. The current gradual application of the brakes is to be applauded.

If the monetary authorities continue this trend and avoid the excessive effects of "even keeling" Treasury financings, they will provide a major contribution toward easing inflationary pressures and ultimately lowering interest rates. A tax increase would make its major contribution in terms of reducing the need for "even keeling" operations on the part of the Federal Reserve.

In conclusion I would like to make these recommendations:

First: that the monetary authorities seek to avoid extreme swings in money supply growth as recommended by this committee in its 1967 Joint Economic Report. If excessive Treasury borrowings create pressures in the money market, pushing interest rates higher, then it is the fault of fiscal policy. This should serve as a red light. If the Federal Reserve tries to keep interest rates from rising by accommodating Treasury needs, then the authorities may be opting for inflation. You may differ with their choice of action, but, at least, we would know what they are doing.

Second: I would urge enactment of a tax increase. This action would help lesson inflationary expectations and would bring home to all taxpayers the problem of fiscal management.

Third: I would like to recommend that this committee sponsor a major study of monetary-fiscal policies, inviting papers from non-Government as well as Government economists. The search for better stabilization techniques should be encouraged.

Thank you.

Chairman Proxmire. Thank you, Mr. Olsen.

And now Mr. O'Leary.

STATEMENT OF JAMES J. O'LEARY, CHAIRMAN OF THE BOARD AND CHIEF ECONOMIST, LIONEL D. EDIE & CO., INC.

Mr. O'Leary. I think, in the interest of saving time, Mr. Chairman, that, as you suggested, I will try to summarize what I have to say, and not actually read the prepared text. I assume that the text will be printed in the record.

My statement is based on three tables which you will find at the end of my text. I might say what I am going to do is, first, outline to you my thinking about what the outlook for 1968 is on the basis of certain assumptions—the outlook for the economy as a whole in GNP terms.

Then I am going to try to translate what that means for financial markets. I noticed the other day that this committee asked some of the Federal Reserve people that question. I have tried in the second table to do that—to indicate what the implications are for financial markets, in my particular projection of the economy.

And then, I am going to discuss certain problems that I think the economy faces, and what policy actions I think are needed.

Let me start out by saying, first of all, that obviously, as we face the outlook for this year, there are tremendous uncertainties. There are uncertainties with respect to Vietnam, uncertainties with respect to the question of whether we will or will not have a tax increase. There are uncertainties with respect to whether we will have, this year, an international monetary crisis. There are uncertainties with respect to what the consumer will do—whether he will continue to save at such a high rate.

So, as you look to 1968, you have to make certain assumptions. And the assumptions that I have made are, first of all, that defense spending will be, roughly, in accord with what the budget calls for. I fully appreciate the fact that this may not actually be the case, but it is necessary to make some assumption, and my assumption is that the spending will be in accordance with the budget. I am also assuming there will not be—that the 10 percent surcharge will not be enacted.

I am assuming, further, that personal savings, rate of personal saving, will stay in 1968——

Chairman PROXMIRE. You are assuming that the 10 percent surtax will not be enacted, and, therefore, all these projections are based on that assumption?

Mr. O'LEARY. That is right. That the surcharge will not be enacted. I am assuming also that personal savings, the rate of personal savings, will stay about as high in 1968 as it did in 1967, when it averaged out around 7.1 percent. In other words, my assumption is that the same uncertainties that were influencing the consumer in 1967 will be in the picture today—that is uncertainty about Vietnam, uncertainty about price increases, uncertainty about a lot of things, whether there is going to be an international crisis—all of these elements of uncertainty—we are assuming they will continue to exist.

These are all very conservative assumptions in the sense that we shall probably have somewhat higher defense spending, and there is the distinct possibility the consumer might return to some of the old patterns of spending. So that I think our assumptions are reasonably conservative in terms of the outlook.

Now, I will tell you what the outlook is.

We are estimating that in 1968 gross national product will increase about 8 percent. In other words, we are estimating that in 1968, GNP will increase to about $850 billion. That is a $65 million increase. It is somewhat higher than the Council is assuming in its projection. I think they have a figure of around $846 billion or $847 billion.

Chairman PROXMIRE. It is a little lower if you recognize the Council assumes they will get the surtax, and they say that will make a difference in fiscal 1968 of $14 billion of GNP; for calendar 1968, $7 billion. So, you are a little bit lower than they are.

Mr. O'LEARY. Right.

Now, one of the main components—as you can see in that table, we are estimating that personal consumption expenditures will rise from $492 billion to $526 billion, up about 7 percent. We think this is a reasonable assumption. The big thing that is going to occur here is that personal income, assuming that the unemployment rate stays below 4 percent, and that you get some lengthening of the work week, will rise strongly, particularly in the first half of the year, when there will be an extra fillip to personal income through the increase in the minimum wage, and through increased social security benefits—something in the order of $5 billion in the first half of the year.

Even applying a 7 percent or better savings rate, you come out with this sort of picture on consumer expenditures.

I should say, generally, that we see the first half of the year much stronger than the second half. Our pattern of GNP would be as follows—for the entire GNP, a $19 billion increase in the first quarter, $19 billion increase in the second quarter, and then a dropping off to $14 billion and $13 billion in the third and fourth quarters.

That is the pattern.

Of course, our thinking is that in the first half we will get the added benefit of the building of steel inventories, and also the pickup in some of the purchases of automobiles lost last year during the strike, and also the additional benefit of the increased income that will flow in through the increase of the minimum wage and the additional social security benefit payments. So, we see the first half stronger that the second half.

That is the pattern.

I think the consumer expenditure figures are fairly conservative in their position—if you accept our flow of income figures. We do have the durables up 10 percent. We are anticipating there that the big factor will be an increase in automobile sales up to a little over 9 million cars in total, and that will account for a large part of the increased durable consumer expenditures.

We also are figuring that housing will be quite strong this year. Our forecast would assume starts, total starts, of 1.5 million, and we think that the higher level of starts is going to help the durable goods side of the sector somewhat.

In the Federal area, as I have indicated, in the defense spending part of this, we are roughly in accord with the budget. We are a little higher that the budget, because we think there will be some updrift in defense spending. We have seen some things happen already—the sending of 10,000 additional troops to Vietnam, and a few other things that are developing, such as the $100 million for South Korea—that suggest maybe a couple of billion dollars updrift in the defense spending area.

I do not think there is much question about the other expenditures—State and local—this has been a pattern developing, and also the other Federal spending is in line with the Budget.

In the fixed investment area, under nonresidential fixed, we have a 7-percent increase. Now, that is an area in which some economists would quarrel with us. Some forecasters feel that capital spending is not going to rise to that extent. The more standard forecast would be an increase of maybe 5 percent. We are one of the groups that do a survey of capital spending, and last September our survey results

showed a 5- to 6-percent increase, and we are now in the process of resurveying these same corporations and the returns now suggest that the 7-percent figure is probably going to be in the ball park.

We expect the rate of residential expenditures to rise in the first quarter of this year to $29 billion, and then to flatten out at about $30 billion in the remaining quarters. The pattern we have is a little stronger first half in housing starts than in the second half.

We expect a big increase in business inventories. This is probably the most difficult part of the whole GNP accounts to forecast. We could be wrong on this. The rate in the fourth quarter was $9 billion—this is total inventories—and our thought is it will rise to something like $11 billion in the first quarter of this year, something like $14 billion in the second quarter, and then go off to $10 billion and $9 billion in the second half of the year. That will be the pattern in the inventory field.

Now, if you will turn to the next table, what we had tried there is to put in for 1968 some of the figures on the financial flows that we think will be consistent with our GNP forecast.

I am not going to comment on all these figures. According to our estimates, the total uses of funds will rise to $86½ billion this year, versus $80.2 billion in 1967. And, you may want to ask some questions later on the table. I am not going to take the time to run through all of it. But I think there are parts of it that are of particular interest to you.

You notice under corporate bonds that the aggregate net increase in corporate bonds in 1967 was $15 billion. We are estimating the figure for 1968 to be $11 billion. This is a pretty significant figure.

Our feeling is that in 1968, for some of the reasons that were already mentioned by Mr. Olsen, there will be a lesser volume of net issues by corporations. For one thing, I think, last year they stockpiled some money. I also feel that expectations on the part of corporate borrowers are changing this year. Their general expectation is that perhaps in the second half of the year they will be able to get lower rates. I think there will be more corporate financing through the banking system this year. Corporations will tend to turn more to the commercial banks for financing, and wait for bond yields to come down. Last year the expectations were that rates were going through the roof, and they all rushed in to sell bond issues. I think there will be some lesser pressure in the corporate bond areas this year.

However, you will notice that we put one- to four-family mortgages up to $13½ billion, and we have put multifamily and commercial mortgages up to $10½ billion versus $8.2 billion. I think that to the extent that corporate demand for funds is less, institutions will turn to the mortgage market to a greater extent.

Now, shifting to the lower part, to sources of funds, you will notice that in the case of the mutual savings banks, we have an estimate of $4.7 billion in there for 1968 versus $5.2 billion in 1967, and for the savings and loan associations, $8½ billion versus $11 billion. This is a reflection of our feeling that, as the year goes on, there will continue to be a slowing down in the flow of funds into these institutions, so that the net new money that they get this year will be less.

Now, you might say how does that tie in with the stepup in the net increase in home mortgages and other mortgages, and our reason-

ing there is that last year these savings institutions tended to rebuild their liquidity. We are also assuming, let us say, that the Federal home loan banks, which are in much more liquid positions, will increase sharply their advances this year to the savings and loans, and that will give them additional money. The figure of $13.5 billion on home mortgages also assumes a substantial volume of FNMA purchases. So, I do not think it is inconsistent, but it shows some important shifts in this market.

We think there can be that amount of home mortgage money made available.

Another very important figure is—under "Commercial banks," we have reduced net available funds from commercial banks to $30 billion. Now, here is where I think the rub may be in this situation. This may not be large enough to accommodate total uses. I suspect we are probably low in terms of our figure on U.S. Government up at the top. We have a $14 billion figure. Other people who make these estimates indicate it may run as high as $16 or $17 billion. Where I think the rub is going to come from is in whether the Federal Reserve will permit the commercial banks to expand their loans and investments to the extent needed to accommodate the uses we foresee. There are some people who feel that, in order for this to balance out, the Fed will have to permit the banking system to expand their loans and investments somewhere in the order of $37 billion or $37.5 billion.

So Federal Reserve policy becomes a very important ingredient in this picture of whether these uses are to be accommodated.

Now, let me turn, then, to the problems underlying our forecast.

First, we are assuming that wage compensation will continue to increase at say 6 to 6½ percent, and that the consumer price index will continue to rise at something like a 4-percent annual rate, which is the current rate.

Now, if that is true, it touches off other problems. One of them is that foreigners are going to be looking at the United States in terms of an economy that is expanding strongly, at least over the next several months, with prices moving up and costs moving up rather sharply. And, it is the sort of thing, I think, that will lead to a decline in the confidence on the part of foreigners and foreign central banks in the ability of the United States to discipline itself. And, I think that this forecast that I have made of the economy here, involving some escalation in prices, probably, is not going to be healthy from the point of view of preserving our whole international monetary system, and it has implicit in it, in the next 4 or 5 months, some rather rough going for the U.S. dollar in terms of the possibility of gold outflows.

Then another aspect of this is that, assuming that prices are moving up, and assuming that there is a good deal of uncertainty abroad about the dollar, there is a danger that the Federal Reserve will be pushed, in my opinion, to go too far in terms of credit restraint.

If you look at what the Federal Reserve has been doing, one of the main impacts of its policies so far has been to slow down the flow of time deposits into the banks. There is a third table which I do not want to take the time to run through. But the rate of net increases in time deposits in the commercial banks, including CD's, and all the different

types of time money has slowed down quite considerably already, and the same thing has happened to the savings institutions.

The danger is that, if the Fed becomes nervous about the international confidence in the dollar, they may step on these credit brakes a little too hard at this time.

Therefore, this points to me the need for some fiscal restraint in this picture.

The other thing that is troublesome to me is that, with the sort of projection we are making, I cannot see long-term interest rates coming down very much, in spite of some reduction in corporate bond offerings. It seems to me that as long as a substantial increase in prices is occurring, as Leif Olsen pointed out, you get an inflation premium on interest rates. People do not want to buy fixed-income obligations with the price level moving up the way it is. And this, to me, is a serious imbalance in the economy, because what happened is that the level of short- and long-term rates is so high that the minute the Fed moves in to tighten credit, it touches off the whole process of disintermediation—the flow of funds out of the savings institutions. And the Fed's hands are relatively tied in terms of its ability to use credit restraint. This is why the Federal Reserve has been asking for a tax increase. I think they feel they are boxed in and cannot do very much in this situation, and about the only way to stop this inflationary process is to get fiscal restraint in the picture.

There is a very serious need to do something to stop this inflationary process, the rising prices. I feel very strongly that the most important need here is to obtain fiscal restraint. And I would like to see it come through Federal expenditure cuts. This would be the better way to do it. But, I doubt that sufficient cuts can be effectuated.

The problem is that we face, over the next several months, a rather critical situation, both domestically and internationally. I am forced to the view that we need the 10 percent personal and corporate income tax surcharge to do the job. Beyond that, I think we need monetary restraint. But I think it has to be done in tandem with fiscal restraint. Otherwise monetary restraint could be used too strongly, and we could create a very serious problem in this situation.

I am not predicting it is going to happen.

The other thing I would say is that it seems to me it would be a good idea to remove the gold cover and free up all our gold.

I will stop at that point. I am afraid I took more than 15 minutes.

(The prepared statement of Mr. O'Leary follows:)

PREPARED STATEMENT OF JAMES J. O'LEARY

There has never been another time in my experience in which greater uncertainties faced the business forecaster. The biggest of these is the uncertainty about the course of events in the Far East and the trend of defense spending. But there are other difficult questions. Will Congress increase personal and corporate income taxes—and how soon and by how much? Will inflationary pressures force the adoption of direct Government controls over wages and prices? Will individuals continue their high rate of saving, or will they begin to spend more freely? Will an international monetary crisis be precipitated by weakening confidence in the U.S. dollar? These questions by no means exhaust the list.

It is hard to recall any other point of time in which the economic, political, and social problems facing our country and the world as a whole have been more difficult and critical.

THE PROSPECTS FOR GENERAL BUSINESS ACTIVITY AND THE FINANCIAL MARKETS

My forecast of general business activity in 1968 is outlined in the table "Estimated Comparison of Selected Economic Indicators" attached to my statement. I expect a very strong expansion of business this year, particularly in the first half. This forecast makes three very important assumptions: (1) that Federal defense expenditures will be in accord with the budget—a very conservative assumption in view of developments in the Far East; (2) that Congress will not enact a personal and corporate tax increase; and (3) that the rate of personal savings will remain at about the same level as in 1967.

Without an increase in taxes, the Federal deficit on a national income accounts basis will run as high as last year—in the $12–14 billion range. It will thus be a powerful force for economic expansion. In addition, although I expect that monetary policy will continue to move toward less credit ease, I believe that the authorities will nonetheless permit a very large increase in commercial bank loans and investments this year.

As shown in the table, we expect that GNP will expand from $785 billion in 1967 to about $850 billion this year, an increase of $65 billion, or about 8.3 percent. A little less than 5 percent of this will be *real* and about 3.5 percent will be the result of an increase of prices. Our pattern is for a stronger first half, with GNP rising by about $38 billion. The rate of expansion in the second half is expected to decline somewhat—to $27 billion. We anticipate that the unemployment rate will remain below 4 percent and that the workweek will lengthen somewhat. We also expect that labor compensation will increase at 6–6.5 percent annual rate.

The higher rate of expansion in the first half is based on (1) the buildup of steel inventories in expectation of a strike on August 1; (2) a catching up of automobile sales and production after the strike of late last year; and (3) an increment of $5–5.5 billion of personal income due to the rise of the minimum wage rate and social security benefit payments.

Turning to the components of GNP, we are estimating that personal consumption expenditures will increase from $492 billion in 1967 to $526 billion in 1968, or by 7 percent. As indicated earlier, we are not counting upon any significant decline in the rate of personal saving. Consumer confidence will still be affected by uncertainty about Vietnam and taxes, as well as by rising prices. In spite of a high rate of personal saving, encouraged by record interest rates, the sharp rise of personal incomes which we are estimating will produce the 7 percent increase in consumer spending.

Aside from the rise of personal income, there are two factors which explain our forecast of a 10 percent increase this year in expenditures for durable goods. One is that we think that total sales of automobiles will rise to about 9.1 million cars. The other is that we expect housing starts in 1968 to total about 1.5 million units, thus swelling the demand for durable consumer goods.

Turning to government purchases of goods and services, we are estimating that Federal defense expenditures will rise by $5 billion, or 7 percent. This is in line with budget estimates. Our figure is likely to be far under the mark for two reasons. Even under the Federal budget there probably will be an updrift of defense spending of about $2 billion. Beyond this, if we increase our troop commitment by as much as 100,000, we could be involved in a defense spending increase of $3–4 billion at a minimum. The increase of "other" Federal purchases of goods and services is in line with the budget. The 12 percent increase of state and local government expenditures is in accord with the experience of the past several years, which we do not expect to change.

Under our model, gross private domestic investment is expected to increase by $17 billion in 1968, or 15 percent. Under "fixed investment", we are estimating that the nonresidential portion will rise by 7 percent. This is somewhat higher than the 5–6 percent increase indicated by the various surveys of capital spending. In periods of general business expansion, the capital spending surveys usually undershoot the mark. We think this will be true in 1968.

Residential construction expenditures in the fourth quarter of 1967 were running at a $28 billion annual rate. Our pattern calls for a rise to $29 billion in the first quarter of this year and then level at a $30 billion annual rate in the last three quarters. We expect that the total of housing starts will be somewhat higher in the first half than in the second, with the rate about 1.5 million starts for the year as a whole. Rising prices will hold up the total expenditures in the second

half even though the rate of housing starts falls off moderately. The main limitation upon housing will, of course, be availability of mortgage financing.

Perhaps the most difficult sector of the GNP to forecast this year is business inventories. In the fourth quarter of last year inventories were being accumulated at an annual rate of $9 billion. We anticipate that the rate will rise further to about $11 billion in the first quarter and to $14 billion in the second. The rate may be expected to decline, in our model, to $11 billion in the third quarter and $9 billion in the fourth. For the year as a whole, we expect an $11 billion accumulation of inventories, compared with $5 billion in 1967, during much of which inventories were being reduced.

We are estimating a decline of net exports to $4 billion this year due to rising imports and some slippage in our exports as increasing costs and prices hurt our export position.

Finally, we are estimating that physical output, as measured by the Federal Reserve Board index of industrial production, will rise by about 6 percent this year, with most of the increase occurring in the first half.

The second table attached, entitled "Financial Flows, 1961–1968", provides estimates of uses and sources of funds in the money and capital markets in 1968. They are based upon our GNP forecast and the assumptions which underlie it, notably that the tax surcharge will not be enacted. As you will see, we are estimating that total uses of funds will rise by $6.3 billion above the record total of $80.2 billion last year.

Time permits only selective comments upon items in the table. We are estimating that the total net increase in corporate bonds this year will amount to about $11 billion, compared with the record $15 billion in 1967. There are two main reasons for this reduction: (1) corporations undoubtedly stockpiled funds last year to some extent in anticipation of a credit squeeze; and (2) corporations are likely to rely more heavily this year on borrowing from the commercial banks in anticipation of a decline, as the year goes on, in corporate bond yields. As you will see, we have raised the net increase this year in bank loans to take account of this.

We have also raised the net increase in mortgages on 1–4 family properties to $13.5 billion, compared with $11.8 billion last year. As you will note in the lower portion of the table, we expect that the net increase in funds available from mutual savings banks and savings and loan associations will be somewhat lower this year due to the "pull" of higher interest returns on investments in the open market. Since these two institutions make a large part of the total mortgage loans on 1–4 family properties, it may at first seem inconsistent to raise the estimate for the net increase of 1–4 family mortgages. Our reasoning is that last year the mortgage lending institutions added substantially to their liquid asset holdings and that they will use some of this liquidity to increase their mortgage holdings. Also, the Federal Home Loan Banks are in a much more liquid position to make advances to the savings and loan associations. Finally, if there does prove to be a decline in corporate bond offerings, money should be released to the mortgage market. This will, in particular, increase availability of funds for the financing of multifamily and commercial mortgages, which is the principal reason for raising the net increase of such mortgages to $10.5 billion this year.

As will be noted in the lower panel of the table, we are estimating that funds available from the commercial banks will increase by $30 billion this year, compared with the record $34 billion in 1967. This is in accord with the view that the Federal Reserve will slow down the expansion of credit moderately this year but that it will be careful not to precipitate a credit crunch.

My forecast of general business activity and of financial flows does not suggest much relaxation of pressures in the money and capital markets this year, assuming no action by Congress on the tax surcharge. The likelihood is that during the first half of the year short- and intermediate-term interest rates will stiffen further as credit demands rise and Federal Reserve policy moves toward lesser ease. It is also probable that during the first half long-term rates will be very firm, and they may indeed edge up from current levels to the peaks of last November. With the slackening in the rate of business activity in the second half of the year, we shall probably see some softening of both short- and long-term rates.

The Problems and Dangers

The forecast which I have presented suggests some very troublesome problems and dangers which I would now like to consider briefly.

1. Since mid-1965, with the exception of the first half of 1967, the conditions of strong demand and low unemployment have spawned a rise in wages well in excess of the increase of productivity. As a result, we have set in motion a spiral of costs and prices, with wage cost rising at a 6 percent rate and the price level moving up at a 4 percent rate. Since wage contracts are negotiated for a period of two or three years, the large increases in compensation get embedded in our cost structure. Rising wage costs lead to higher prices in a spiral under conditions of high employment and strong demands. It is difficult to see how this spiral can be broken without deflation of demand.

2. The escalation of wages and prices in the United States is the basic force weakening foreign confidence in the dollar. Foreign public and private holders of liquid dollar assets are not happy about seeing the value of their holdings decline at a four percent rate each year.

The President's New Year's program to cut the deficit in our balance of payments by $3 billion can help to restore confidence in the dollar, but it does not get to the heart of the problem. Last year, our export surplus—which must be kept strong if we are to solve our payments problem—was cut by the declining competitive position of many of our products in foreign markets as prices rose. We must bring a halt to inflation if we are to narrow our payments deficit.

Failure to halt inflation presents the danger of continued speculation against the dollar. Last November, we saw how relentless the speculators can be in bringing down a currency. Unless we succeed in bringing inflation under control in the United States, we run the great risk of further large sales of gold by the United States and the danger of wrecking the international monetary system.

3. Since early 1966, the failure to employ fiscal restraint to curb inflation has created serious imbalances in the economy, and the same problem is likely to be with us this year. The "credit crunch" of 1966 was the direct product of the failure to employ fiscal restraint. The full burden of halting inflation was placed on the Federal Reserve authorities and, as interest rates rose sharply, the outcome was a traumatic "disintermediation" process for the financial institutions and a liquidity crisis. In the process, housing was dragged down to a very low level.

We again face the danger that failure to employ fiscal restraint to halt inflation will place a heavy burden upon monetary restraint. There are already alarming indications that we are on the way to disintermediation. As shown in the attached table entitled "Data on the Money Supply and Related Factors", the annual rate of increase of time deposits at all commercial banks fell to 6 percent in the past three months, compared with a 17 percent rate of increase in the previous nine months. In the larger commercial banks, the rate of increase of time deposits has fallen to 7 percent during the past three months compared with a 15 percent rate of increase during the previous nine months. Similarly, the annual rate of increase of larger denomination certificates of deposit has dropped to 13 percent from 21 percent during the previous nine months. The annual rate of increase of other certificates of deposit has fallen to 10 percent during the past three months compared with 26 percent in the previous nine months. Savings deposits in commercial banks have been expanding at only a 1.4 percent rate during the past three months compared with 5.3 percent during the previous nine months.

The mutual savings banks and the savings and loans associations are also experiencing a similar decline in the rate of inflow of deposits. The reason for this trend, of course, is that interest rates on competing investments in the open market are pulling funds away from time deposits in the commercial banks and savings institutions. The danger is that, without the aid of fiscal restraint, the Federal Reserve authorities will be forced to step too hard on the credit brakes to halt inflation and to protect the dollar in foreign exchange markets. The result could be another liquidity crisis and a choking off of housing.

4. So long as prices are rising strongly, we are going to have very high interest rates. With the value of the dollar declining, the attractiveness of fixed-interest obligations falls and interest rates take on an inflation premium. Interest rates are not going to come down from their present very high levels until we succeed in getting inflation under control. At the present high level of interest rates, the Federal Reserve cannot exert credit restraint without quickly touching off the disintermediation process.

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THE POLICY MEASURES NEEDED

The time is long overdue for us to recognize and act upon the fact that we cannot have both guns and butter. It has long been clear—and it is even clearer today—that we need a strong measure of fiscal restraint. I subscribe enthusiastically to the view that Federal spending must be brought under control. I would welcome a cut of several billion dollars in Federal expenditures because this would be the most effective way to exert fiscal restraint. But, in my view, we face a national and international financial emergency, and I doubt that expenditures are going to be cut by several billion dollars. This is why I strongly support the prompt enactment of the 10 percent income tax surcharge. I can see no other way to obtain the fiscal restraint so urgently needed to halt inflation and to strengthen the dollar abroad.

With enactment of the surcharge, the Federal Reserve authorities will be permitted to move gradually and carefully toward lesser availability of credit. Teamed with fiscal restraint, monetary restraint can be used in a balanced way to take the steam out of inflation.

Although there are many aspects of the President's New Year's balance of payments program which I dislike because they interfere with the free flow of goods and services and free capital movements, I nonetheless think the program is needed on a temporary basis until inflation is brought under control.

Finally, it makes sense to remove the gold cover behind Federal Reserve notes. There are risks in doing so. It may remove some of the pressure to halt inflation, and it may also encourage a rise in gold purchases by foreigners. On balance, however, it seems to me that it is desirable to remove the gold cover.

In conclusion, then, it is my judgment that the risks this year are on the side of too much exuberance in the rate of economic expansion. They are on the side of an escalation of wages and prices. Preservation of confidence at home and abroad in the value of the dollar requires a balanced use of fiscal and monetary restraint.

ESTIMATED COMPARISON OF SELECTED ECONOMIC INDICATORS

	1967	1968[1]	Percent change
FRB index (1957-59=100):			
Total	158	167	+6
Manufacturing	160	169	+6
Durable	164	173	+6
Nondurable	154	162	+5
Mining	123	124	+1
Utilities	185	197	+6
Income and expenditures (billions of dollars):			
Gross national product	785	850	+8
Personal consumption expenditures	492	526	+7
Government purchase	176	192	+9
Gross private domestic investment	112	129	+15
Net exports	5	4	
Personal consumption expenditures	492	526	+7
Durables	72	79	+10
Nondurables	218	229	+5
Services	202	218	+8
Government purchases of goods and services	176	192	+9
Federal	90	96	+7
National defense	73	78	+7
Other	17	19	+12
State and local	86	96	+12
Gross private domestic investment	112	129	+15
Fixed investment	107	118	+10
Nonresidential	83	89	+7
Structures	27	28	+4
Producers' durable equipment	56	61	+9
Residential	25	30	+20
Changes in business inventories	5	11	

[1] Estimated.

FINANCIAL FLOWS, 1961-11968

[In billions of dollars]

	1961	1962	1963	1964	1965	1966	1967 [1]	1968 [1]
Uses of funds	44.2	54.2	58.5	67.1	72.1	68.9	80.2	86.5
U.S. Government (direct issues, agencies and PC's)	7.7	7.9	5.0	7.0	3.5	6.7	15.9	14.0
State and local obligations	4.9	5.0	6.7	5.9	7.4	5.9	9.4	9.5
Corporate bonds	4.6	4.6	3.9	4.0	5.4	10.2	15.0	11.0
Corporate stocks	2.5	.5	-.3	1.4		1.2	1.7	1.5
1-4 family mortgages	11.4	13.0	15.2	15.7	16.0	10.4	11.8	13.5
Multifamily and commercial mortgages	5.1	7.9	9.3	10.0	9.5	8.5	8.2	10.5
Banks loans	2.2	4.7	5.4	6.5	13.6	10.8	6.3	10.5
Loans from finance companies, etc	1.5	3.0	2.7	4.2	4.7	6.9	4.1	6.0
Consumer credit	1.7	5.5	7.3	8.0	9.4	6.9	4.3	8.5
Foreign borrowers	2.6	2.1	3.3	4.4	2.6	1.4	3.5	1.5
Sources of funds	44.2	54.2	58.5	67.1	72.1	68.9	80.2	86.5
Insurance companies	6.1	6.7	6.9	7.3	8.4	8.4	9.1	9.5
Uninsured pension funds	3.9	4.0	4.4	4.9	4.9	5.9	5.9	7.0
Mutual savings banks	1.9	3.6	4.0	5.2	4.7	3.7	5.2	4.7
Savings and loans associations	9.3	9.4	11.1	10.6	8.4	3.6	11.0	8.5
Mutual funds	1.9	1.9	1.2	1.8	3.1	4.0	2.5	4.0
Commercial banks	12.8	17.1	19.3	19.5	27.3	15.2	34.0	30.0
U.S. Government (direct loans and cash balances)	2.6	4.6	2.4	4.0	3.7	7.0	2.8	6.0
Funds from net issues of financial corporations	.8	-1.1	-.1	4.9	1.3	7.6	3.5	6.0
Foreign lenders	2.7	2.2	1.9	2.5	0.4	-.8	3.2	2.0
Households and other sources	2.2	5.8	7.4	6.4	9.9	13.8	4.0	8.8
Memorandum, trade credit	3.2	3.6	3.1	6.1	6.3	4.0	4.4	5.0

[1] Estimated.

Note: Total may not always add due to rounding.
Assumption: No income tax surcharge will be enacted.
Source: Period, 1961-66, Federal Reserve Board; period, 1967-68, L. D. Edie estimates.

DATA ON THE MONEY SUPPLY AND RELATED FACTORS, FEDERAL RESERVE BANK OF ST. LOUIS (SEASONABLY ADJUSTED)

1. *Federal Reserve Credit.*—annual rates of change (adjusted for reserve requirement changes)—average of 4 weeks ended Feb. 7, 1968 from 4 weeks ended: Nov. 8, 1967, +11.3; May 10, 1967, +9.1; Aug. 9, 1967, +10.3; Feb. 8, 1967, +12.6; 1957–66, +7.4.

2. *Total Reserves.*—all member banks, annual rates of change, average of 4 weeks ended Feb. 7, 1968 from 4 weeks ended: Nov. 8, 1967, +7.1; May 10, 1967, +8.3; Aug. 9, 1967, +9.2; Feb. 8, 1967, +9.8; 1957–66, +3.1.

3. *Reserves Available for Private Demand Deposits.*—annual rates of change, average of 4 weeks ended Feb. 7, 1968 from 4 weeks ended: Nov. 8, 1967, −8.7; May 10, 1967, +2.9; Aug. 9, 1967, −2.1; Feb. 8, 1967, +3.6; 1957–66, +1.5.

4. *Money Stock.*—annual rate of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +4.9; May 3, 1967, +7.6; Aug. 2, 1967, +5.1; Feb. 1, 1967, +7.1; 1964–66, +2.4.

5. *Money Stock Plus Time Deposits,* annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +5.4; May 3, 1967, +9.9; Aug. 2, 1967, +7.5; Feb. 1, 1967, +10.5; 1957–66, +6.0.

6. *Time Deposits,* all commercial banks, annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +6.0; May 3, 1967, +12.1; Aug. 2, 1967, +10.1; Feb. 1, 1967, +14.1; 1957–66, +12.1.

7. *Certificates of Deposit,* large commercial banks, annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended (seasonally unadjusted) : Nov. 1, 1967, +12.8; May 3, 1967, +14.3; Aug. 2, 1967, +10.7; Feb. 1, 1967, +19.5; 1964–66, +20.3.

8. *Business Loans,* large commercial banks, annual rates of change, average of 4 weeks ended Jan. 31, 1968 from 4 weeks ended: Nov. 1, 1967, +11.5; May 3, 1967, +7.1; Aug. 2, 1967, +4.3; Feb. 1, 1967, +7.7; 1960–66, +9.7.

[In percent]

	Annual rate of increase	
	Last 3 months ending Jan. 31, 1968	Previous 9 months
Time deposits at all commercial banks	6.0	17.0
Large commercial banks	7.0	15.0
Larger denomination CD's	13.0	21.0
Other CD's	10.0	26.0
Savings deposits	1.4	5.3

Ceilings on rates:	*Percent*
On savings deposits	4
On CD's of 90 days or more maturity	5
On CD's of $100,000 or more	5½

Chairman PROXMIRE. Thank you, Mr. O'Leary.
Professor Hart?

STATEMENT OF ALBERT G. HART, PROFESSOR OF ECONOMICS, COLUMBIA UNIVERSITY

Mr. HART. May I say a few words before I get to my brief statement?

In the first place, I would like to express appreciation from the standpoint of the economic profession of the way the joint committee works as a point of contact between the economists and the responsibile policymakers in Congress.

This is an extremely valuable thing. It raises the prospects of the profession making a real contribution, and the fact we know from time to time we are called upon is I think healthy for our way of looking at things. It keeps us a little bit more in touch with policy problems in a very healthy way.

If I may, I would like to comment also briefly on a point raised by Mr. Olsen, which I think might well be worth more discussion later.

He mentions a competition between two theories of the effect of policy on the economy, one of which stresses monetary forces, while the other stresses fiscal forces.

It seems to me this competition is real, and that the fact that these theories are in competition, rather than being brought together to work harmoniously in our analysis, reflects a point of weakness in the work of the economists up to date.

The so-called fiscal theory leaves too much of the monetary side of things out of account. It has a pro forma way of dealing with interest rates which I think is decidedly artificial and does not really serve our purposes.

On the other hand, the so-called modern quantity theory, which puts the stress on money, relies entirely too much on mere numbers and algebra, and it has not produced the right kind of demonstration of a mechanism through which the monetary forces work.

One must respect the kind of feel of the financial situation represented by Mr. Olsen but lacking either formal analytical reasoning or definite quantitative analysis which relates the theories to the evidence, the so-called modern quantity theory remains weak.

A major contribution to the integration of these views has just been printed in the form of an interim report in the Federal Reserve Bul-

letin for January. This is a study by the Federal Reserve-MIT group, under the leadership of Frank Modigliani who is certainly one of the really fruitful minds in the profession.

There is a good deal of further working being done in this direction. I am working on some aspects of this myself.

My sense is that within a few years we will be able to produce a much more sensible integration of these two views. But I think that Mr. Olsen is correct in presenting them as being for the moment competing theories, neither of which is really satisfactory; and I think we should not conceal that there is a weakness in our economics at that point which impairs our ability to give first-rate policy counsel.

While the statement is brief, I think I can state what I have to say still more briefly, and if I may, I will accept the privilege of incorporating the statement, and making a few summary remarks.

You will have noticed that Mr. O'Leary puts a great deal of stress on the uncertainty of the situation in the large, and point by point as he analyzes aspects—each one of these has a lot of uncertainty.

It is plain that behind his presentation there is a certain amount of integration which does not appear on the surface. To some extent these uncertainities of his items are offsetting, and if there is less of one thing there will be more of another, which is implicitly taken account of in the way he presents things.

For all that, it seems to me the fact that we are at a crossroads and do not know which way the economy is going is the salient fact of the policy situation.

In particular, obviously, the overshadowing uncertainty of all is the economic impact of the war in Vietnam.

The budget picture seems to be that we have rather crested over, and that this should run, roughly, level. It seems to me this is the kind of thing that does not happen, this is the kind of cost that goes either up or down. And I would say here—as I would also say of a lot of the business decisions—that the decisions which will settle this are still open, or insofar as they have been taken, they are behind the scenes. But, I think, on the whole, they are still open.

It seems to me there is such a thing as a policy which can hedge our bets, so that the policy will work fairly well over a range of possibilities. The object of the game is not to find the policy which would be best if we took our best guess and called that a certainty, but to find the policy which will give enough freedom of action so that things can turn out well over the range of uncertainties.

One aspect of this is the question of cost-price problems. If we knew the economy was going to soften, let's say that the Vietnam war was going to be terminated, and we could wind it up and release these tensions, we might be able to postpone this cost-price question.

It seems to me this postponement would be too risky, and that the recommendation that has been made for setting up an agency (outside the Council of Economic Advisers) to focus on the problems of the wage-price guideposts is a sensible recommendation at this point.

I must say when you list the kind of thing that seems to be possible to improve the price mechanism, this leads into a very wide swinging line of activity.

My general position would be that our wage-price structure has

shown a great deal of resistance to inflation. There is an inherent anti-inflationary bias in the way the price-wage mechanism works in the United States, and it has almost sufficed; but the evidence seems to be that when employment is really good, there is an appreciable creep. If we knew it would not accelerate, this might be all right—even from the standpoint of the people who retire on fixed incomes, if interest rates are 1 percent per annum higher than otherwise, because everybody knows prices are creeping up by 1 percent per annum, this is pretty good compensation. But there is always a danger it may accelerate.

It would seem to me that there is quite an interesting list of possibilities for improving the price-wage mechanism. I have made some suggestions in the statement; and the general stress would be on trying to restrain price increases where the firms that are thinking of marking up the prices have a real alternative of producing more goods instead.

The favorable experience of the United States with price control in World War II (and also in the Korean War) testifies, I think, that many firms which are seriously interested in raising prices are also in a position where if the price rise is barred, they can put more goods on the market instead of raising the price. This is very specifically anti-inflationary. It increases our ability to raise employment without setting up inflation, and to a considerable degree get us out of policy dilemmas. This is, obviously, not easy, but it is a direction in which there definitely is room for much more effective policy than we have had. The efforts to deter price increases have concentrated entirely too much I think on areas where there was not room to increase output.

As to the tax surcharge, it seems to me that a policy of hedging our bets against uncertainty does call for the surcharge. If I had to bet with expenditures on a fixed schedule—if I had to bet as to whether the tax surcharge was or was not likely to actually pull down activity, I might bet that it would. But, it seems to me that contrary to the usual situation, we are in a position where it would be quite easy to organize a rather prompt increase in expenditures. Contrary to Mr. O'Leary, my feeling would be that nondefense expenditures really need to be expanded. In the existing situation, I can see that there has to be pressure upon them, and, in fact, we have a number of programs related to the war on poverty which are being compressed—although they are ready for expansion, and I would advocate their expansion on a number of grounds. It seems to me that if we have the tax increase, and it proves to be more than is necessary to finance the budget now in prospect, we could hedge our bets by being in a position to expand these expenditures rather rapidly—we should say, thank God, and go to it.

In ordinary circumstances, I do not think one can count on short-term flexibility of expenditures to take up the slack. But in the 1968–69 situation, it seems to me that we have this in reserve, and should be only too glad to do it.

As to the mix of monetary and fiscal policies, we have been relying, it seems to me, too much upon monetary restraint in the last few years. Within reason, one can substitute monetary restraint for fiscal restraint. As I said earlier, the theory of this is not as clear as it should be. We do not really know as much as we should about how the mechanism works. But, if you have a fiscal policy which would be too

inflationary with the existing monetary policy, the effects can be offset by tightening monetary policy.

It seems to me, though, that we have got out of the field of good substitution possibilities—that we are trying to do too much of monetary policy—and that we should try to get back more to the center of the range of possible substitution. If monetary policy is overloaded, it does more damage than a better balanced combination of monetary and fiscal policies.

On the whole, it seems to me that the danger that without the tax increase (if we do get an acceleration of expenditures), the danger that the Federal Reserve may have to put on another very serious pinch is quite real.

The Federal Reserve has almost certainly been expanding too fast—I would agree with what I think is the view of both of the other speakers in this matter—in the last while, and will almost have to create some financial strain.

But it will be possible to carry out this operation in a much more sure-footed way, I think, if we can be reasonably sure our taxes are not inadequate.

Accordingly, it would seem that the bet hedging strategy does call for moving toward a stronger tax position at this time, and that to a considerable degree, we can hedge our bets by keeping decisions open on some of these expenditure programs.

Thank you, Mr. Chairman.

(The prepared statement of Professor Hart follows:)

PREPARED STATEMENT OF ALBERT G. HART

The economic outlook for the rest of 1968 and into 1969 appears to me extremely uncertain. The overshadowing uncertainty is of course the economic impact of the war in Vietnam. Official estimates indicate that the buildup has been terminated, and that we can look forward to some sort of plateau of economic effects from Vietnam. This projection I brand as unlikely. While I suppose there are horizontal routes from the crossroads where the United States now stands, it seems to me that of the roads we are at all likely to follow, one leads uphill and one down. I am among those who feel the United States should disengage. If we can and do disengage, economic tensions will ease (even though there may well be some transitional expenditures to face). If further escalation takes place, as seems all too likely, tensions will intensify.

Even if we could adopt a horizonal projection of the Vietnam war's impact, we would confront a "mixed situation". Some markets have a real inflationary feel. The level of unemployment is the most favorable in a number of years, and the last news about it seems reassuring; though we must note that overtime work has been much curtailed and that recent accession rates have been below the peak. On the other hand, it is easy also to cite indications that a recession may be in the making. Besides the drop in working hours and in manpower accessions (which are among the "leading indicators"), we have the stock market movement to suggest that many key decision-makers feel the situation as headed for decline rather than inflation; and the cresting over of capital appropriations of major manufacturing firms several quarters ago also suggests recession. But I would note that almost all the bearish indicators can be read to register not so much a *probable decline* as an *increase of uncertainty*.

Faced with an uncertain future, some policy-advisers would hold that the best we can do is to figure out which of the possible futures looks most likely, and to offer the advice that would be best if we knew this particular course of events was a certainty. I would urge that we can better that solution by recognizing that uncertainty may have no "certainty equivalent". In face of uncertainty, it always makes sense to look for a line of action that will work out reasonably well across a wide range of possibilities, rather than one that may be excellent but also may work out very badly in some probable contingencies. That is,

policy should take the form of a *hedging strategy*. In the present situation, it seems to me that such a hedging strategy is not too hard to design.

COST-PRICE PROBLEMS

Like the Joint Economic Committee—and like many other economists concerned with "macro-economic" issues—I have been watching over the years the working of the mechanisms that set prices and wage rates, and asking whether those mechanisms could be altered to strengthen the inherent resistance of the economy to inflation and make it safe to push harder toward high employment and toward such objectives as easing urban problems and mitigating air pollution. Recent advances in the price-level confirm the impression that these mechanisms leave room for improvement. Yet on the whole, it seems to me that the postwar record is reassuring: we *almost* have enough inflation-resistance to give employment policy and development policy a free hand within the range of actual availability of real resources.

There is undoubtedly a tendency for wage rate to outpace productivity at times when employment and profits are high. The fact that prices of industrial products ran level from 1959 through 1964 is not quite evidence of a satisfactory working of the wage-price mechanism because the unemployment rate throughout these years ranged from 5% upwards—appreciably worse than acceptable levels. Yet the mechanism *almost* works. Even the 2%-per-annum rise in industrial prices we have experienced since late 1964 might be livable as a long-term rate if we could be confident it would not accelerate: even retired people can face such a rate of secular price-increase if along with it they benefit from an interest rate a couple of percentage points higher than they would otherwise get. It would seem to follow that far short of a revolution in wage-price-setting, moderate improvements might bring us from almost-satisfactory to satisfactory performance.

There is a good deal of interest lately in proposals to do better than previously with the policy-instrument of "wage-price guideposts", setting up a special agency (distinct from the Council of Economic Advisers) to formulate and apply the guideposts. If we could be sure that the inflation-threat was about to dissipate, we could afford to set this question over for consideration another year. But as part of a hedging-strategy for 1968, the step of setting up such an agency seems to me appropriate. It may well be urgently needed later in the year; if not, it could well use a breathing-spell to clarify the problems, taking the chance to consult a number of those who will be affected. We may take it as virtually certain that the United States will experience a few months at least of inflation-threat every few years, and few years pass without a few moves on the wage-price front that seems to increase our inflation-vulnerability, so that we are not likley to see such an agency sitting idle or drifting off into unintended or inappropriate lines of activity for lack of business in its own jurisdiction.

It seems to me that policy in recent years has wasted a good many opportunities for constructive intervention in wage-price processes. In particular:

(1) In applying "moral suasion" to big companies to avert price increases, it seems to me that attention should focus on *situations where a margin of capacity exists*, and where therefore there is a real option to take the benefits of a stronger market in increased sales-volume rather than in higher price. To put more output on the market at a constant price is directly anti-inflationary. In contrast (think of the copper market in the last few years) to hold down price when suppliers have no capacity and cannot satisfy the demand produces a disorderly market; and to a considerable degree the price increase is simply generated in the industries that use the product in question. Release of surplus goods or relaxation of import restraints should be used as a *reinforcement of physical volume* in such cases. Certainly it is inappropriate to bargain with suppliers, as the government recently did in the case of aluminum, and *withhold* surplus that could be placed on the market in consideration of holding down price under conditions where output cannot rise.

(2) Where supply cannot or should not be expanded and demand cannot be satisfied at a low price, there is much to be said for an excise tax, to give "rationing by price" at the consumption level without creating a windfall profit which in turn may stimulate inappropriate wage increases. The automobile excise seems to me a case in point. Given congestion, air pollution,

etc., I cannot put a very high social value in 1968 on getting more cars into use by price cuts. Profits in the auto industry seem more than adequate, and an increase in profits sets up an inflationary focus in the wage-structure, since other workers will feel they have a claim to keep pace. I would infer that the wage-price machine will work worse if we terminate this excise, and might work better if we increased it again.

(3) The general pattern of taxes upon profits may make the wage-price mechanism more inflationary by bunching available profits more than necessary in years of high activity. I have in mind particularly the averaging of losses in a company's bad years against its profits in good years. Existing tax rules use a mixture of carry-forward arrangements that reduce taxes in a peak year because the company previously had losses, and of carry-back arrangements that enable companies to claim refunds in loss years because they previously paid taxes on the profits of good years. From the standpoint of persuading workers to exercise wage restraint, it is less than no help to give the employer a tax abatement in years of high profit.

(4) Just as it makes sense to ask employers to forgo price increases when they could instead put more goods on the market, it makes sense to ask workers to forgo wage increases when they could instead be expanding employment and production by absorbing more workers into their activities. I do not mean by this simply or even primarily that there may be more employment for labor of the existing types at lower wages. I am thinking in particular of the combinations of work rules, building codes, etc., which close the doors to employment of workers below rather high skill-levels. Consider as an important example the possibilities of rehabilitating slum housing in ways that give employment to slum dwellers. Proposals to this end immediately bump into the fact that even if unions are fully open to everybody with their traditional skills, the rules as to who can do what kind of work simply bar the use of really unskilled labor. Here and in many other areas, we operate as if the contribution to a job of anybody whose work is worth less than some fairly high hourly work is worth nothing at all. The claim to an increased wage-rate should be viewed as stronger in industries where enough flexibility is created to make room for workers who start from the skill-levels the under-privileged members of society actually have, than in industries where the starting-point is kept out of the reach of such workers.

It will be plain that these opportunities for improving the wage-price mechanism cannot be dealt with strictly within the frame of reference of a labor dispute or of a publicized industrial price-increase. Any agency assigned the responsibility of framing and administering a guidepost program will have to deal with cases. and do what it can in these cases by publicity, and by advice to private parties and public officials, even though the frame of reference limits drastically what can be done. But my view is that the primary problem of such an agency would be to work back from these cases and try to design an improvement of the frame. If its basic standard is one of getting the private economy to expand output and employment rather than push up prices and wages, its most valuable diagnoses and policy proposals may well lie outside its immediate area of responsibility—in such areas as tax policy or standards for property-rehabilitation in model cities.

THE MONETARY-FISCAL MIX

Since the United States of economy began to show signs of "overheating" in 1965, our basic instruments of restraint have been monetary. To a considerable degree, it is possible to exercise restraint when needed either through monetary policy or through fiscal policy (taxes and government outlays). But to rely too heavily on either the monetary or the fiscal instrument may do serious damage. It seems to me that we are well out of the range where we can substitute one instrument for the other, and into the range where more fiscal restraint is needed to permit an easier monetary policy and obviate the risk of a "crunch".

The administration's proposal of a tax "surcharge" seems to me to have a rather satisfactory form—except for the fact that many members of the public seem to think the suggested figure of 10 percent applies to *taxable income* rather than to *tax otherwise payable;* it would be less confusing to talk about "adding a tenth to people's tax bills". The magnitude is enough to make a noticeable impression on the economy, without being so great as to risk a severe shock. The proposal to set a termination date of June 1969 also makes sense to me. It offers incentives to *postpone* some outlays, and should thus store up a backlog of demand for a

time when we are likely to need it. It cannot be guaranteed, of course, that no extension will be needed; but the form of the proposal does guarantee that extension will not be made without appropriate consideration, subject to a presumption that taxes should revert to non-emergency levels.

Some of my colleagues in the profession of economics feel that the tax increase should not be recommended because if a recession sets in, it will not be needed and the economy may even need stimulation. But in terms of hedging-strategy, I would answer that the United States is in a position where a number of highly-desirable expenditures for urban problems and the like, which were just ready for an expansion I would recommend, have been cut back to help offset the inflationary pressure. If it turns out that the budget with the tax increase and without the expenditure-items that have been lopped off is too restrictive, and that economic activity tends to fall off, there is an unusual amount of scope for expanding outlays quickly by picking up some of these programs. Furthermore, in this spring's budget-making process, I would guess that the Congress will be more inclined to continue a nucleus of some of these activities (rather than close up the reduced programs on which an expansion can build) if the tax increase is enacted. Consequently I disagree drastically with those of my friends who feel that opposition to the war in Vietnam should be expressed by opposing the tax increase. Opposing the war myself, I feel that the tax increase is necessary to minimize the extent to which the war kills off the programs we ought to be carrying on within the United States. Those who feel that pushing the war to a successful military conclusion is feasible and is the best way to clear the way for our national objectives should also welcome the prospect that the tax increase will limit the cutbacks in domestic programs related to the war against poverty. In short, I hold that this should be common ground for people with a variety of opinions.

Chairman PROXMIRE. Thank you very much, gentlemen. These are very excellent papers. I especially appreciate your emphasis on monetary policy. We have not had enough of that. We did not get enough of it from either the Federal Reserve Board or the Treasury. It is good to have so clear and concise an emphasis there. And, it is good to have Mr. O'Leary's response to the question we were unable to elicit an answer to from Mr. Martin on what would be the demand and supply—the ingredients involved—in the so-called credit situation. And we certainly value Mr. Hart's very helpful analysis.

Now, I would like to start off by asking you gentlemen this.

All of you seem to stress uncertainties. Mr. Olsen, Mr. O'Leary, Mr. Hart all agree that this is a hard year to forecast.

International developments might change the situation dramatically. If the situation remains the same in Vietnam we have one set of possibilities. If we have to escalate very greatly, and possibly send troops to Korea, of course, the situation is different.

Under these circumstances, I am very skepitcal about the wisdom of a tax increase because it does seem to be a firm commitment that is extremely hard to withdraw from.

I have asked witnesses in the past to cite a single tax increase that has been repealed before its expiration date. We have gotten no examples. In fact, it is hard to find one that was allowed to expire on its first expiration date. I suspect if unemployment is rising but prices are rising, too, in July of 1969, we might very well continue the surtax, rather than repeal it.

Congress hates to change taxes. Business hates to have changes if they are not fully justified.

So, under these circumstances I am concerned with this prescription of policy. And I am especially concerned in view of Mr. O'Leary's very helpful analysis of the timing of the economic expansion.

You say, Mr. O'Leary, that in the first quarter you expect a growth in GNP of $19 billion, second quarter, $19 billion, and then quite a sharp slowdown. The rise will be only about 70 percent as big in the second half of the year—$14 billion in the third and $13 billion in the fourth. In all probability the tax increase won't hit until the third quarter of the year. Most people will agree it should have hit the first of January. It is not going to. It won't hit until after the first of July. On the basis of much of what we have seen in the past, it is unlikely to have much effect, because of the lag in changing consumer-spending patterns.

Under these circumstances, let me start off with Mr. Olsen. Would you still feel that we should go for a 10-percent surtax, rather than emphasize expenditure reductions?

Mr. OLSEN. Well, I still would favor a tax increase, although I must say that my preference is to seek a reduction in expenditures. I must say that the two are not—do not represent alternatives. The reduction in expenditures is an absolute reduction in the level of demand of the economy, whereas in a tax increase, as I indicated, to a great extent it represents a shift of demand from the private sector to the Government. So that actually you can achieve, I think, somewhat more with an expenditure reduction than you can with a tax increase in that respect.

But I do feel that the size of the Federal financing which is implied in the absence of a tax increase, and the propensity of the Federal Reserve to even keel Treasury operations, suggests we have a continued excessive expansion of money in the absence of a tax increase.

Now, I have stated that I believe monetary policy can achieve the same results as the tax increase. What is being sought here is a restraint on the private sector of the economy. And the approach that is being applied now is a gradual slowdown in monetary expansion—I believe it can achieve largely the same effects that would be sought through a tax increase.

However, I do think that given the Vietnamese war, which poses such uncertainties in the sense that all through this period defense expenditures can suddenly balloon, and also the fact that I feel that when fiscal needs are as great as they have become in the last year and a half, that it is desirable to bring this to the attention of taxpayers in the form of a tax increase, rather than to risk, as we have over the past 2 years, to impose not a tax increase, but excessively high rates of inflation on the electorate as the alternative.

If I may take another moment to say another one of the policy problems we face here is that the State Department and the Defense Department are largely looking at an economy which begins at the shores of the United States and moves out, whereas the Commerce Department and the Council of Economic Advisers has been looking at an economy which begins at the shores of the United States and moves inward. And the war in Vietnam has been particularly difficult because it is a war of attrition to a large extent. We have no timetable on its conclusion. It has been—assumptions have been made it will conclude at the end of this fiscal year—the next fiscal year. The ups and downs, the demands of the expenditures there, have raised havoc with economic policymaking in this period of time.

A war, by its very nature, demands a certain sacrifice on the part of the private sector of the economy. We have sought to conduct this war with a minimum pain on the private sector of the economy. And by doing so, we have risked and experienced excessive rates of inflation.

Chairman PROXMIRE. Let me interrupt at that point to say—all of us agree there is a terrible inequity of sacrifice—that American soldiers in Vietnam are making a terrific sacrifice, and the rest of us are not making any sacrifice at all. I suppose, unfortunately, some benefit from this situation.

At the same time if we look at it economically, it is awfully hard to see this is a war economy in the usual sense. I have before me the special analysis of the Budget, which shows that in 1956—certainly not a war year—we were spending 9.6 percent of GNP on defense; in 1958, 10.2 percent; 1962, 9.3 percent. This year, including Vietnam, we are spending 9.1 percent. That is 1968. And it would seem, unless there is a big escalation in Vietnam, it is unlikely we will spend more. Furthermore, defense indicators we are getting suggest that the impact of all military expenditures on the economy is lessening.

Under these circumstances does it really make economic sense to say we have to somehow take it out of our hide with a tax increase or some other sacrifice?

Mr. OLSEN. Yes. But I would measure the impact of the war not in terms of the defense expenditures as a percentage of total GNP, but rather in terms of the total size of the increase in Government expenditures over expenditures in previous years. Also the demands of the Government on the——

Chairman PROXMIRE. Then you get right back to the argument made by some people—I have not made it very much—that, Why shouldn't the Government make the sacrifices? The Government is making the big increase in spending.

Mr. OLSEN. I would certainly stress that. And I have, all along, felt that expenditure cuts should be achieved. The lamentable fact is that so far apparently the expenditure reductions have not been sufficient to satisfy the Congress. And in the meantime, with this impasse, time is passing, and we are continuing to incur for us a very high rate of inflation.

Chairman PROXMIRE. Mr. O'Leary?

Mr. O'LEARY. Well, your question is a very good one, and the general approach that it takes is one that I think has a good deal of merit to it, and certainly is part of this whole picture.

My own assessment of the situation is that in spite of the uncertainties that we face, the risks, I think, are all on the side of over exuberance in the economy. That is my feeling. So that——

Chairman PROXMIRE. Don't you think there are risks also in having unemployment rising next July and August, in view of the riots in our cities that occurred last July and August, in a nation in which we have 3 million unemployed, and in which the people who are hit hardest are the very people in the ethnic groups that are likely to be ignited by it?

Mr. O'LEARY. That is the difficulty. There are complexities to this. But the risks that I would put are these:

First of all, I think that we should have had a tax increase early in 1966. And I continue to feel this way. Because I think since early 1966

we have been putting too much pressure on monetary policy. That is the reason we had the fiasco that we had in terms of the credit crunch in the middle of 1966. So I have been consistent on this.

I think one of our difficulties here is that in focusing so strongly on the very low unemployment rate, and trying to get that unemployment rate down, we have created a situation where over a period of time we may cause some very, very unfortunate developments.

Chairman PROXMIRE. We are also focusing strongly on growth. We grew very poorly last year. We had a poor record. This committee, it seems to me, should be concerned with getting maximum growth. That is part of our directive from Congress. We grew in real terms only 2½ percent last year. We grew less in absolute terms than the Soviet Union did. This is most disappointing. And I am concerned with the possibility that we might abort our growth in the coming year by too much restraint.

Mr. O'LEARY. I do not argue with that—I want to see us grow just as fast as possible. I want to see unemployment as low as possible. But as I see it, we have some very serious difficulties here in that we have had an escalation in prices—it may be and is to a large extent the product of Vietnam. But the fact is, we have it. And some things are happening which are extremely alarming to me. A general philosophy is growing in the investment markets that fixed income obligations are not a good investment. What you are seeing is a phenomenon, for example, of the life insurance business, for the first time in history, in a major sort of way getting into the mutual fund business. And they are trying their best to find products that they think will appeal to the equity consciousness of the public. This is the reason interest rates are so high. One of the things that is bound to occur—in trying so hard to get growth and very low unemployment—is a decline in the value of the dollar. And then you have decisions taken in the investment area which I think represent a dislocation.

One of our problems is, as I see it—that as a result of this process, we automatically get relatively high historic long-term interest rates—the highest long-term interest rates in history.

Now, the difficulty with that is that when you have interest rates at that level, you automatically create very serious problems for monetary policy.

As the Fed has to come in now to tighten credit, after it has gone through this period of excessive ease, what is it up against? It is up against the fact that just as soon as it begins to tighten, it touches off a disintermediation process, because the rates that now exist are virtually at the regulatory ceiling rates for these institutions? And you would say, Why not raise the ceiling rates?—they are regulatory. The effective ceiling is what these institutions can earn. They are not earning on their assets what they are currently receiving. For example, life insurance companies today are investing their new money at anywhere from 7 to 7½ percent. But, what are they earning on the average on their assets—less than 5 percent. And the same thing is true of savings banks and savings and loan associations. The rate of return they pay to depositors must be based on the rate of return they are earning on assets they have acquired over a period of time. So, you cannot get out of this box by lifting the ceilings. The minute the Fed moves toward tightening credit at this stage of the game, it automati-

cally touches off the sort of process that occurred in 1966. And, so, what happens? They cannot tighten credit very much. They know they are in a box. And you get this sort of problem.

You also get a problem in the short run which I think is terribly important. You talk about unemployment. I think you get the problem of the fact we have been running a deficit in our balance of payments for a long period of time, and the rise of prices that is going on today is not going to help our balance-of-payments situation.

Chairman PROXMIRE. The surtax is not going to help it. We cut taxes in 1964 for the express purpose of benefiting our balance of payments and it worked. Unfortunately I did not have the figures when we had the economists here, yesterday, on the balance of payments. But it worked.

The Secretary of the Treasury said the thing to do to improve our balance of payments is to reduce taxes—and he was right. In 1965, our balance of payments improved dramatically; 1966 it improved even more. There are good reasons for that. Now, I submit you cannot have it both ways. If a tax cut helps our balance of payments, a tax hike will not hurt our balance of payments.

Mr. O'LEARY. I supported the tax cut in 1964. And I think it was the right thing to do under the circumstances. But, I can tell you this: Before the President announced his January 1 program I was committed to go to Europe, and be in London and Paris, in the early part of this year. The one thing over there that is being watched like a hawk, in terms of whether the U.S. dollar is something that they want to hold, is whether we pass the surtax.

They are not taking any comfort in this January 1 program. This does not mean a thing to them. The thing that is important to them is whether the U.S. Government is going to have the courage to discipline itself in the fiscal area. They see our rising prices and the lack of action in the fiscal area as evidence that the dollar is going down the drain. And, between now and June, if we do not halt inflation, we are going to get more runs on gold, and the whole international monetary mechanism is going to be in jeopardy.

I am worrying about unemployment in the sense that if we wreck the international monetary system, we could go through a period of deflation that would be much more serious than the slight concern we have now of whether unemployment is going to be a little lower in the second half of this year versus the first half. These are the stakes we are playing for. We have built something in the last 25 years in terms of an international monetary structure. Why run the risk of wrecking that whole thing simply over what I would regard as a relatively modest increase in taxes in a period in which we are overextending ourselves, with a war going on in Vietnam, threatening to expand to Korea.

Chairman PROXMIRE. My time is long past due. I would appreciate, Mr. Hart—I know it is asking something—if you defer your reply.

Congressman Brock?

Representative BROCK. Thank you, Mr. Chairman.

You know, one of the things that bothers me about all this discussion is that we seem to be justifying the tax increase largely on psychological grounds rather than economic grounds.

The argument is made that in the puritanical sense we must raise

taxes because we all have to share the burden of Vietnam. The argument is made—and I am fully aware of it, Mr. O'Leary—that the great single thing that they are looking at in this country, is the imposition of a tax increase, for evidence of fiscal responsibility.

The question we have here, though—certainly we have to consider the psychological factors. But can we ignore the economic factors? Are there sufficient economic justifications in terms of the kind and quality of inflation that we have today?

I would ask you this question: Is there an excess of demand in this country today, which is forcing prices up?

Mr. O'LEARY. I would say first of all, the level of demand is high enough today to effectuate the cost-push type of inflation which we are getting. And I think that is the crucial thing. The level of demand, at $19 billion a quarter, I think, is excessive. But, it seems to me, that is not the important question. The important question is whether in this climate the increased costs that have been built into our system can be passed on in the form of price increases and apparently the level of demand is high enough to accommodate that. Otherwise the price increases would not occur.

That is No. 1.

You suggest that we are overemphasizing psychological factors. But the simple fact of the matter is that you cannot separate the psychological from the economic.

If you look at any economic treatise, you will find that economics in recent years, since J. M. Keynes' "General Theory" in the middle thirties, has a tremendous amount of psychology in it. It emphasizes psychological expectations. I suggest that the rise in interest rates in 1967 was largely the product of expectations. And I think what happens this year is going to be the product of expectations.

So, when you say, Can't we get down to fundamental economics—take the consumer spending, for example. Why is consumer spending not as strong as you might expect it to be? It is basically consumer psychology. Why did interest rates rise so high last year in the face of the massive credit ease by the Federal Reserve? It was basically psychology. You cannot depart from the psychology. And if Europeans—no matter how much we say we have an $850 billion GNP, and we are such a marvelous country—think that we are not disciplining ourselves in the fiscal area, and that the dollar is going to deteriorate in value, that is the important thing they will operate on. And, that is why I am so worried. I think we ought to be changing some of this psychology.

Why are the life insurance companies out starting mutual funds? Because what they are saying is that what we have ahead of us is a 4-percent increase in prices built in over a period of years, and they better get into the common-stock field.

Representative BROCK. I am not arguing with you that we should not include psychology as a part of our decision process.

Mr. O'LEARY. I am sorry if I am so vociferous. I feel strongly about it.

Representative BROCK. I do think we have perhaps put excessive emphasis upon the psychological aspect.

There is a factor in the tax increase which has not been discussed, and that is the simple fact it does relieve pressure on monetary policy,

and on the policy of the Fed. And there is an obvious need to help finance the Federal debt. When they do that, they do increase the monetary supply, and they do create additional inflationary pressure.

Now, this is where you get into an immediate economic justification for a tax increase. But we do not talk about that.

Mr. O'LEARY. If I did not emphasize it, I would like to do so. One of my reasons for wanting the surcharge, or fiscal restraint, is to take some of the pressure off the Fed, and to permit the Fed, in a more orderly way, to facilitate Treasury financing. That is one of the big objectives. I would agree 100 percent with you there. And I think this would be healthy.

Another thing I think is true. I think if we got the surcharge, you would see long-term interest rates come down fairly markedly. I think psychologically it would have that effect.

Some people would quarrel with me—but this is my judgment.

Representative BROCK. You mentioned earlier you had a very deep concern that the Fed might step on the credit too hard.

Mr. O'LEARY. Yes.

Representative BROCK. It would be almost impossible for them to step on the credit too hard at this particular juncture with the quantity of the deficit that we have projected for this year and next year. Very difficult for them to step down too hard.

Mr. O'LEARY. What you are saying is the same thing I was saying. Namely, that the Fed is in a box in the sense that, since most of the Treasury financing is going to have to be done with the commercial banks, the monetary authorities are going to have to permit an expansion of the money supply to accommodate that, so that they are restricted in what they can do. I would say they are also restricted, because if they step on the credit brakes very much, they will tip off the disintermediation process and hurt the housing industry pretty badly.

Representative BROCK. We went through that in 1966. I do not think there is a member of this panel that would disagree with you, that we would very much wish we imposed a tax increase in 1966. My question is today, with the different qualities involved.

Mr. OLSEN. I differ a little bit. I do not believe that the Federal Reserve would necessarily create distintermediation if it were to pursue a cautious slowing down of greater monetary expansion, such as it has demonstrated in the last few months. To a great extent the market is becoming more sophisticated, and they are aware that a slowdown in monetary expansion leads to a slowdown in economic activity, and this brings interest rates down. It is the way in which monetary policy is executed that is important.

Mr. O'LEARY. I don't disagree with that. You notice I said if they step on the brakes too hard. If they pursue a cautious moderate reduction in availability, I would agree.

Representative BROCK. Mr. Hart, would you want to comment?

Mr. HART. Yes.

It seems to me that as to whether there is a substantive necessity of coming in with a tax increase, there are two or three points to be made. One is the interrelation with this cost-push process.

If we want the trade union people to be reasonable about their wage demands, and if we want the employers to feel they should show resist-

ance to wage demands, the aspect of the tax surcharge which hits profits is the right kind of thing. The notion that profits are subject to a bite changes the climate to some degree in wage negotiations. From this standpont, a surcharge of 10 percent may even be too small. But the notion that tax rates are higher at times when corporate profits are higher is favorable to a better development of the wagemaking process. This is one of the points, which I did not get into orally, in my prepared statement.

From this standpoint, I would be inclined to agree that we have a pricemaking machine which at times of high employment and high profits tends to generate wage increases. True, profits have been subject lately to something of a squeeze. They are not as high as we might expect—given the right expansion of gross product. But, they are still high enough to create a rather favorable situation for wage increases. We would like to ask the unions to be reasonable. But, to say they should be reasonable for the benefit of the shareholders is not quite that attractive a proposition.

Representative BROCK. A little hard to sell.

Then I want to pursue something. Go ahead, Mr. Olsen.

Mr. OLSEN. I only want to say—in answer to your question as to whether we have excessive demand at the present time—a rate of inflation of 4 percent represents excessive demand. Even indeed if you have a certain slack in the economy, it still means you have excessive demand if you have that rate of inflation.

Representative BROCK. Can that demand be more in the public sector than in the private?

Mr. OLSEN. That may be to a certain extent.

Representative BROCK. If that were true, wouldn't it be equally important to cut expenditures?

Mr. OLSEN. Yes; I would agree with that, definitely.

The other is that while the tax increase would be helpful in either case, corporate or individual, a tax increase on corporations alone would not necessarily do the job if the individual or noncorporate sector demand continues to be strong. Corporate management in sitting down to negotiations even if a tax increase is reducing their earnings—where they have orders piling up, on the other hand—they are going to yield to excessive demands under those cases because of the strong demand they face. So, I think a tax increase must be across the board for the whole spending area.

Representative BROCK. I read an interesting article in U.S. News by the president of the First National City Bank on the balance-of-payments proposals. I would like for you to comment on what specific steps you recommend we might take in the balance-of-payments area, the immediate liquidity problem we have. If you adhere to the President's program, I would like to know that. If not, I would like to hear some alternatives.

Mr. OLSEN. Well, as you may appreciate, we get asked this question every day in our business world, too. And one of the best answers is that the options open to us have rapidly been reduced—in the process of attrition that has gone on here for the last few years. But I still hold to the view, despite the fact that it is more of a long-term approach in effect, that we must seek to improve the surplus on our current account, and we must seek to reduce Government expenditures overseas

wherever possible. The private sector can do a great deal to benefit the balance of payments, and indeed has been a big income producer throughout this entire period.

A tax increase in this respect would be one of the best things that we could undertake to do, and despite the fact that its effect would be to a great extent psychological, it is worth something, because confidence is a very important factor at the present time—given the very delicate nature of our balance-of-payments problem, as Mr. O'Leary indicated.

So that I would feel that one of the first and immediate steps we could undertake would be the tax increase.

Secondly, I would certainly back away from any indication of further controls. The controls area that we have entered into is extremely dangerous. Controls can have perverse effects frequently that are unforseen at the time those controls are put into effect.

I just might mention one area alone. Foreigners hold something in the neighborhood of about $13 billion of portfolio and long-term investments in the United States. And if they at any time suspected that those dollars might be blocked in the United States, if we move toward controls, you could get a rather rapid pull-out of funds of that sort.

So, the controls area has some great danger attached to it.

Representative BROCK. I am sorry I am going to have to interrupt. My time has expired. If you have further comments, gentlemen, I would be very grateful if you would submit them for the record.

Chairman PROXMIRE. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

I would like to pursue monetary policy, which all of you can address yourselves to.

It seems to me there are three views of monetary policy floating around—there may be more.

One is Professor Milton Friedman's view—to put an educated horse in charge of the Fed and have him create money at the rate of 3 percent a year. That is considered by many a little too mechanical.

Then you have the view of the Joint Economic Committee, in which there is a considerable agreement between Republicans and Democrats—though, as you would expect, Democrats would be 1 percent more liberal in the money created, and Republicans 1 percent more conservative. But, allowing for that, and putting the two parties together, our Joint Economic Committee advice, which nobody much takes, is to create money at the rate of 2 to 5 percent a year; in years of slower growth and greater unemployment, aiming toward the high side of monetary creation, and in years of inflationary pressures, to create money on the low end of the register. Beyond that, we admit our incapacity, in the present state of the art, to come to grips with such criteria as interest rates, bank credit, and so forth.

Then you have the third group, the Federal Reserve, which, unless you gentlemen can give me a better definition of it, seems to be largely anti-Friedmanite. Mr. Friedman is sort of a red rag to the bull. The one thing the Fed does not want to do is to seem to be doing what Mr. Friedman advocates. Thus, as Mr. Olsen pointed out, in the period April 1966 to January 1967, the Fed created money at a negative rate, minus 1 percent, and then in the next period, January to August

1967, they swung the ship in the other direction and created money at the rate of 9 percent on an annual basis.

We do not learn anywhere from reading the minutes of the Open Market Committee or from anything else just what are the factors which the Fed feeds into its computer. We read the minutes, and we see that somebody says we have to help the Treasury this morning, or somebody else says even though our inner voice tells us we ought to ease up on money creation; nevertheless, what will this do to the housing market?—so, better not do it. And another says—the administration has a tax program coming up, maybe we should go on for a while doing what we are doing, even though we know it is not exactly the right thing to do.

I cannot possibly work out any formula from this. There seems to be those three views. At the moment, until we know more, until the Modigliani study is carried forward, and we get some answers, the Joint Economic Committee's proposed monetary policy is the best of the three—the least harmful.

I would welcome your comments, Mr. Olsen.

Mr. OLSEN. Well——

Representative REUSS. And do not be polite to us.

Mr. OLSEN. As you know, from my prepared remarks, I have already endorsed the Joint Economic Committee's view on monetary policy to avoid the wide swings.

I am not unmindful, however, of the fact that the execution of monetary policy is made difficult by the wide swings of fiscal policy. And this, of course, was the main part of my remarks to you.

However, I do feel that in this respect we should let fiscal policy worry about monetary policy instead of vice versa. Because, otherwise, you get an overall perverse policy, which misses entirely the target of high growth at relatively stable prices. And I feel that the range proposed by the Joint Economic Committee here at least aims at that kind of an approach, I think—rather than the wide swings which the Federal Reserve has pursued.

Representative REUSS. Mr. O'Leary?

Mr. O'LEARY. Well, my answer would be quite along the same lines. I would put it this way.

In the early sixties we heard a lot about the new economics. And, basically, I am pretty much a disciple of the new economics. In the period of the early sixties, when we needed a strongly expansionary policy, we took the approach which I think was right—the tax reduction. I subscribed to that. I think it was necessary.

But I think implicit in the new economics is the idea that fiscal policy and monetary policy will work together, and just as in the early sixties it made sense to cut taxes, it seems to me that since mid-1965, with the escalation of the war in Vietnam, and the movement of the economy to full employment, it made sense to raise taxes, or at least to cut expenditures, or to exercise fiscal restraint. Let us put it in those terms—so we do not enter into the question of whether it would have been better to raise taxes or cut expenditures.

But, just as it was right in the early sixties to ease things from a fiscal point of view, from mid-1965 on, I think, we ought to have applied more fiscal restraint.

Now, it is recognized that the new economics works all right from the fiscal standpoint in a period in which there is slack in the economy, but it does not work on the up side. In 1966, when the Fed stepped in and tried to tighten credit, it precipitated a credit crunch. The monetary authorities now face again the danger that, with interest rates so high, they will again touch off disintermediation and another credit crunch if they tighten credit to combat inflation. The Fed is now at that point where it is difficult for them to tighten at the rate they need to, because with the level of rates where they are, they are, up against two limiting factors. Without fiscal restraint, the Treasury will have a huge job of financing which the Fed must support.

The other is, if they tighten credit very much, they are going to precipitate disintermediation.

So, in effect, what happened here in the new economics is that you have pretty much taken away the freedom of monetary action, and we are not exerting any flexibility in the fiscal area, and the sad prospect is that there is nothing to hold this inflation back without fiscal restraint.

That is the thing that worries me.

I subscribe to what I think is the Joint Economic Committee view of monetary policy. But I think also implicit is the idea that fiscal policy would have some flexibility. And, if that is the case, then let us get some flexibility on the fiscal side, so that the Fed does not have to go through these tremendous gyrations, so it can be more even keel, so it can stay within these relatively small limits.

Representative Reuss. Mr. Hart?

Mr. Hart. I would be very much in agreement with what Mr. O'Leary just said—that the notion of flexibility in fiscal policy is fundamental, and I do find myself thinking of a tax surcharge partly as a demonstration that we mean something by flexible policy. Everybody was very enthusiastic a few years ago over the fact that, at least, we had arrived at a rationalistic tax policy. On one occasion we made a tax cut which was then appropriate, and would have been appropriate sooner—if this remains the only exhibit, we are in a position where the only flexible element of policy, after all, is monetary.

I had occasion the other day to rewrite a textbook chapter. We used to keep a score chart on Federal Reserve policy. And down through 1951, one could argue that Federal Reserve policy was almost always wrong. Since that time it has been right almost all the time, if we assume that you could expect a very rapid impact. Of course, as someone said the other day, the policy of leaning against the wind should be leaning against next year's winds, perhaps, and this is a difficult trick. But their action has generally been rather appropriate to the situation at the time.

However, from about the beginning of 1966 onward, they have been in a position where they have no way to be right. And it seems to me that the reason that the Federal Reserve has had no way to be right has been that fiscal policy apparently had got into a one-way street.

If I thought that we were taking a major unemployment risk by a tax rise, I might be somewhat worried. But, as I said a few months ago, we have these expenditure programs which are crying aloud to

be increased, and for which the machinery for expansion is already present.

If unemployment did increase, these programs could be expanded, and would in good part pinpoint their effects right at the places where additional unemployment would be creating hardship. So that I find myself feeling that the unemployment risk that we would get into is acceptable, doubly acceptable because we have had experience of high employment lately. We can afford to take unemployment risks now as we could not in 1964 when our recent experience had all been of subnormal employment.

Representative REUSS. If I may recapitulate what I think is the point of view on which all three of you gentlemen agree—it is that, one, both monetary and fiscal policy are mighty important, and both should be at least modestly flexible. Is that correct?

Mr. O'LEARY. Right.

Mr. OLSEN. As the discussion went across, it drifted away from my own point of view. If I may make a point.

First, I perhaps should confess some of my past transgressions, because I have not been in favor of a tax increase over the past two and a half years. I delivered a paper before the Tax Foundation, a meeting at which the chairman was present, entitled, "The Case Against the Tax Increase." And I still find that a tax increase has certain problems. But, I am in favor of a tax increase at this time because of the war, because of the balance-of-payments problem on which it has a psychological effect, which I do not think can be understated. And the war, in which defense expenditures are $25 to $30 billion higher than they otherwise would be, cannot be dismissed lightly.

But I do argue with the suggestion that what we are putting in place here is a stabilization theory which would call for flexible changes in tax rates as may be needed in a mix with monetary policy. I think it is unrealistic to expect that Congress can be made an easy partner to a stabilization policy in which changes in tax rates would be undertaken quickly and easily. I think it has been demonstrated this is a very difficult thing to do.

Representative REUSS. I do not think your colleagues have said a highly flexible tax policy. I think they have said a flexible fiscal policy.

Mr. OLSEN. Yes; to be sure. At the present time the argument seems to be so much on the tax increase side—you are quite right—flexible fiscal policy in this case. But the Council's argument, however, is centered largely on changes in tax rates. And so, I may point my remarks at that proposal. Increases in tax rates produce increases in revenues, which have implications which go far beyond stabilization. One can argue for a tax rate increase, for a stabilization purpose, which on the other hand may be related to expenditure programs. It may be difficult to determine what is being sought—stabilization or new spending programs. So that I think it would be a bad mix, in which we sought to achieve flexible changes in tax rates as a stabilization process over a long time.

Representative REUSS. Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman. I think maybe one thing that is emerging from this testimony is that the new

economics is running up against the old politics. And this is one of the problems we have.

But, to get back to economics—I agree with you, Mr. O'Leary. I think we should have had a tax increase last year. I committed myself to support it last year.

However, I am not sure there is not a different picture facing us this year. This is strictly economics—not the fact that it happens to be an election year.

You clearly predict a stronger first half of this year—I refer particularly to page 2 of your projections of gross national product where you cite a rising $38 billion in the first half, and a dropping off to an expansion rate of $27 billion in the second half. This is, as I understand it, based on the assumption that Congress would not enact a tax increase.

Mr. O'LEARY. Right.

Representative MOORHEAD. Do you have, or did you compute, on the opposite assumption, that Congress would enact a tax increase that would probably really not bite until, let's say, the middle of the year, around the first of July? Did you make any projections? Presumably it would cause the $27 billion to decline; is that not correct?

Mr. O'LEARY. If they did enact the surcharge. I think we should say, and lay it right on the table, something that I think we all recognize. Economic forecasting is not an exact science. And this being so full of uncertainties, it is extremely difficult to rationalize this.

You see, my reason for the surcharge goes very heavily to the danger we face with respect to the whole international monetary system.

I am not too convinced that whether we do or do not have this surcharge is going to have an awful lot of impact on the domestic economy. What I feel is that to the extent we do have a surcharge, then the Fed will pursue a comparatively easier credit policy. If we do not have the surcharge, they are going to have to be tighter.

Part of the reason for the softer second half, in my thinking, is not only the fact that we will be over the steel inventory accumulation, and over the special stimulus in the automobile area, but part of my reasoning is that, if you do not have the surcharge, then the Fed is going to have to move in—they will be careful about it—but what they are going to have to do is provide less credit than the market wants to sustain that rate of advance of $38 billion in the first half. What they are going to do is, through credit restraint, to top off the business expansion. We would expect it to go off in the second half on this basis, because, I think, implicit in this is some slowing down in the rate of flow of mortgage credit as the year goes on.

What I am assuming is this: If the surcharge is enacted, the monetary authorities may not be driven to tighten credit. They may go fairly well through the year accommodating credit demands. You could say that, let us say, in 1967 the Fed permitted an expansion of loans and investments of some $35 million—you could say they might wind up providing $37 billion in 1968, and that this would be somewhat less easy—it would be somewhat less easy relative to the expansion going on in the economy. I suspect that the way the Fed is going to behave—that it will still permit one whale of a big increase in loans and investments on the part of the banks, but that, relatively speak-

ing, they will in effect be sort of leaning against the wind, and tightening in that sense.

My own sources and uses of funds figures, I think, may overdo it, because we have a figure in there for an actual cutback in availability. It may turn out that there won't be a cutback. It may simply be a slightly larger figure, but not enough to accommodate the business expansion.

So, I think that the second half, in a sense, is going to be a product of the fact that the Fed will have to do something, and that this will be part of that slowing down process. Part of my thinking is, if you had the surcharge, you would have a better balance between fiscal and monetary policy, and you could cool off fears in the international area. I think if we had somewhat more fiscal restraint and lesser monetary restraint, we could probably go through this period, barring some major escalation in the Far East, in a better-balanced way, particularly in terms of growth of employment, that would look pretty good. It might not look too good in terms of the price rise.

Representative MOORHEAD. As I understand your testimony, you would not vary your predictions very much as far as GNP is concerned?

Mr. O'LEARY. That is right.

Representative MOORHEAD. But, the individual items going into the total might vary.

Mr. O'LEARY. That is right. You would get better housing, for example, than I think will happen if you put too much pressure in the monetary area.

Mr. OLSEN. Just briefly—Jim O'Leary and I have almost identically the same figures on GNP, and even in the accounts. But we are assuming that the tax increase is enacted. As you may notice, both of us, however, place the key on how monetary policy responds. How it responds if there is a tax increase and how it responds if there is no tax increase. And we would assume with a tax increase the monetary authorities might very well pursue a somewhat more expansive policy than they would in the absence of a tax increase, because they would tend to follow the fiscal theory of the Council, that the tax increase by itself would dampen demand, and, therefore, they must offset that, and be somewhat more expansive than they otherwise would be.

Representative MOORHEAD. Professor Hart?

Mr. HART. I would like to comment.

In the first place, I would say that I suspect a large proportion of the academic economists would be in the camp of the Council of Economic Advisers rather than Mr. Olsen's. We would say that fiscal flexibility cannot be very real unless there is some kind of tax flexibility.

Government expenditure has been the great destabilizer of the U.S. economy since World War II, and while there are a few items of expenditure which are open to manipulation from the standpoint of stabilization, broadly speaking, the fluctuations in expenditure happen in spite of economic stabilization considerations, rather than because of them. And admitting that there are political difficulties, and that temporary tax changes have a way of perpetuating themselves, yet,

it seems to me that the time shape of a proposal to have added taxes that will expire in June 1969, is rather favorable.

By the way, this is just the kind of thing which ought to help substitute fiscal policy for monetary policy. One hopes, in a time of tight demand, to get demands postponed. One of the things monetary policy can do is to create a prospect that if you postpone your financing you can get it on better terms, so why not slow down expansion now and wait until later? A temporary tax increase has also some of these dimensions. It suggests that the market won't expand quite that fast insofar as consumer spending is being pinched. It suggests that the availability of internal funds will be better later than in the next year or so. It seems to me that this is the kind of policy which points toward a safe sort of tapering off of a boom—that we can hope to get some investment demand, in particular, postponed until past the expiring date of the tax, at which time we will have time to turn around on policy. If there is a tendency of the economy to sag off then, the demand that had been left over will be there to sustain things. This is the kind of adjustment we usually hope to get through monetary policy. But, when monetary policy is running so far on the tight side, and yet cannot be tight enough to avert mild inflation, postponement of demand through monetary policy is not working out terribly well.

Representative MOORHEAD. We had some testimony that enactment of a tax increase would cause unemployment. The figure, as I recall, Mr. Chairman, was 300,000 additional unemployed in the first full year that the tax increase would be felt.

I take it from your testimony that you gentlemen would not agree with that projection; is that correct?

Chairman PROXMIRE. That was the estimate of Chairman Ackley in response to a letter I wrote him.

Mr. HART. I have not seen the reasoning that underlies the statement. But it seems to me that all of us on the panel agree that we hope to get essentially the same level of fiscal activity with less price and wage rise.

Representative MOORHEAD. What do you think of doing this by a partial surcharge and partial tax reform?

Mr. HART. I like the idea of getting at the loopholes extremely well. It seems to me there has been a deterioration of the American tax system in recent years through the opening of more and more loopholes, and it is always in season to improve those. If we have a situation where there is a prospect of doing something about it, Heaven forbid we should miss the chance. Yet, in terms of timing it seems to me this has the drawback that we need some time to get the full benefit of it, and that we certainly hope loophole-reform would not be temporary. Of course, if we can get the loophole thing fixed, it ought to set forward the date when we can have a reduction of tax rates; and the combination of lower rates and a wider base is, of course, very attractive.

The damage done by taxes is largely a function of the rates, and the economic benefits are largely a function of the revenue. So, to the extent you can get more revenue and lower rates, this is highly desirable.

However, in terms of what ails us—it is a little extreme to call it a crisis situation—in terms of what ails us in 1968, it seems to me that the timing of the loophole closing is not the most favorable. Obviously, it would do us more good to get this through now, in terms of timing, than to get it through a year later. And, if the fact that here is something of a fiscal crisis creates a sense of urgency, fine. It is also true, on the other hand, that loophole-closing is one of the most time-consuming types of tax legislation. And, if consideration of tax reform is going to get in the way of getting anything else done until an agreement has been reached on that, it sets back the date at which anything will happen in the way of tax increases.

Representative MOORHEAD. Thank you, Mr. Chairman. My time has expired.

Chairman PROXMIRE. I would like to go back to Mr. O'Leary before I come to Mr. Hart, who has waited so long to answer that first question. But, Mr. O'Leary, I think you walked right square into it—and I think that Mr. Moorhead did a fine job of pointing up the weakness of your case.

Now, I want to say I have great respect for you. I think you are an excellent forecaster. But, you have done something that very few witnesses do in sticking your neck out. You have given us the figures. And with those figures, I think that your case for a surtax disappears.

Here is why.

You predict July 1 the economy will slow down to an increase at an annual rate of 2½ percent in the last half of the year. We just worked out the figures. And, that is what it worked out to. This is unsatisfactory on anybody's estimate.

I do not know an economist who says this economy should go along at a 2½-percent increase. This means increased unemployment. It means very serious business problems in the country; that our growth is much too slow. And I emphasize this is without a surtax. With a surtax the economy might not grow at all. Unemployment would really soar.

Now, your argument that the surtax won't slow the economy down further contradicts the position of the Council of Economic Advisers. You and Mr. Olsen take that position. You say the surtax is just going to shift the kind of production of goods and services into more housing and less of some consumer goods.

I think you are absolutely wrong, because I do not think there is that much flexibility. But, on the assumption you are right, the surtax wouldn't have a price effect. It would do nothing about inflation.

Either the Council has to show you are going to get a diminution in the production of goods and services, or you won't get any really significant effect on inflation. You cannot have it both ways. The only way you can reduce the demand is to reduce demand; reduce effective demand—less is purchased, and there are fewer jobs.

So, it seems to me it is very inconsistent for you gentlemen to say that the surtax is not going to really have any effect on gross national product, unless you agree it is not going to have any effect on prices. If it is not going to have any effect on prices, it is not going to have any effect on the balance-of-payments problem really, and it is not going to do what the President and everybody else argues it will do—including the Council. They say it will slow down inflation.

Mr. O'Leary. May I be the first to reply?

Chairman Proxmire. Please.

Mr. O'Leary. Well, you know, I have been reading the newspaper account of these hearings, and some of the transcripts, so I was well aware when I came in here today I would be hit because of the fact I have the second half relatively less strong than the first half.

Chairman Proxmire. That was a good honest forecast.

Mr. O'Leary. So, I felt that I was going to be leading with my chin, in that it would provide you with the opportunity to make your case.

But I think you are 100-percent wrong about this. I think you are just deluding yourself. This is the way we have been talking for two and a half years, and there is more to this thing than simply whether we are going to have a little more unemployment in the second half of the year, or whether the rate of growth is going to slow down. I think there are some basic structural difficulties here that have to be knocked out of this economy on the longrun basis, or the growth of this country——

Chairman Proxmire. You are saying we have to have the unemployment, the slowdown, in order to do something effective about prices?

Mr. O'Leary. Absolutely.

Chairman Proxmire. Now you are changing your position. A minute ago you said the surtax was not going to reduce unemployment.

Mr. O'Leary. I am saying if you get the surcharge, if we can demonstrate to the world that we have the courage to take action in the tax area, and not be afraid of the politics of this thing—and I am not suggesting you are, because I have tremendous respect for Senator Proxmire.

Chairman Proxmire. I do not run this year.

Mr. O'Leary. My feeling is that, first of all, if we are to avoid an international crisis, we have to show the world that we have the courage to discipline ourselves when we have prices and wages moving the way they are. And, to my way of thinking, if we do not do that, we are, between now and the second half of this year, running an unreasonable risk in terms of wrecking the international monetary system.

Chairman Proxmire. You say we have to show the world that we can stablize our prices. We have done the best job of any country in the world. In the last 7 years, no country can compare with us. In the last 2 years Germany and France have done a little better, that is true. But over the years we have done much better. They can hardly say to us, "You are leading the world in an inflationary direction." The fact is that we have done better than they have.

Mr. O'Leary. All these things are true. All I can tell you is if you sit and talk with people in Paris and in Zurich the——

Chairman Proxmire. Who have listened to the people from this country tell them over and over we have to have the guts to pass a surtax, and that this is the answer to our problem. That is what they know about our country.

After all, if we sent an expert to Germany to comment on the German economy, the first thing he would do would be to talk with the top people in the German economic establishment, and the German Government, get their views; and then he would be likely to offer them as sound if he respected the German experts. And I suggested that is just what the Europeans are doing to us. They think a surtax is necessary

here because this is what Fowler asks for, Samuelson, the establishment, the people they regard as competent—so they say that must be it. This European call for a surtax is just an echo.

Mr. O'LEARY. The important thing is that the password over there is that this is an election year, and there won't be any surcharge, that the economy will be permitted to go merrily on its way and expand strongly with inflationary excesses. What they are saying is that this is an evidence of the fact that the United States does not have the ability or determination to discipline itself.

Chairman PROXMIRE. Maybe they say that. But what difference does it make? What do we care? The fact is that the cut in taxes in 1964 was proposed, among other things, because it would help our balance of payments, and it did. You cannot have it both ways again. Now they say you need a tax increase because that will help our balance of payments. And, I cannot understand how a tax cut helps our balance of payments, and now a tax increase does, when conditions, really, if you analyze them closely, were a lot similar in 1964 to what they are today.

Mr. O'LEARY. You ask what difference it makes. It makes quite a bit of difference, because they hold billions of dollars of liquid dollar claims, and once they lose confidence in the dollar they can convert it into gold.

Chairman PROXMIRE. What does the tax increase do? It reduces the profitability of the American investment. It hits the corporation income profits with a 10 percent reduction. It makes investment here less attractive. Then, in addition, what you and Mr. Olsen have been saying is that it is going to reduce interest rates. But, if it reduces American interest rates here, what happens to the flow of funds? They flow abroad. So funds flow abroad for two reasons. One, because our profits are less, and the return is less, and the yield is less and it makes less attractive investment. It flows abroad for another reason because our interest rates are less as compared with theirs. So, from the standpoint of balance of payments, I think the arguments are all the other way.

Mr. O'LEARY. I think what Leif said earlier is perfectly true. That is, what we have been doing in the whole area of capital movements, and in terms of free flow of goods, is we have been moving toward restrictionism in this country—this is another dimension of this thing. We started with the interest equalization tax, and now we have the $3 billion program. How does this tie in with the traditional policy of the United States for free expansion of trade and exchange?

Chairman PROXMIRE. I agree with that.

Mr. O'LEARY. Why are we doing it? We are doing it because we had to come forward with a crash program that was the product of the fact that we are not—we have not done anything in the fiscal area. This was a stopgap thing. This is what Europe is saying. Europe is saying—Mr. Johnson put forward a stopgap program, a hastily conceived one, because he cannot get a tax increase through. And, furthermore, it complicates the problem. You start to trace what the ramifications of this are. This $3 billion program could be the very thing that would make it exterenly difficult for the British to work out their problem.

Chairman PROXMIRE. Well, I disagree with you on the source of the balance-of-payments problem.

Mr. O'LEARY. Are these risks worth running over what I think really ought to be an increase in taxes to pay for the fact that we have a war going on?

Chairman PROXMIRE. The fact is, though, that the private sector, as far as international balance of payments are concerned, is still in healthy balance. It is the public sector. We have troops stationed in Europe. A Vietnam war. These are the elements that have really contributed to the deterioration in our balance of payments.

I would like to ask Mr. Hart to answer my first question, which was related to the fact that—unpredictability would suggest that a surtax is a mistake. And I would like to stress to you that I would agree with what I think is your own bias, and mine, too—that we should not reduce the Government investments in human resources, that the antipoverty program should be increased not reduced, that manpower training programs should be increased, not reduced. I think we have such an irrational system, however, of our Government expenditures, with our supersonic transport, our space program going on heavily, our public works programs, which are very, very hard to justify under present circumstances, have always been cut back in similar situations. I think there is plenty of room for some restraint there, where we can be fast on our feet, and restore the spending if we need it—rather than in emphasizing a tax commitment which is going to freeze us into a tax position for several years.

Mr. HART. Well, may I tie this in, with the question you raised as to whether one seriously expects price effects in the United States. When you are comparing 1964 with 1967——

Chairman PROXMIRE. I was comparing that in terms of the balance of payments.

Mr. HART. Yes. At that moment we had had a record of several years of stability in the level of industrial prices, and in labor cost per unit of industrial output. And there was reason, looking forward, I think, to feel that our position internationally was solid, and also any inflation risk for the United States was over the horizon, and there was time to turn around and do something about it if it intensified.

Now, at the present time we have a recent record of a rise in the industrial price index, a rise in cost per unit of output which represents partly wages and partly the rise in social security contributions—which has made a difference of the order of a couple of percent I think in that relationship—and the consequence is that it is not unreasonable to say that the relation between tax cut situations and the balance of payments is rather different in kind.

It seems to me that a tax increase of the dimensions we are talking about should be expected to have fairly intense anti-inflationary price effects. It changes the climate of wage price policy. If the decisions that are made this spring are made knowing that this tax will be in effect a year from——

Chairman PROXMIRE. It seems to me this is a very slow, awkward and cruel way to do it. We had a situation, for example, in 1958, with almost 7 percent unemployment, the kind of situation where you certainly think you would not have excessive demand. Yet, in 1958, we had a high rate of inflation—in fact higher than it was last year.

So, under these circumstances, it seems to me, if you are going to sufficiently slow down the economy with a surtax, and create a psy-

chological situation with sufficient depth and time to slow down wage determination, it is going to take a long, long time. That is not the way to do it. The way to do it is to have a wage-price guideline policy with bite in it, a specific figure, the kind of thing that is unanimously recommended by four experts who appeared before us, including Mr. Sheahan, who has written a fine monograph on it for Brookings.

This is the way to bite at the wage-price situation rather than go way around Robin Hood's barn and hit it through a tax increase that can do so many other things.

Mr. HART. However, if our firm is confronted with a situation where a full volume of output can be sold at higher prices—so that we cannot stand interruption of output because we are going to lose sales we could otherwise have—and where profits are going to be satisfactory, this is the sort of situation where it is very hard to look to the guidelines. At best, there have always been some settlements that came outside them. I would certainly say "Yes," it is a good idea to do something fresh and more effective and better aimed in the way of guidepost work. And, yet, I would say that this is complementary with a policy which aims to make it more doubtful that employers can expand sales and raise their prices, too, and which makes it pretty certain that the tax bite on profits will be larger. With such a tax situation, it involves less inequity to ask the wage earners to accept sacrifices than what wage earners concede goes right into the pockets of the stockholders. The notion that the stockholders are having to make sacrifices through the rise in corporate tax is something of a sweetener to the notion that the unions should be more moderate, in the wage figures they will accept.

Chairman PROXMIRE. My time is up.

Just one parting thought. It is my feeling that when members of militant labor unions have their pay envelopes reduced by an increase in the withholding tax, they are not in the mood to have their leadership ask for a weaker increase in wages. There is a real tendency for them to ask for more to make up for what they have lost by the increase in withholding when their take-home pay is reduced.

Mr. Brock?

Representative BROCK. Just one quick comment on your point, and then I would like to go back to balance of payments.

I think the thing that concerns most of us, and the Senator is voicing a pretty substantial sentiment up here when he talks about it, is the difference between a tax increase and the guidepost. At the very time when we broke out of this very stable structure we had going for several years was the time we abandoned the guideposts. And now we see a situation where, after abandoning the guideposts, the settlement pattern is about double what the guidepost was. And I think there has to be some relationship between the two.

Now, Mr. O'Leary, I would like to go back to your argument for the tax increase as it relates to the balance of payments. I have heard this argument made so many times, about $14 billion investment in this country—if foreign investors lose confidence in us, they are going to pull that money out.

Now, let us be honest about it.

That money is over here because it makes a profit for them. There is a yield out of this economy, a profitability that they cannot obtain

at home, or it would not be here. Money finds its level. It is the most fluid commodity of all. And that capital is not going to be pulled out of here unless we are getting into a situation where this economy is not profitable or the particular investment is not profitable.

I do not see this dramatic drain of $121 billion. I do not see any prospect of it.

When you are talking about the fact that we may have 4 percent inflation in this economy, you cannot talk about 4 percent as if it were a domestic situation. It is a relative situation; 4 percent as it relates to what in France, or in Germany, or what in England.

If it is 4 percent and 3 percent there, there is only 1 percent disadvantage. And if they are getting 5 percent on their investment, 1 percent still leaves them a net profit of 4 percent more than they had before.

I do not see the direct relationship that is implied by your premise.

Mr. O'Leary. I think the line of reasoning is that as our gold stock has declined—and at the present time the relatively small amount of free gold, with the gold cover in effect—I think that what speculators are betting on is that somewhere along the line the United States will have to raise the price of gold to get out of this box. And, what in effect they are saying is if the United States does raise the price of gold it will be a pretty big increase, because they would not raise it by some small amount, since that would still leave open the expectation that they would do it again. What they are in effect saying is, somewhere along the line we are betting that the United States will raise the price of gold, let us say, to $70 an ounce. And this the reason they are choosing to hold gold rather than dollars, because they expect to get a big profit on their gold holdings. I do not expect that the entire volume of our gold reserves is going out.

You see, the interesting thing is there is all sorts of crazy psychology in this. I agree with some of the things the chairman has said. Psychology seems crazy. But, it is there.

One of the things Europeans think is that the U.S. military has told the American Government that—we need $10 billion or $12 billion of gold simply as a war chest, in case we get involved in World War III, and so, they are betting we are not going to sell much more gold, that we will have an incentive to hold onto what we have, because we need it as a war chest. There is all of this crazy speculation. But, if you have that sort of thing, and—what could tip this off is that we may show in the first quarter a continuing rather poor balance-of-payments position. The pound may not look so hot. The pound and the dollar are tending to be tied together. What you might get would be two or three flurries where we lost $200 million or $300 million of gold. And, who is to say that the psychology of this thing is not going to be as bad as what happened to the pound in November.

Representative Brock. When we talk about gold—let us not get too far afield from the balance-of-payments program as it has been proposed. I think you made one most pertinent point earlier in the discussion, when you said one reason they might pull this money out that is invested in our economy is that they might fear exchange controls. Now, that is a realistic fear, because the very proposals that were made by this administration on the first of January were the first and

second steps toward exchange control. That is the danger. That is where your psychological factor enters in a major degree.

I think the most damaging single thing this country can do is impose controls on overseas investment. This is the most profitable aspect of our entire international program. We simply must address ourselves to the public rather than to the private sector, in our international dealings.

Mr. O'LEARY. Let me just make this point. You cannot underestimate the nervousness that exists.

People keep calling me about what is going to happen. And I know on the day of the state of the Union message there was a rumor in the financial district that the President was going to announce that night that the price of gold would be increased to $70 an ounce. This was a pervasive rumor. It was a crazy thing. My reaction was, How crazy can you get? But the fact is that there is an irrationality about this.

And within the last couple of weeks, there was a very strong rumor around in the financial community that the Canadian dollar was going to have to be devalued. There is a very nervous situation here. I do not think we ought to underestimate it. Part of the dimension is the very thing you are talking about.

Representative BROCK. But, you do remember that their nervousness is largely a matter of private sector nervousness. The people who hold large quantities of dollars—some $14 billion—which can be used to call gold—you are talking now about gold as a commodity itself—those dollars are held in central banks. You have only seven or eight central bankers that are in a position to call any quantity of gold from this country. These are awfully sophisticated men. They may reflect the psychology that exists in that country, but not to the extreme swings.

Mr. HART. They cannot quite ignore it. The central banker is a trustee. And, however much he may hope we can hold out, if he is afraid that he cannot take out what belongs to his constituents because somebody else will get there first, he may have to move.

Representative BROCK. I am not arguing on the psychology of the tax increase. I have heard it expressed too many times to not admit it is there. But, I am saying I think the adverse psychological effect of our balance-of-payments program, the emphasis upon the private sector, investment, tax rebates and so forth, is equally adverse as the refusal to enact a tax increase.

Mr. O'LEARY. Absolutely.

I think we did the right thing in announcing the $3 billion program. I supported it, even though I had some reservations about it. But, at the same time, I think you have to recognize that the ramifications of it are hard to figure.

I was in London at the time this was announced, and they were trying to figure out what the impact on Britain was going to be. To me it was a rather surprising line of reasoning. They said that the direct impact of controls over capital investment will not be very great, but the indirect effect will be very, very great. Their reasoning was that U.S. companies would now have to borrow heavily in the Euro-dollar market and thus drive interest rates up. The British argued that this would make the 8-percent bank rate there relatively

ineffective in pulling back funds and would hurt their chance to build their reserves through the high bank rate. This does not seem to have happened so far. The other thing they were afraid of was that the impact of our program would be deflationary for France and West Germany, and that the effect of this would be to hurt the British ability to build their exports up by sending goods to France and Germany. Their reasoning there was that the restriction on tourism would hurt the French, the restriction on direct investments would hurt them, and the same thing would be true in West Germany. And they reason also that these countries would be less willing to pursue expansionary policies, because they would be afraid that they would pull in too many imports from Britain and so forth.

Now, actually France and Western Germany have gone along and pursued relatively expansionary policies.

But this whole thing has all sorts of ramifications.

Our program, our January 1 program, could be the sort of thing that would really make it tough for the British to make their devaluation work.

Representative BROCK. I am more concerned that that program will require on their part—not encourage, but require, at least sub rosa retaliatory measures which will wash out any effect on our balance of payments. And, certainly—I heard it over there—we are going to have to take some action to protect ourselves, because the pound is in a critical condition already. We may have to devalue—without anything else.

Mr. HART. May I intervene a moment. When you say we were taking the first and second steps—the difficulty about this New Year's Day program, it seems to me, is that on its face it is unenforceable; and when you start calculating what measures it would take to transform it into an enforceable program, you do find you are moving a good way toward exchange control. When you talk about the possibility of retaliation, it is not so much retaliation against the program as it stands. But, if we decide to put concrete meaning into the program, we will have to do things which may be very painful abroad, and may set off a process of retaliatory moves.

Representative BROCK. As Mr. Moorhead said, controls beget controls. I think that is an excellent summary of the situation.

My time has expired. Thank you very much.

Mr. OLSEN. While investors seek high return, there are two considerations which go into investment. One is the rate of return and one is the risk. And when the risk becomes greater than the return, the investment is liquidated.

Chairman PROXMIRE. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

Gentlemen, in addition to the tax increase, what should we do to improve our balance-of-payments position—or is your testimony that the tax increase, in your judgment, of itself would do the job for us?

Mr. HART. Could I make a distinction, sir, between the balance-of-payments situation and the monetary reserve situation.

The monetary reserve situation has some of the dimensions of a banking position exposed to the possibility of a run. Here we are thinking in terms of possible transfers of capital funds above all.

It is true that a few years ago the U.S. situation as international

banker was very secure, and that the erosion of that position has been the cumulative effect of the balance-of-payments situation in the meantime. However, it would be possible that we could get a strong improvement of our balance of payments in the next 6 months and be in a worse position as an international banker at the end of it, or vice versa. And, in particular, the proposition that we must strengthen our exports relative to our imports, in order to strengthen our position as international banker—it is not totally irrelevant, but it does not bite very strongly on this.

It seems to me that basically our position as an international banker, with the gold-exchange standard based on the dollar, is unworkable at the present time. The only real remedy for that is to internationalize the role of banker in the gold exchange standard. So long as we try to run it as a unilateral U.S. banking operation, we are getting into a more and more difficult situation; even if the import-export situation improved, we would still have this hazard on our hands.

It is plain that if we could score a dramatic improvement in the balance of payments, which people could be sure would hold several years, our position as a banker would be strong. But we have got into a nasty situation which has much the same characteristics as the internal American banking situation before the Federal Reserve. If the foreign central bankers change the form in which they hold their reserves, or if some of their customers choose to transfer funds out of the financial center into the periphery, then a change in the composition of reserves produced a shortage of reserves.

We have responsibility, as the central banker, toward the other countries in the gold exchange standard. They have no reciprocal responsibilities toward us. The Federal Reserve System was set up to be responsible as the trustee of the reserves—but the member banks also took on a responsibility to keep reserves there. They no longer had the privilege of changing the composition of the reserves, taking cash home into vaults, and leaving the holder of the central reserve short.

The dollar-exchange standard was workable only temporarily; we are reaching the end of its workability, and this would be true even if the balance-of-payments situation was going to show a rather substantial improvement.

Representative Moorhead. Professor Hart, that statement you just made has helped me better to understand this than anything I have heard before.

Mr. Olsen. I have made some comments, previously, on how to improve the balance of payments. I would like to remark that, presently, we have two labor negotiation problems in the United States which are costing us a very substantial amount in terms of our trade-surplus position. One is the continuing strike in the copper industry, which is costing us somewhere in the neighborhood of $750 million to a billion dollars in additional imports of copper on an annual-rate basis that would otherwise not take place. The second in the steel industry, where the unfortunate and almost absurd situation of delaying settlement until some time in August when the contract expires, is inducing an inventory accumulation which is pulling imports in from overseas, and is estimated to cost us somewhere in the neighborhood of $500 million between now and midyear in additional steel imports.

What is likely to occur—even in the face of the control program—is that we may have some savings on capital account, we may have some savings on the tourist account, but we may see our exports run at a much slower rate than imports. Imports would run upward. So our current accounts surplus will shrink from last year's level, and we may very well have higher overseas expenditures by the Government. And the combined effects of these will offset what ever savings we may realize as a result of the controls. This is the unfortunate result of attempting to compartmentalize the balance-of-payments problem.

Representative MOORHEAD. Mr. Hart, let us see if I can put your statement into simpler language that I can understand. Our position, as I see it—the most dangerous one—is what I would call a balance sheet situation, that as banker we are making a profit in our banking operations, but we have been investing long term and borrowing short time to do it, so that we have a possibly dangerous liquidity situation. Is that right?

Mr. HART. Well, one could put it in terms of the two partners in international financial relationships—the surplus versus the deficit country. One way of looking at the cumulative movement over recent years is that it reflects what is the matter with the capital market in Europe. The Europeans have been expanding their capital investment on a huge scale. They have been saving enough to finance it. But the European saver prefers to move into a creditor position. The European companies are not selling equities on a vast scale to their own people. Notice, we do not get a huge wave of people establishing investment trusts—either here or in Europe—to operate in the stocks of European companies. This is partly a testimonial to the alleged superiority of American management. It is partly a testimonial to the fact that American companies give the investor information which tells them where he is, and the position of the minority stockholder in the American company is much better protected than the minority position of the European company. The consequence is that U.S. firms become owners of equities in Europe, and Europeans become creditors toward the United States. The European draft toward creditorship is scored as a balance-of-payments deficit, and has pushed us cumulatively over the years into this unworkable world banker position.

To say this is all our fault because we are exporting capital is crazy. De Gaulle fumes about the movement of American capital, and a tendency of U.S. firms to take over French concerns. He should be worried over what is the matter with the French economy, that, though they are saving and investing enough, they cannot manage to make financial machinery to do their job, but get foreigners to supply the equity capital which is necessary for the expansion of the French economy.

The European governments really have an obligation to themselves, by their own standards, to create a situation as to capital flows, where their own new capital will finance their own enterprises, and they won't need our capital. The defects of the European capital market have really been at the root of the difficulty. It is not the commodity and service situation. It is not even Government oversea expenditure. It is the fact that the European capital market has not been doing its job. This is very hard to remedy from the U.S. side. And makeshift

controls on capital outflow from here are a very unsatisfactory remedy for this underlying trouble.

Representative MOORHEAD. Of course, if we could promote a program of persuading the Europeans to invest in the equities in our market, this would be one way.

Mr. HART. The European is apparently much more willing to invest in equities in American companies than in European companies, because the whole situation is so much more transparent, and he really has more confidence in the management—or at least in the management's relationship to him as the minority stockholder with no control.

Representative MOORHEAD. A further development of the International Monetary Fund along the line of the special drawing rights would be an important step toward internationalizing our position as a world banker. Is that correct?

Mr. HART. Well, I would call this very much of a half measure. It seems to me what is called for is that countries should hold their reserves through the International Monetary Fund. The IMF should come to hold a large fraction of the world's gold, instead of holding $3 of $4 billion, and it should be assured against a gold run. When one talks about reciprocal obligations, it would be absurd to say all the other central banks should accept obligations toward the Federal Reserve. But they could accept obligations toward an international reserve pool; this is compatible with their national dignity. If we could transfer the U.S. gold exchange liabilities to the International Monetary Fund, giving them long-term claims upon the United States in exchange, then we could have a workable situation. The articles of agreement of the International Monetary Fund could be amended so that every country, including the United States, was under obligation to hold a good part of its international reserves through the monetary fund. This is something which cannot be done through any national central bank as focus. And the dollar exchange standard, it seems to me, is about played out. It is a miracle it has lasted this long.

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. OLSEN. I only wanted to ask, if time permitted, if I could take minutes——

Chairman PROXMIRE. Take all the time you want.

Mr. OLSEN. Earlier, in your references to Mr. O'Leary, in commenting on the tax increase, and the slight slowdown in the second half of the year, I felt you reached a conclusion there. I would like to add to a point that Mr. O'Leary made in defense of his position, and I think partly in defense of mine, if I may.

Chairman PROXMIRE. Yes, indeed.

Mr. OLSEN. Forcasting quarterly patterns is an extremely difficult thing to do. With a forecast for a 12-month period—you can reach a measure of success. But a quarterly pattern is a greater guessing game than the year would be.

As it stands, we have a slowdown in the second half, but not nearly as great a slowdown as Mr. O'Leary has in his forecast for the second half, although we have the same figures for the full year as a whole. Actually, the forecasts we have put together, and I think Mr. O'Leary would share my view, if anything would tend to err on the low side, because we have the possibility that consumption, personal consumption, would break out on the high side. The consumer is in quite a

strong financial position in terms of his liquidity buildup, in terms of his slow accumulation of debt and rapidly rising income. We do not allow for a higher level of consumption than could actually occur. We could also have a breakout on the high side in terms of defense spending. The assumption made on defense spending has proved erroneous before. We could have a higher level of plant and equipment expenditure.

Chairman PROXMIRE. All these could be higher, too.

Mr. OLSEN. They could be. But the chances of them being lower are much less than higher—just because the character of these areas as they now stand, and based on past precedent, as well as theoretical application.

The other is that I feel that this time is not the time to err on the side of inflation. It is not a time to seek fine tuning of the economy at the present time. If we err, then the risk should be probably in overrestraint.

Chairman PROXMIRE. Rather have us err on the side of increasing unemployment?

Mr. OLSEN. I would even say that, if that is the risk. The assumption, for example, that overemployment, and that high rates of inflation somehow are less painful than unemployment, and a stable price structure, I find to be somewhat lacking in logic.

Chairman PROXMIRE. You see, you gentlemen and the administration are so concerned about an overheated, overexpanded economy at a time when we have grown so little, and at a time when the January figures are so mixed—and, if anything, discouraging. Now, the one figure that I hear those advocates of restraint latch onto is the unemployment figures. What does that figure consist of? Three and a half percent unemployment is low, it is true. However, this is accountable because 500,000 women left the work force, in some cases they figured they could not get a job, and, secondly, a much more significant figure, buried in the mass of unemployment data, is that hours of work per week dropped from 40.8 to 40.5, and that is as low as they have been in any year since 1962.

I submit this is a much more sensitive indication of the demand on manpower than you get from the gross overall unemployment figure.

Now, if this is the best we can do at the peak of 1968 fiscal boom, it seems to me that we really are not in the kind of stretched out, strained, overheated economy situation that so many establishment and administration economists are arguing.

Mr. OLSEN. I do not think we are yet at the peak of the boom. And you cannot take one month's figure and draw a conclusion for the whole year.

Chairman PROXMIRE. You say it is going to slow down from now on—at least, beginning in July or in August. You say your figures show that, and Mr. O'Leary's figures show it. Most everybody who has appeared, including the Council of Economic Advisers, agree the economy is going to slow down.

Mr. OLSEN. Our figures are dependent on the mechanical approach. It reflects the cessation of steel inventory accumulation, and the end of the automobile catchup phase. This is largely the effects we see in the second half. The second is—which I said earlier—if it is necessary

indeed to achieve some slack in the economy, even if you are not operating at peak capacity in terms of employment, and utilization, if you have an excessive rate of inflation, then it may very well require some even greater slack in order to alleviate that inflation, because——

Chairman PROXMIRE. Seven percent unemployment that we had in 1958?

Mr. OLSEN. No; I certainly would not assume that. I would certainly assume something a good deal less than that.

But, there is no question that inflationary expectations are a factor.

Chairman PROXMIRE. You see, it is no trick to reduce inflation by just letting the economy slow down, and increasing unemployment. The trick is, and the responsibility we have from the Congress 22 years ago, is to permit the economy to grow just as much as it possibly can, keep unemployment at a minimum rate, and slow down prices. To do that, we have to move that stubborn Phillips curve. To do that, we have to have effective wage and price policies. And this is what nobody seems to call for. Absent that we are in a position where we say—well, we have to have growing unemployment to slow down inflation; and why? Because the kind of people hit with unemployment are not up here testifying, and their representatives are not testifying, and many of them do not vote. But the people who favor restraint are outspoken, and pass over unemployment.

Mr. OLSEN. Yes. Every man who sets a price and every man who demands a wage sees that monetary expansion is running at an excessive rate, Government spending is running at a high rate, Government wages are being set at high levels. In other words, the leadership from Washington seems to suggest little concern with the inflation, and the inflation that lies ahead. And this pervades decisionmaking—even if you have some slack in the economy.

Chairman PROXMIRE. The President says this is our principal problem.

Mr. OLSEN. Yes; it is. But the inflation is here. And it is continuing.

Mr. O'LEARY. I just want to say one thing. I know you are anxious to close, and you have a session this afternoon. I would like to say I am glad that Leif made that statement, because, in my prepared statement, you will find I have stressed the fact that even though we see the economy turning down in the second half of the year, we think that the risks, generally, of escalation in Vietnam, of the consumer coming in more strongly, are on the side of a greater expansion.

Chairman PROXMIRE. Why not keep our powder dry. If we get escalation in Vietnam, then perhaps we will have to have a tax increase. And then I think the Congress would give it, and rather promptly. If you have a big escalation—obviously, you have that kind of need. But, if we have to vote on the tax increase—and unemployment is increasing, and if all the predictions are that we are going to have a weaker second half, and grow as you said, Mr. O'Leary, at a 2½ percent or 2.6 percent rate in the last half of the year—I just cannot understand, for the life of me, why we should increase taxes at that point.

Mr. O'LEARY. The only thing——

Chairman PROXMIRE. This is when we are going to vote on it.

Mr. O'LEARY. I am just as anxious as you are to have high employment and strong growth. And I would like to say something—I am

just as anxious as you are to see programs that deal with the important problems of our cities, and so forth. I would associate myself with what Al said. I am anxious to see employment high and strong growth. I think the only difference in view is that I think the whole record since mid-1965 shows we have temporized on this matter of using fiscal restraint——

Chairman PROXMIRE. Since what year?

Mr. O'LEARY. Since mid-1965. I think we have temporized in using fiscal restraint, and I think the risk is that unless we take some action here it is going to be just the same old question of a year from now saying we missed the boat on it. And I think we ought to have prompt action on the surcharge. I think the risks are not that we are going to turn the economy down so strongly, but if we do not have it the risks are greater in other areas. From the point of view of labor and job opportunities, the thing that worries me is that the course we have been on has built-in dislocations and structural problems in the economy which, in the end, I think, could be harder on labor than would be the case if we corrected them. One of the things we talked about here today—getting a better balance between the use of fiscal and monetary policy, getting some flexibility in the fiscal area is terribly important. I depart from my colleagues in a sense—I depart at least from one of them—I would be willing to take the program that President Kennedy announced of giving the executive branch some flexibility in setting tax rates. I think it is important that we get this flexibility. And, basically, I think this committee has felt that way over the years.

Chairman PROXMIRE. I do not want to prolong this hearing. I think you have made an excellent statement.

But, I think the trouble is that Congres is not going to do that. And, because of that—they are not going to repeal the surtax if they pass it. It is going to be allowed to run until the middle of 1969, and running, I am afraid, longer, with increasing unemployment. The prices are likely to continue to rise because we have planted a monetary bombshell.

I would like to conclude by putting in the record an excellent editorial from this morning's Washington Post entitled "War, Inflation, and Taxes." It cites a very fascinating precedent in the early 1950's, when we found that fiscal policy did not succeed at all in stemming inflation, and—because it was monetarily responsible for doing so.

(The editorial from the Washington Post referred to follows:)

[From the Washington Post, Feb. 21, 1968]

WAR, INFLATION AND TAXES

Last week a member of the Joint Economic Committee asked Chairman William McChesney Martin of the Federal Reserve Board whether "some new Government machinery or technique" is needed to check inflationary pressures. He replied that new machinery would be less necessary if taxes are raised, but added, "I think we're going to need it anyhow . . . we're in a wartime economy." A spokesman for the Federal Reserve Board later explained that Mr. Martin does not favor mandatory wage and price controls, and so there is little to be said for belaboring that point. But his statements about a "wartime economy" and the efficacy of fiscal measures merit some scrutiny.

What is a "wartime economy?" There are no standard definitions. But operationally the term denotes a situation in which a substantial proportion of a country's resources is diverted to military use. a situation in which productive capacity is fully utilized and in which excessive demand generates inflationary

pressures. There is little doubt that the Second World War meets the foregoing specifications. In 1944, defense expenditures accounted for 41.9 per cent of the Gross National Product and 17.3 per cent of the labor force was in the armed forces. In 1952, at the height of the Korean War effort, defense programs absorbed 13.5 per cent of the GNP and 5.4 per cent of the labor force.

The demands imposed by the war in Vietnam are much smaller. In the fourth quarter of 1967, the entire defense effort—of which the Vietnam War accounts for less than half—absorbed only 9.2 per cent of the GNP and 4.3 per cent of the labor force. The Korean War, in which defense outlays rose from $14.1 billion in 1950 to $45.9 billion in 1952, a more than 200 per cent increase, placed strains upon our productive capacity and on the economies of other countries which had not yet fully recovered from the Second World War. But that has not been true of the Vietnam War, as is witnessed by the fact that there was a quasi-recession, a short-lived decline in the output of goods and service and a rise in idle productive capacity at the beginning of 1967.

Mr. Martin and other proponents of fiscal action assert that higher taxes will dampen inflationary pressures, but they seldom if ever review a highly relevant historical experience. With the outbreak of the Korean War in June 1950, President Truman appealed to the Congress for fiscal restraints and they acted promptly. Taxes were raised by $9.3 billion in 1950 and by $5.4 billion in 1951. As a result there was budgetary surplus—as measured in the national income accounts—at the annual rate of $18.6 billion in the first quarter of 1951, the highest of the postwar period.

Surely Mr. Martin would approve of such resolute fiscal action. But what happened to prices? Despite the huge budgetary surplus, despite the imposition of mandatory wage-price controls in January 1951, consumers prices rose by 12.7 per cent between June 1950 and in July 1953 or at an annual rate of nearly 4.1 percent. Curiously, the price rise did not begin to level off until the second half of 1952, a time at which there was a large budgetary deficit.

The evidence suggests that fiscal policy had little if any effect on prices during the Korean War. What was relevant was monetary policy. In 1950–51, the stock of money was permitted to expand very rapidly—at an annual rate of nearly 5 per cent—and it was only after the growth of the money stock was slowed, at the end of 1951, that the inflation abated.

Mr. Martin and his colleagues, who now call for higher taxes while permitting the money stock to increase at an inordinately rapid rate, have something to learn from history.

Chairman Proxmire. I want to thank you gentlemen very, very much for excellent testimony. I want to apologize if my questioning seemed a little astringent. I did not mean to indicate a lack of respect. I have the greatest respect and admiration for all of you. You are very competent men.

The committee will reconvene at 1:45 p.m. this afternoon to hear four more eminent economists.

(Whereupon, at 12:45 p.m. the committee was recessed, to reconvene at 1:45 p.m. on the same day.)

AFTERNOON SESSION

Chairman Proxmire. The Joint Economic Committee will come to order. We are starting a little earlier than 2 o'clock—we are starting at 1:45—because one of our witnesses has to leave early. We want to move along as rapidly as we can. Other members of the committee will be here later, and the other witnesses I am sure will be along shortly.

Mr. Saulnier, we would appreciate if you could start off, and we will move in alphabetical order. It must be a rare occasion that Saulnier is first in alphabetical order.

STATEMENT OF RAYMOND J. SAULNIER, PROFESSOR OF ECONOMICS, BARNARD COLLEGE, COLUMBIA UNIVERSITY

Mr. SAULNIER. It is a pleasure to be here, Mr. Chairman. I have a short statement which I will read—it will take only a few minutes.

I am sorry if there is alarm in what I have to say today, but the fact is, I am alarmed. And I feel sure I am not alone in this. It has been my observation in the past few weeks, both in the United States and in Europe, that thoughtful people are deeply concerned that, while the United States is caught in a kind of impasse between expenditure policy and tax policy, developments over which we have little control will precipitate a financial crisis with worldwide effects.

Trouble could come from either of two directions. It could be generated domestically, if failure to limit Federal spending and lift taxes were to invite an abrupt shift in monetary policy to a firmly anti-inflationary style. This happened in 1966 and it could happen again. With the help from fiscal policy a more gradual shift might be brought off successfully; but if it is done to offset a perverse and inflationary fiscal policy it will have to be severe and there is a risk—as we saw in 1966—of interest rate escalation, disintermediation, a drying up of the mortgage market, a sharp drop in stock prices, and general suppression of economic activity.

On the other hand, if monetary authorities try to work themselves out of the dilemma by continuing to expand the money supply at inflationary rates—hoping all the time that something will happen to permit a change in the script—the danger is that the contingencies, as the saying has it, will go against us and trouble will develop from the international side. The cutting edge would be a heavy drain on gold.

It is in this context that we must consider the economic outlook. The GNP numbers look reasonably good, but this is a year in which it will take a lot of doing from policy to make those numbers come true. Looking ahead, one gets the impression that, subject to certain reservations, everything will be all right in 1968 so long as the whole situation doesn't fall apart. What is needed is a formula for defusing what virtually everyone concedes is a highly explosive condition.

Basically, the risks are due to the impasse between expenditure policy and tax policy. The Joint Economic Committee would perform an enormous service if it could devise a formula for breaking this impasse. It might be done, it seems to me, if the committee were to propose a program along the following lines, especially if it made its proposals in a unanimous report:

(1) Remove the gold reserve requirement against Federal Reserve notes

Although this is only indirectly involved in the expenditure policy-tax policy question, I put it in first place because it is already at the top of the legislative agenda, and especially because it is urgently needed to avoid the gold drain which would otherwise be an immediate danger.

Failure to change the law would mean that, unless the requirement were suspended by the Federal Reserve authorities, the dollar, in all probability, would be inconvertible into gold within 2 years. But a suspension would not solve the problem. Unless the Federal Reserve

authorities were willing to use blatantly evasive tactics, suspension would, in time, seriously restrict their ability to fulfill their obligations under the Federal Reserve Act and the Employment Act of 1946. It would be only a matter of time—and I expect only a relatively short time—before such awkward arrangements would collapse and force us, quite possibly in an atmosphere of crisis, to do what we can do now in an atmosphere of relative calm.

So, I put removal of the requirement to hold gold as a reserve against currency at the top of my list. This is by no means all that needs to be done in the area of international monetary arrangements, but it is an essential first step.

(2) *Devise some means to put a reasonable ceiling on Federal expenditures*

I put this in second place because it is apparent that satisfaction on expenditure policy is a necessary precondition to action on tax policy.

Obviously, your committee must first decide whether the President's fiscal 1969 proposals for new obligational authority and expenditures, including net lending, are appropriate in the circumstances. I doubt that they are. It has been my feeling that fiscal 1969 spending should not exceed the level contemplated for fiscal 1968. It must be conceded that the budget goes a fair distance in that direction, when you consider that it contemplates expenditures that rise $10 billion as compared with annual increases that recently averaged close to $20 billion. But, it is hard for me to believe that it goes as far as one can properly and realistically expect it to go—again, in the circumstances. Moreover, the fact that it requests an increase of $15.2 billion in obligational authority as compared with a $3.9 billion increase in fiscal 1968 suggests that expenditures will soon rise sharply again.

My suggestion is that the Joint Economic Committee scrutinize the 1969 budget in the light of the economy's financial condition and propose realistic but tight ceilings for obligational authority and expenditures, possibly with special exception for Vietnam costs. The Appropriations Committees will study and act on budget specifics; this committee is in a unique position to supply guidance on budget aggregates.

If the committee feels the budget is right as it stands, it could say so. If not, it might clear the way for tax action by proposing the establishment of ceilings on expenditures and obligational authority in the manner provided for in section 138 of the Legislative Reorganization Act of 1946. I am sure the committee is familiar with the pertinent provisions of that statute. I suggest that you utilize the authority it gives the Congress to exercise restraint over itself in voting authorizations to spend and over the executive branch in making actual disbursements.

(3) *Propose the establishment of an independent, bipartisan commission on budget policy*

Another move that could clear the way for tax action would be for your committee to urge appointment of an independent, bipartisan commission to make recommendations on Federal budget policy. We have had a commission, and a useful one it was, reporting on the form

of the budget; what we need now is an independent appraisal on its substance. The commission would evaluate spending priorities and define the kind of budget that will enable the American people to finance their Federal Government without inflation and at a tax level that will not suppress economic growth.

Proposals to this end already have support from the administration. In his recent budget message the President wrote of such suggestions:

I urge the Congress to take prompt and favorable action in support of these proposals to cull out lower priority programs.

Secretary Fowler stated before the Ways and Means Committee, on November 29, 1967, that "the President is prepared to establish a special bipartisan task force of outstanding Americans to take a look at long-range Federal program priorities."

The Secretary's statement was seconded on that occasion by Professor Schultze, who is here today, and who was speaking then as Director of the Bureau of the Budget.

(4) Urge prompt enactment of the President's proposals for tax surcharges

When the committee has said what it believes is right on the subject of obligational authority and expenditures, it should strongly urge the prompt enactment of the proposed tax surcharges. And if what the committee says on expenditure policy carries persuasion, action on taxes should come soon thereafter. That would break the expenditure policy-tax policy impasse, which is the key to everything else.

There may be opposition to the surcharges on the ground that the economy is not sufficiently buoyant, but I can't think of anything more dangerously irrelevant than to debate this question on the basis of what happened last week to retail sales or to freight car loadings or to some other detail in the economic picture. One cannot exclude the possibility that the economy will get a new thrust from a sharp increase in defense spending, but, in the absence of that, the imbalances are such, and their implications for policy are such, that the most likely near-term prognosis for the economy is relatively slow growth—hopefully, with receding cost and price inflation.

This may come about because huge Federal deficits escalate interest rates and suppress private investment expenditures, especially on home construction. The crucial point is that $20 billion budget deficits, back to back, clog capital markets, force interest rates up, slow economic growth, increase its vulnerability to international monetary pressures, and compromise monetary policy to the point where all one can expect is either a credit crunch or inflation that will ultimately correct itself in deflation and recession. Deficits of this magnitude are completely unacceptable and we should get down at once to the business of eliminating them.

(5) Urge that if recent developments in Vietnam and Korea require significantly larger defense expenditures, budgetary authority be requested promptly and a fiscal plan be proposed for financing these through additional expenditure limitations or still higher taxes, or both

One of the chief causes of concern in the country today is a feeling

that the budget has been made obsolete by recent happenings in Vietnam and Korea. There is little that one outside Government can say on these developments except that it is dreadfully dangerous to defray facing up to their fiscal consequences. The committee could usefully urge the administration to settle doubts on this critical question at the earliest possible moment. And the committee should signify in its report that if more money is needed it will support proposals that would raise it without increasing the deficit.

(6) Urge a return to noninflationary money supply increases

This committee typically deals with monetary policy and I believe it should go on record this year to point out that, as steps are taken to move the Federal budget back to balance, the Federal Reserve System should reduce money supply increases to a rate consistent with stable costs and prices.

There is room for controversy as to what constitutes a noninflationary monetary policy, but one in which the money stock rises 7 percent a year or faster—or nearly twice that rate when time deposits are included—is clearly destined to put persistent upward pressure on costs and prices. What is called for is not an abrupt move to monetary austerity; on the contrary, all that is needed is a start back to money supply increases more nearly consistent with cost and price stability. It is not deflation, and perhaps not even disinflation, that we need; only a retreat from excessive expansionism. This will probably involve annual money stock increases closer to 3 or 4 percent than to 7 percent. I suggest that the committee give its explicit support to such a policy.

The committee can be sure that a monetary policy of this character, jointly with an expenditure limitation and a tax increase, would be interpreted abroad as a powerful assist to our balance-of-payments program. Indeed, in the absence of such policies, few here or abroad will believe that the program can work, except through increasingly restrictive direct controls and increasing recourse to essentially protectionist devices. The result would be irritation everywhere, and a higher and higher risk that heavy gold drains will resume.

(7) Propose removal of the 4¼-percent limitation on contract interest payable on long-term Federal securities

With the Federal debt rising as it is, and with interest rates as high as they are, I am amazed that this step—which is essential to give the Treasury the options it needs to manage the public debt in a noninflationary manner—appears not to be a part of the President's program. Nor do I find it mentioned in the Council's Economic Report.

Legislation on this point is needed more urgently today than ever before, and I suggest that the committee take the lead in sponsoring it.

(8) Suggest a guideline that will permit a return to wage increase-productivity improvement balance

One need not be an advocate of numerical wage guidelines, which I am not, to know we cannot operate our economy safely when labor costs are rising twice as fast as productivity is being improved. Yet, that is what is happening now, and the Economic Report says nothing better can be hoped for in 1968.

In the circumstances one might expect to find not only some firm

language in the Economic Report but some inventiveness on how to extract ourselves from a situation that is admittedly unsound. Instead, one finds (i) a discussion of the "inflationary bias" in labor markets at full employment in which the major emphasis is on market imperfections rather than on the cost-and-price-raising effects of persistently excessive aggregate demands; (ii) an explicitly defeatist attitude toward labor cost developments in 1968; and (iii) the view that it is "unrealistic" to expect labor to accept money-wage increase that do no more than compensate for increases in the cost of living.

The critical deficiency in this treatment of the guidepost problem is that it gives no guidance at a time when guidance is urgently needed. What is needed is a strong reaffirmation of the basic principle that overall price stability requires labor cost increases broadly equivalent to average productivity improvements and some formula by which—with partial recognition of cost-of-living increases in the interim—we can ultimately work our way back to a balance between average wage increases and average productivity improvements.

It would also be helpful if the committee pointed out that a non-inflationary policy with respect to aggregate demand is an absolute prerequisite to success for any program that hopes to preserve stability of unit cost and prices.

I believe it can be said with confidence that the legislative and administrative program outlined here, if put into effect, would have the following beneficial results:

It would promise a reasonable possibility of returning, without too much delay, to cost and price stability;

It would return confidence and a sense of stability to capital markets and promise a return to more stable interest rates;

It would greatly enhance the chances of success for our balance-of-payments program; and

It would virtually eliminate the risk of developments—domestic or international—that could precipitate a financial crisis.

On the other hand, a continuation of the impasse between expenditures policy and tax policy—with huge deficits persisting, back to back, year after year—has implications that are simply too grave to talk about.

I repeat that what we need is a formula that will get some action started, something that will break the impasse. And I can't think of anything more helpful to that end that a unanimous report from the Joint Economic Committee on the few issues—as I have tried to identify them in this listing—that are central and critical to everything else.

Thank you very much for this opportunity to appear again before this committee.

Chairman Proxmire. Thank you very much, Mr. Saulnier. I neglected, and I apologize, to identify you properly as the very distinguished and able and nationally known economist you are, a former Chairman of the Council of Economic Advisers in the Eisenhower administration, a distinguished professor at Columbia University—Barnard College, I believe.

Mr. Saulnier. Yes; thank you, sir.

Chairman Proxmire. I have discussed this with Congressman Bolling, and he agrees; we are going to depart a little from the usual pro-

cedure, because Senator Miller, unfortunately, has to leave, and he asked for 5 minutes to ask questions now and then; he is going to have to depart for a meeting of the Armed Services Committee which he has to attend. So, we will get to the other three presentations immediately after Senator Miller finishes.

Senator MILLER. I thank my chairman for his usual deference. I do want to apologize to the other members of the panel for not being able to be here for their presentations. But I assure them I will read their papers very carefully.

Mr. Saulnier, I hope you don't mind my asking one question.

Mr. SAULNIER. Not at all.

Senator MILLER. I am concerned about this advocacy to remove the gold reserve requirement. I asked Secretary Fowler, the other day, what would happen if we did it. I understand that we might well run out of our free gold. But, when we get to a vote on this—and we may do so fairly soon in the Senate—Members of the Senate are going to have to ask themselves a question: Suppose I vote for this, suppose I vote against it. If I vote against it, what will be the results?

The Treasury, I do not believe, has yet furnished us a full reply to that question. I did have a chance to look briefly at your comment on this, and I notice that you say it would only be a matter of time before awkward arrangements caused by failure to suspend the requirement might collapse. But, it would amount to running out of free gold, and then saying to dollar holders overseas, "We are sorry, but we are not paying out any more gold at this time."

Now, what would be the impact of that? Have you thought through that possibility? Because we are going to have to do that in the Senate when we get to a rollcall vote on this.

There are some, you know, who think that maybe the results would be worse the other way—because, if the gold cover is repealed, then we end up with sort of a managed paper currency.

Mr. SAULNIER. Senator Miller, failure to lift this requirement would be a very unfortunate signal for us to be giving to the rest of the world at this time, and I think it would increase the likelihood of a gold drain.

I understand perfectly well that it is possible for the Federal Reserve System itself to suspend this requirement, and for a time one could get along with that I have described here as rather awkward arrangements—but the question is, How long would this condition be likely to prevail?

My guess is, not very long.

At a fairly early date, the Federal Reserve System would find itself in the position of having to post, really, very inappropriate discount rates, or else to adopt tactics of avoidance which would be quite unbecoming for the System and for our country.

I don't think anybody here or abroad would regard this as anything but a completely nonviable situation, and through a gold drain, we would quickly be brought to the point where the dollar would be inconvertible, not necessarily because we had run out of gold, down to the very bottom of the barrel, but because we had run down to that amount of gold beyond which losses would be regarded as inimical to the national interest.

At that point, Senator, the dollar would be inconvertible, and the gold bullion exchange standard would be finished.

Obviously, this is not the way to move into a reform of the international monetary system. It would seem to me a most awkward and dangerous way to move into that reform.

I believe we ought to be working for reform now on an entirely different basis.

Senator MILLER. And what would happen if we reached the point where the dollar was not convertible to gold, because we had run down to the limit of our free gold? That is what I am getting at. What happens then? I mean, what is the disaster? Some people forecast that if we remove the gold cover, we turn ourselves into a managed paper currency; that we are going to have runaway inflation, and that is a disaster.

Well, what is the disaster facing us, if there is a disaster, if we do reach that point? That's what I'm seeking.

Mr. SAULNIER. The developments could very well go something like this—and here, Senator, I would like to make it quite clear that I am not forecasting anything; I am offering an answer to a hypothetical question. And my answer is this:

If the dollar should become no longer convertible into gold for foreign governments and central banks, as it is today, then some steps would have to be taken to stabilize exchange rates of the various major countries of the world.

I do not myself believe that we could simply allow exchange rates in these troubled times to find their own level. It is hard for me to believe that a responsible government would do that.

So, some kind of ad hoc arrangement would have to be devised to give a reasonable degree of stability to exchange rates.

Now, that arrangement might last for a considerable period of time, but my guess is—and here I am pursuing to another stage my answer to the hypothetical question—that some more formal arrangements would be desired. I mean by that, Senator, some more formal international monetary system.

The next question that the experts and the political figures involved would face would be this: Is gold to play a role in the new system? Now, I do not know what the answer to that would be; conceivably it could be "No." In that case we would move into some kind of a paper-gold system. As has been said, almost anybody could define such a system on the back of an envelope, and a lot of people have. We could do this.

On the other hand, a paper-gold system requires such a high degree of international collaboration, and such a high degree of mutual confidence among nations, confidence that each will conduct its domestic affairs in a reasonable manner, that many people doubt we are prepared at this time to go on to a paper-gold type of system.

Now, if we don't, we will go to a gold system. And, if we go on to a system which incorporates gold, we are going to find, very quickly, that there is not enough gold, and there will be an increase in the price of gold. This will ultimately have rather serious inflationary implications for the world, because the people who have got gold now—and I am not talking about central banks or government, I am talking about private holdings, will have an asset valued at an

increased price, and if they monetize their assets you will have a very powerful inflationary factor in the world economy.

Now, that is the crossroads. Do you take the paper-gold route, or do you take the gold route? And, I would rather not, if you don't mind, Senator, discuss the probabilities of which route will be taken.

But let me just say that if you take the gold route, to pursue that a little further, my guess is that the first effect would be disruption and a paralysis to world trade as the arrangements were being put together, and that this would be followed by definite inflationary effects.

These are the consequences.

What I am anxious to see is that we avoid the conditions that will precipitate the gold drain that will start all of this. And I see no hope for doing that until somehow we can break, as I say, this impasse between expenditure policy and tax policy.

Senator MILLER. I appreciate that answer. I would just make this observation. If the Congress doesn't see fit to follow your very well reasoned recommendations here, it looks to me like it is just going to be a question of time before all of the free gold runs out, and we are going to be reached with that problem that you just outlined a little later—maybe another couple or 3 years. But, I think we are really just buying time right now.

I appreciate your going into this. It will be helpful, I am sure, in my consideration of what to do on this.

Mr. SAULNIER. If I may add one point, Senator. I personally believe that a failure to take this step—which, mind you, I recommend very reluctantly—that a failure to take this step will have the effect of bringing a lot closer to us the point at which we will become inconvertible, our dollar will become inconvertible, into gold.

Senator MILLER. I understand.

I thank the chairman very much.

Chairman PROXMIRE. Thank you.

Our next witness is a very good friend of the committee, and a man who has won the admiration and respect of the Appropriations Committees in the House and Senate for his remarkable ability as Budget Director, now a senior fellow of the Brookings Institution, and professor at the University of Maryland, Mr. Charles L. Schultze.

STATEMENT OF CHARLES L. SCHULTZE, SENIOR FELLOW, THE BROOKINGS INSTITUTION, FORMER DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. SCHULTZE. Thank you, Mr. Chairman.

Both the President's Economic Report and the hearings of this committee have primarily focused upon one central economic policy question.

Chairman PROXMIRE. If I may just interrupt for a minute. We do want to have the chance to ask questions. There will be other members of the committee here. If at any time you would like to abbreviate your remarks, the full remarks will be printed in toto in the record. But, go right ahead.

Mr. SCHULTZE. I shall take that as both permission and a suggestion.

Chairman PROXMIRE. Exactly the way it was intended.

Mr. SCHULTZE. As I indicated—the Economic Report of the President and this committee have focused on one major question. Among many others, I think one has stood out:

> How should fiscal policy be designed over the next 18 months in order to moderate the recent acceleration of price increases and upward pressure on interest rates, while still preserving high employment and economic growth?

Now, in the context of present circumstances this question can be separated into two parts:

> 1. In the absence of a tax increase, the Federal budget deficit will exceed $20 billion—and on a national income accounts basis, approach $15 billion—for 2 years in a row. Is a substantially more restrictive fiscal policy called for?
>
> 2. If the answer to this first question is "Yes," should a significantly larger part of that restriction take the form of expenditure reductions and a smaller part the form of tax increases, than has been proposed in the President's economic and budget messages?

This way of posing the question quite clearly rules out the approach which one sometimes hears—"The economy is not strong enough to stand a tax increase. We do need, however, sharp expenditure reductions." If an actually or potentially overheated economy requires more restrictive fiscal policy, then the particular combination of tax increase and expenditure reductions to achieve this end is indeed a legitimate question of policy. But, one cannot argue that the economy is too weak to stand the reduction in disposable income which a tax increase accomplishes, and at the same time propose a reduction in disposable income through the medium of expenditure cuts.

I. IS A RESTRICTIVE FISCAL POLICY NEEDED?

Let me turn then to the first question—whether or not a more restrictive fiscal policy is required in the coming year and a half.

Appropriate Federal fiscal policy decisions obviously depend upon the behavior of the non-Federal sectors of the economy. A large and growing Federal deficit may be temporarily called for when private demands are so weak as to threaten high unemployment and underutilized economic potential. In early 1967, as private inventory investment fell by the huge amount of $18 billion during a period of only 6 months, the Federal budget deficit rose sharply—from $3 billion in the last quarter of 1966 to $15 billion in the second quarter of 1967.

This rise was much larger than the automatic growth in the deficit associated with the slowing down of the economy. In part at least, because of this swing in the deficit what might have been a recession turned out to be only a short-lived pause in economic growth.

Conversely, in periods when the level and rate of growth of demand for goods and services exceed the level and rate of growth in the Nation's economic potential a reduced Federal deficit—or a surplus, depending upon the specific nature of this situation—will be called for.

Fiscal policy must be planned in advance. Moreover, the impact of that policy takes time to be felt throughout the economy. As a consequence, intelligent fiscal policy decisions hinge importantly upon a forecast of the future behavior of the major private sectors of the

economy. Even a decision to "do nothing" implies a forecast that the fiscal policy which results from "doing nothing," taken together with the expected behavior of the private sector in the economy, will bring the overall economic results we desire. And, in any event, it is literally impossible to "do nothing" in a fiscal policy framework. Expenditure decisions have to be made. Normal economic growth brings large annual increases in Federal revenues. If "doing nothing" means holding expenditures constant and keeping tax rates unchanged, then "doing nothing" will automatically result in a large change in the full employment surplus or deficit. We cannot, in other words, avoid forecasting, unless we wish to ignore the impact of fiscal policy decisions on employment, growth, and price levels.

Given the expenditures proposed in the President's 1969 budget and in the absence of a tax increase, the Federal deficit, on a national income accounts basis, would range in the neighborhood of $13 to $14 billion for both fiscal 1968 and 1969. Will such deficits lead to excessive aggregate demand, an acceleration of the rate of price increase, and a significant tightening of credit conditions? The answer to this question depends upon a forecast of the strength of demands in non-Federal sectors of the economy. If it appears likely that there will be a significant shortfall of private spending relative to the income which would be generated by a stable path of economic growth, then an offsetting excess of Federal spending relative to income will be necessary to balance overall demand against potential output, and prevent rising unemployment. Conversely, if private spending appears likely to approximate the level of private income generated by stable growth, then a substantial Federal deficit will generate an overheated economy and demand-pull inflation.

The administration's economic forecast foresees the latter situation. With the 10-percent surcharge, the extension of excise taxes, and the other proposed revenue measures—and a consequent NIA deficit for fiscal 1969 of about $2½ billion—the Council of Economic Advisers forecasts a rise of almost 8 percent in GNP from 1967 to 1968. Roughly speaking, this would keep the rate of unemployment at about yearend 1967 levels, provide for economic growth about in line with the growth of economic potential, and offer a reasonable hope of some deceleration in the rate of price increase by yearend 1968.

This forecast, of course, implies that private demands relative to private income are strong enough to warrant a tax increase. Conversely, it implies that without a tax increase, and with a NIA deficit approaching $15 billion, total demands for goods and services would substantially exceed economic potential, with consequent demand-pull inflationary pressures.

Instead of reviewing with the committee the specific components of the Council's forecast, I should like to approach the question of its overall reasonableness from several different standpoints.

1. Postwar surpluses or deficits in periods of full employment:

Do periods of full employment, once attained, typically require the support of large Federal deficits? Or, put another way, once full employment is attained are private demands typically so weak relative to full employment levels of income as to require a large Federal deficit if full employment is to be maintained? The short answer is "No."

Table 1 shows the Federal surplus or deficit during prior postwar periods of relatively full employment. With one exception, we have not seen NIA deficits during such periods. The only exception is the 1952–1953 period. Even here, the size of the deficit in relationship to GNP was significantly smaller than it was in 1967 and is projected for 1968, barring a tax increase. And this 1952–1953 period was followed by drastic reductions in defense expenditures consequent upon the end of the Korean War—so we do not know what the consequences of such deficits might have been.

TABLE 1.—FEDERAL DEFICITS OR SURFLUSES IN PERIODS OF HIGH EMPLOYMENT

Period (calendar year)	Unemployment rate (percent)	Federal surplus (+) or deficit (−)[1] (billions of dollars)	Surplus or deficit as percent of GNP (percent)
1948	3.8	+8.4	+3.3
1952 and 1953 (1st half)	2.9	−4.3	−1.2
1956 and 1957 (1st half)	4.1	+4.9	+1.2
1965	4.5	+1.4	+0.2
1966	3.8	+0.3	
1967	3.8	−12.6	−1.6
1968 without tax increase	?	−13 to −14	−1.7

[1] National income accounts basis.

By themselves, of course, these statistics prove nothing. Starting from a period of full employment, private demands could of course weaken substantially, and call for a substantial Federal deficit in order to maintain full employment conditions. Yet, it is significant, I believe, that during the postwar era we have typically run budget surpluses in periods of full employment.

2. The deficit in relation to the growth of GNP—and its consequences:

Relating the Federal deficit to the absolute size of GNP misses its real meaning. The projected 1968 deficit of $13 to $14 billion is, after all, only 1½ to 2 percent of GNP. How can such a small relative magnitude be so important? But what is relevant to problems of economic growth, demand-pull inflation, and unemployment, is the increase in total market demand relative to the increase in economic potential. Starting from full employment, a rise in GNP of, say, $10 to $20 billion in excess of the rise in economic potential would have significant inflationary consequences, even though that excess rise were only 1½ to 2 percent of the level of GNP.

Looked at in this context, a $13 to $14 billion Federal deficit looms quite large in terms of the $55 to $60 billion rise in GNP which would be consistent with stable economic growth in the year ahead.

If we were facing a sharp reduction in one or more sectors of the economy, such a deficit might indeed be warranted—as the $13 to $15 billion deficit in early 1967 helped offset the precipitous drop in inventory investment which occurred during that period. Without attempting to forecast the specific movement in particular sectors of the economy, let us examine each of them to determine whether such a reduction may be expected, and whether, therefore, a large Federal deficit is a necessary prerequisite for maintaining steady economic growth.

Consumer demand.—The consumer saving rate rose sharply in 1967.

In the fourth quarter it stood at 7.5 percent of disposable income, compared to a 5.6-percent average during the prior 5 years. Some of the increase may have reflected consumers' desires to increase their liquid assets—since the ratio of household liquid assets to disposable income had declined in 1966.

But by the end of 1967, the liquid asset ratio had been restored to, and slightly above, its earlier level. With the consumer saving rate already at an abnormally high level, and with the liquid asset ratio having been restored, a further increase in the saving rate in 1968 seems most unlikely. Indeed, the chances for a decline in the saving rate toward more normal levels would appear a better than even bet.

In short, consumer behavior does not seem likely to be a source of economic weakness in 1968.

TABLE 2.—RATIO OF HOUSEHOLD LIQUID ASSETS TO DISPOSABLE PERSONAL INCOME, 1956–67

End of calendar year	Ratio	End of calendar year	Ratio
1956	0.788	1962	0.845
1957	.796	1963	.873
1958	.800	1964	.871
1959	.807	1965	.877
1960	.810	1966	.867
1961	.811	1967	[1] .879

[1] Preliminary.

Note: Liquid assets include currency, demand deposits, time and savings accounts, U.S. savings bonds, and short-term U.S. securities.

Source: Board of Governors of the Federal Reserve System.

Business fixed investment.—In 1965 and early 1966 business plant and equipment did appear to be rising at an unsustainable rate. But no sharp contractions followed. After a slight decline in the first part of 1967, plant and equipment investment has turned up again. All of the surveys of business plans indicate a modest but healthy rise in 1968. There is no evidence that this sector of the economy will be a major source of weakness in the coming year.

State and local spending.—State and local expenditures have been rising at a rapidly accelerating rate. Total State and local outlays rose by $3½ billion per year in the last half of the 1950's, by $5 billion per year from 1960 to 1965, by $8 billion in 1966 and by $10 billion in 1967. This increase shows no signs of decelerating.

Housing.—The housing recovery in 1967 was a major source of economic strength. That rate of increase will not be repeated in 1968. But the basic income and demographic factors affecting the demand for housing remain strong. Residential construction will be a major source of weakness in 1968 only if credit conditions tighten up significantly. A large Federal deficit could indeed bring this about. In the absence of a large deficit, however, there is no reason to look forward to a sharp fall in housing construction.

Inventory investment.—The abnormally high ratios of inventories to sales which built up in late 1966 and early 1967 have been eliminated. Inventory investment in the last quarter of 1967 may have been slightly higher than a long-term sustainable rate. But, unlike the situation a year ago, there is no evidence which would indicate that inventories will be an independent depressant in the economy during the year ahead.

In summary, failure to take restrictive fiscal action now means:
—running a NIA deficit of $13 to $14 billion for 2 years in a row during a period of full employment;
—running a deficit equal to more than 20 percent of the normal growth in GNP;
—despite the fact that in postwar years the American economy has not appeared to require large deficits to sustain full employment, once achieved; and
—in the absence of any convincing evidence that there are major weaknesses in the non-Federal sectors of the economy, which might warrant such extraordinary measures.

The major inflationary consequences of failure to take restrictive fiscal action would show up in late 1968 and in 1969. No matter what fiscal action is taken now, prices will likely rise by an annual rate of 3 percent or more in the next 6 to 9 months.

Prior advances in the consumer price index and lags in the response of wages and prices to economic conditions almost guarantee excessive wage and price increases in the period immediately ahead. But without appropriately restrictive fiscal action, we shall be building inflationary wage and price increases into late 1968, 1969, and even 1970.

A wage-price spiral, once started, tends to continue for some time after the initial conditions which got it underway are removed. If we fail to remove those conditions now, we are insuring price and wage problems for several years to come.

There are risks in any fiscal policy, including a policy of "doing nothing." But, it seems to me, that the balance of risks in the present situation overwhelmingly dictates taking restrictive fiscal action. In the face of past experience, it seems abundantly clear that the burden of proof should be on those who believe a large and continuing deficit is needed to offset pronounced weakness in the private economy. To date, no such evidence has been forthcoming.

There are those, Mr. Chairman, who believe it is the rate of change in growth in the money supply which is most important, and that essentially shortrun tax action has no impact on the economy. Not attempting to quarrel with that point of view, I might point out that in terms of the balance of risks, if I am right, and you fail to take fiscal action, the economy is in trouble. If they are right and you take fiscal action, little harm is done. Because by definition, the argument goes it is essentially not the shortrun tax action which will substantially affect the economy.

So, on a balance-of-risks basis, it seems to me that tax action is called for, or at least a restrictive fiscal policy is called for.

The overall excess demands generated by a continued heavy Federal deficit could be offset by a very restrictive monetary policy. And, this is, of course, a possible option. But a monetary policy restrictive enough to accomplish the same overall results as the 10-percent surcharge would impose most of the burden of economic stabilization on new homebuilding.

Moreover, an unbalanced stabilization policy of this kind would be less likely to avoid price increases than the more evenly distributed impact of a tax increase. Excess demands in areas other than housing would generate increasing upward price pressure. But the slack-

ening of demand for home construction—if past history is any guide—would not lead to offsetting price decreases.

In other words, an unbalanced stabilization policy—even though it leads to the same overall movement in GNP as a balanced policy—will have less success in restraining price increases.

II. Expenditure Reduction vs. Tax Increase

Granted that a more restrictive fiscal policy is required, what form should it take? Many of the opponents of a tax increase argue that fiscal restriction is needed, but that it should be achieved by expenditure cuts, not by tax increases.

In the first place, the yield of the President's proposed tax measures in fiscal 1969 is $13 billion. To assume that the 1969 budget could be reduced by $13 billion is wildly unrealistic. Most of the reductions would have to come from the nondefense sector of the budget.

In making up the 1969 budget, the President and Secretary McNamara already reduced the appropriation requests of the military services by over $20 billion. But, in the civilian budget, if we exclude interest, the social insurance trust funds, and veterans' pensions and compensation, we are left with only $48 billion. Cutting $13 billion, or 30 percent, from that total is clearly out of the question—particularly, since an important part of the $48 billion residual represents programs like public assistance, Federal law enforcement, and air navigation services—which cannot realistically be pared significantly.

If it is unrealistic to substitute expenditure reductions for a tax increase, why not reduce expenditures by a lesser amount and accompany this with a tax increase, but one smaller than the proposed 10-percent surcharge? The answer to this, obviously, depends upon one's evaluation of the merits of the programs to be reduced as against the saving in tax burden. A few points might help put this possibility in context.

In the first place, as you know, virtually all of the expenditure increases proposed in the President's 1969 budget represent either outlays for national defense or increases in programs where payments are fixed by law. In fact, four items alone make up 95 percent of the increase—defense, social insurance programs, interests, and automatic Federal civilian and military pay increases scheduled for next July 1.

These cannot be reduced significantly. Consequently, cuts below the President's budget, would, in total, represent reductions below last year, rather than simply a moderation in the rate of increase.

In turn, if we ask ourselves realistically where such cuts would have to come, it is clear that a very large percentage of them would be concentrated in foreign aid and in the major social programs—education, health, poverty, manpower training, housing, and air and water pollution. With some exceptions, to be sure, other programs represent either workload items like the Internal Revenue Service and the Federal Aviation Agency, which cannot be cut significantly, or politically popular programs where cuts might indeed be proposed but have little likelihood of being enacted.

Large cuts in foreign appropriations would yield very little expenditure reductions in the next 18 months, given the long lag between appropriations and expenditures in this program. And the President's

budget submission for AID is already the lowest in many years. To gut that budget for the sake of perhaps two-tenths of a percentage point reduction in the surtax seems, to me at least, a strange inversion of priorities.

There are some who propose large reductions in public works programs. Wherever it is possible to reduce or stretch out construction programs, the President's budget proposes it. The real control over public works comes in the "new starts" provided each year. These have little effect on immediate expenditures, but do control the rate of outlays several years ahead. Realistically, however, the hope for major reductions here is, I submit, chasing a will-o'-the-wisp.

In every recent year the Congress—usually by a large majority—has substantially increased the new starts in public works programs—in fiscal 1968, from a proposed 9 to over 40. Holding up a tax increase while waiting for a cut in such programs will most assuredly not result in must fiscal restraint.

There is also a body of opinion which holds that failure to pass a tax increase quickly may make it possible to extract further expenditure reductions from the administration—after which some tax increase should be enacted. In my view this is a dangerous game of "chicken."

In the first place, substantial expenditure cuts were made in the fall of last year—and no tax increase was forthcoming. Second, while this game is being played, the continuation of large deficits is adding to inflationary pressures. Third, such cuts—perhaps $2 billion to $4 billion in magnitude—would substitute for several percentage points in the surtax.

This translates in several tenths of a percentage point relative to individual income. In a budget which is already tight, and in a situation where the Nation faces serious social problems—particularly in its large cities—I do not believe that major Federal social programs should be traded for the gain of a few tenths of a percentage point in after-tax income.

It is not as if Federal expenditures in recent years had been taking an ever-larger share of our Nation's income and output. Apart from the social security and medicare programs, this is not the case. Federal expenditures—excluding the social insurance programs—represented 16 percent of GNP in the late 1950's. In 1969, *including* 3 percent for the costs of Vietnam, they will account for 16.9 percent of GNP, and will have dropped sharply to 13.9 percent if we exclude Vietnam.

Social security benefits and medicare payments have indeed been rising as a percentage of GNP—from 3 percent in the late 1950's to 4.4 percent in 1969. But, whatever one believes about the desirability of these increases, they have been overwhelmingly approved by the majority of Congress. They scarcely constitute a reason for denying a temporary increase in taxes to help provide the needed fiscal restraint during a period of extraordinary defense expenditures. Indeed, were it not for Vietnam, Federal expenditures, including the rapidly rising social security benefits, would be a lower percentage of GNP in 1969 than in the late 1950's.

In summary, I think a sharp reduction in the Federal deficit is required to prevent excess demand inflation an undesirable tightening of credit markets, and a further deterioration in our balance of pay-

ments. It is clearly infeasible and unrealistic to provide the needed reductions in the deficit solely through expenditures reductions.

Finally, given the tightness of the President's 1969 budget and the gravity of the social problems which face the country, I do not believe a mixed strategy—some expenditure cuts and a smaller than 10-percent surtax—is warranted. The saving in lower taxes—amounting to several tenths of 1 percent on individual income—is not, in my judgment, worth the loss in public benefits from those programs which, realistically, would have to bear the burden of the cuts.

Chairman PROXMIRE. Thank you, Mr. Schultze.

Our next witness is a very highly valued former member of the staff of the Joint Economic Committee, Mr. Norman Ture. He was a tax expert with this committee for a number of years. He is now the director of tax research at the National Bureau of Economic Research, Inc.

Mr. Ture, you may proceed.

STATEMENT OF NORMAN B. TURE, DIRECTOR OF TAX RESEARCH, NATIONAL BUREAU OF ECONOMIC RESEARCH, INC.

Mr. TURE. Thank you, Mr. Chairman.

ISSUES IN FISCAL AND MONETARY POLICY IN 1968

I appreciate the opportunity to appear before the Joint Economic Committee and to present my views concerning the issues of fiscal and monetary policy in the United States in 1968.

Let me emphasize that the views I shall express are my own. They are not to be construed as a report of findings or conclusions by the National Bureau of Economic Research, Inc.

The central issue of fiscal and monetary policy, as I conceive it, is whether these policies should be focused on efforts to deal with short-term problems or longrun objectives. A few years ago, it appeared the latter was to be the major concern. The tax legislation of 1963–64 clearly and explicitly was aimed at a fundamental revision of the public financial framework for the U.S. economy. It was not, as is often claimed today by advocates of frequent, finely tuned fiscal and monetary adjustments for economic stabilization, concerned with any short-term deviations of the economy from the path of full employment with price level stability. President Kennedy, in the latter part of 1962, explicitly rejected an emergency tax reduction to avert or cushion the economic "pause" then observable which many persons feared would be transformed into recession unless some public policy action were taken. In promising tax legislation in 1963, he emphasized that he would seek basic structural reform intended to change the tax climate and to make it more congenial to those activities in the private sector of the economy upon which the growth of the economy fundamentally depends. The chairman of the Ways and Means Committee in the House confirmed and elaborated that purpose in his statement of September 16, 1963, when he characterized the reduction as the choice by the Congress of tax reduction in lieu of rapidly expanding Federal expenditures as the road toward a prosperous economy.

This concern with long-term objectives has been subordinated since

1965 by ad hoc efforts to treat economic disturbances which are deemed to be transitory in nature. It is the conviction, unsupported by fact, that fiscal and monetary instruments can effectively deal with these disturbances which accounts for the chaotic character of public financial policy in recent years.

The conflict between fiscal and monetary policy activism, fine tuning, or what have you, and the longer term focus of these policies is currently exemplified by the arguments concerning the temporary income tax surcharge proposal. The Nation is exhorted to adopt this measure as a means of dealing with the inflationary strains now in evidence and anticipated to strengthen this year. It is urged upon us as a means of preventing disorderly conditions in financial markets in the next several months. Surely it is not contended that failure to enact the surcharge will result in permanent disarray in these markets or perpetually rising interest rates. This marvelously versatile income tax surcharge is also needed, we are told, to overcome our balance-of-payments difficulties. Here, too, one must infer that the surcharge advocates have a temporary disturbance in mind, unless they believe that the temporary tax increase will, in some mystical way, effect a permanent remedy of our balance-of-payments problems. Finally, the surcharge is urged as a war-finance measure, to get us over the presumably temporary hump of Vietnam defense requirements.

On any one or all of these grounds, the income tax surcharge is not warranted. A temporary income tax surcharge is not likely to have any significant or predictable effect on the pace of expansion of aggregate demand this year. By the same token and for the same reasons, it is not likely to have any significant or predictable effect on the aggregate demand for financing and, therefore, on basic financial market conditions—although it might well change the composition of the total demands. By the same token, and for the same reasons, it is not likely to have any material or predictable effect on our balance-of-payments situation, though it might, on irrational grounds, affect the anticipations of foreigners holding dollar balances and alter their preferences as between dollars and gold. Nor should the surcharge be construed as a temporary war-finance measure, unless one chooses to overlook the budget realities.

On the other hand, enacting the income tax surcharge will have one clearly predictable effect. It will weaken the limited pressure now in force for constraining the ad hoc growth of Federal expenditures. It will thereby delay the day when the fundamental decision must be taken to put Federal expenditures and tax policies on an orderly long-term basis.

I should like to discuss somewhat more fully the arguments advanced in favor of the surcharge proposal before taking up an alternative approach to fiscal and monetary policy.

The income tax surcharge as a war-finance measure

In the conclusion of his 1968 Economic Report, the President observes:

> 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 that the American people will accept the cost of doing that—by paying an extra cent of each dollar of income in taxes . . . (p. 27).

The view that the proposed tax increase is required to defray the expenses of the war in Vietnam is, at best, merely a matter of perspective. The claim would be somewhat more credible or persuasive if nondefense expenditures of the Federal Government had remained at their 1965, preescalation level or even if they had grown moderately. But in fact, as table 1 shows, defense expenditures account for considerably less than half—$30.2 billion, or 45.7 percent—of the officially estimated $66.1 billion increase in expenditures—unified budget concept—between fiscal years 1965 and 1969. Nondefense expenditures, on the other hand, account for $35.9 billion, or 54.3 percent of the increase.

TABLE A.—DEFENSE AND NONDEFENSE EXPENDITURES, FISCAL YEARS 1965, 1968, AND 1969

[In billions of dollars]

Expenditure	1965	1968	1969	Increase	
				1965–69	1968–69
Defense:					
Amount	$49.6	$76.5	$79.8	30.2	$3.3
Percent of total	42.5	54 0	43.7	45.7	25.5
Nondefense:					
Amount	$67.1	$93.4	$103.0	$35.9	$9.6
Percent of total	57.5	55.0	56.4	54.3	74.5
Total	116.7	169.9	183.8	$66.1	12.9

Source: The Budget in Brief (p. 68.)

More recent budgetary developments make it even more difficult to accept the characterization of the proposed surcharge as a war-finance measure. The estimated increase between the current fiscal year and fiscal 1969 in defense expenditures is $3.3 billion, scarcely a quarter of the total increase of $12.9 billion. Indeed, the proposed increase in expenditures for the health, labor, and welfare function alone is $5.5 billion. Very much the same results are found in the NIA estimates.

In short, as between fiscal 1968 and fiscal 1969, it is not the proposed increase in defense but in nondefense expenditures which conceivably might provide the occasion for a tax increase. It is assuredly more consistent with the budget facts to characterize the proposed income tax surcharge as a welfare program finance measure. Similarly it would be more appropriate for the President to urge the Nation to pay an additional $10.8 billion in taxes to meet the increased demands of nondefense programs, rather than invoking the sacrifices of young Americans in Vietnam as the occasion for this request.

The surcharge as a curb on the expansion of aggregate demand

Heavily stressed in the administration's arguments for the surcharge proposal is the contention that it is needed to repress an otherwise excessive increase in aggregate demand and accompanying increase in inflationary pressures.

The Council of Economic Advisers now forecasts a 1968 GNP of approximately $846 billion, up $61 billion from the current estimate of $785 billion in 1967. This $61 billion increment, it is forecast, will represent a gain of somewhat more than 4 percent in real output and an increase of somewhat more than 3 percent in the general level of prices.

On the basis of the past forecasting performance, the widespread

reluctance to base the tax action on the official estimates for calendar 1968 is quite understandable. As shown in table 2, the CEA's forecasts have missed the mark by a wide margin in 1964, 1965, 1966, and 1967.

TABLE 2.—APPRAISAL OF COUNCIL OF ECONOMIC ADVISERS' FORECASTS, 1964–67

[Dollar amounts in billions]

Year	Gross national product		GNP increase over prior year		Percent difference between CEA forecast and actual
	CEA forecast [1]	Actual	CEA forecast [1]	Actual	
1964	$620.5–$630.9	$632.4	$30.4–$40.4	$41.9	3.6–27.4
1965	665.6–675.8	683.9	33.2–43.4	51.5	15.7–35.5
1966	725.9–735.9	743.3	41.9–52.0	59.4	12.5–30.3
1967	[2] 790.9	785.0	47.6	41.7	14.1
	793.9–[3] 795.9	([4])	50.6–52.6		21.3–26.1

[1] Adjusted for subsequent revision in prior year's GNP.
[2] CEA adjusted mean forecast, January 1967, with income tax surcharge effective July 1, 1967.
[3] CEA adjusted mean forecast, January 1967, without income tax surcharge.
[4] Preliminary.

The January 1964 forecast was interesting because it explicitly estimated the effect on gross national product of each month's delay in enacting the tax reduction. Allowing for the delay that actually occurred and for the revision in the measure of 1963's gross national product, the midpoint of the Council's estimate for 1964 missed the actual result by 15.5 percent. At the bottom of the $10 billion range around their estimate, the error was 27.4 percent, while at the top it was 3.6 percent. The January 1965 forecast of the increase in gross national product in 1965 missed the actual outcome by not less than 15.7 percent or as much as 35.5 percent, depending on whether one refers to the upper or lower end of their estimate range. The January 1966 estimate was somewhat better; the error range was 12.5 to 30.3 percent. The early 1967 forecast, adjusted for the subsequent revision in the measured 1966 gross national product and with the 10-percent surcharge effective July 1, 1967, was a gross national product of $790.9 billion. Without the surcharge, the actual outcome in 1967 is now estimated at $785 billion. If one assumes the Council believed the July 1, 1967, enactment of the surcharge would have no effect on gross national product in 1967, their forecasting error was 14.1 percent. If, on the other hand, one interprets the remarks of former CEA Chairman Gardner Ackley last summer as holding that prompt enactment of the surtax would reduce the second half gain in gross national product by about $3 billion to $5 billion, then the January 1967 forecast erred by 21.3 to 26.1 percent.

The most recent testable forecast was presented by Dr. Ackley, before the Ways and Means Committee on August 14, 1967, and called for an increase of between $29 billion and $35 billion for the second half of the year, without the tax increase. While the actual result, an increase of $32.5 billion—annual rate—came out very well, comparison of his estimates with actual results for the increases in major gross national product components leaves one convinced that the overall estimate was a lucky one.

For example, Dr. Ackley estimated an increase in consumption expenditures, in the absence of the proposed tax increase, of $16 billion to $18 billion. The actual increase was $12.1 billion; the error in

the forecast was between 32.2 and 48.8 percent. Housing expenditures were forecast as increasing by $3.5 billion; the actual increase was $4.5 billion, an error of 22.2 percent. Incidentally, in commenting on this estimate, I suggested it was substantially on the high side, which shows you how meager are my qualifications as a forecaster. For plant and equipment expenditures, Dr. Ackley forecast an increase of $1 billion. The actual change was $2.5 billion; the error was 60 percent. Inventories increased $8.7 billion compared with Dr. Ackley's estimate of $1 billion to $2 billion; he missed by 77 to 88.5 percent. For State and local governments, Dr. Ackley forecast an increase of $4.5 billion; the actual increase was 9.8 percent less, $4.1 billion. And for Federal purchases, the CEA estimated a second-half increase of $0.3 billion to $3.5 billion, or 11.1 percent to 122.2 percent above the actual (see table 3).

TABLE 3.—INCREASE IN GROSS NATIONAL PRODUCT COMPONENTS, 2D HALF 1967 COUNCIL OF ECONOMIC ADVISERS' ESTIMATE COMPARED WITH ACTUAL

[Dollar amounts in billions]

GNP component	Increase, 1967 2d quarter, to 1967 4th quarter		Percent difference between CEA estimate and actual [3]
	CEA [1]	Actual [2]	
Personal consumption	$16–$18	$12.1	32.2–48.8
Gross private domestic investment:			
Fixed nonresidential investment	1.0	2.5	60.0
Residential investment	3.5	4.5	22.2
Change in inventories	1.0–2.0	8.7	77.0–88.5
Government purchases:			
Federal	3.0–6.0	2.7	11.1–122.2
State and local	4.5	4.1	9.8

[1] Hearings on President's 1967 Tax Proposals, Committee on Ways and Means, House of Representatives, 90th Cong 1st sess., pt. I, p. 88.
[2] Preliminary estimates by Office of Business Economics, Department of Commerce, Feb. 14, 1968.
[3] Difference between Council of Economic Advisers' estimate and actual, divided by actual.

I think the Council deserves our heartfelt sympathy in this regard. Theirs is a thankless task. More's the pity, it's also a useless one. For even if the forecasts were vastly better than they are in fact, they would have little if any operational significance. To take the present case in point, even if the Council's current forecast of an excessive increase in aggregate demand without a tax increase were accepted as correct, there is little if any basis for confidence that the proposed tax increase would significantly affect the outcome.

The assertion that they would be effective is based on the assumption that private spending, by households and businesses, responds quickly to changes in the rate of expansion of private disposable income. Few economists, if any, would represent corporate spending decisions as affected at all by temporary changes in corporate profits after taxes, let alone quickly affected. Even fewer corporate decisionmakers would attempt to alter spending plans on the basis of changes in effective tax rates when these changes are designated as, and deemed to be, temporary. Even more implausible is the notion that the small changes in the timing of tax payments, involving no change in tax liabilities, have any noticeable effect on business spending.

In the case of households, there is a widespread consensus among

economists that current consumption decisions and behavior are not a function of the household's current aftertax income and that whether changes in current aftertax income result in changes in consumption depends on numerous other factors. While there is a continuing argument among economists concerning the determinants of consumption, there is much less disagreement about the proposition that temporary income tax changes are likely to have little near-term impact on consumption.

If no systematic and predictable relationship between changes in consumption outlays and in disposable income in the shortrun can be assumed, the argument for a temporary income tax surcharge on grounds of restricting the shortrun expansion of aggregate demand is of no force. Many new economists are disconcerted by the allegedly puzzling behavior of the personal-saving rate in the recent past and the evidence that, accordingly, the predictability of consumption changes by reference to income changes is much less than conventionally assumed. One would think this would at least give them pause in their advocacy of the surcharge.

Whether or not one finds the theory appealing, actual experience of the U.S. economy in the years since World War II affords no convincing evidence of a predictable relationship between changes in fiscal policy and in the pace of economic activity. Perhaps the least demanding test one might require of the view that there is such a relationship is that decreases and increases in the so-called "full-employment surplus" should result in speeding up and slowing down, respectively, of the expansion of GNP, within a reasonably short period of time. In fact, this test is failed at least as often as it is passed, based on quarterly data, lagged or unlagged, since the first quarter of 1947.

To take a couple of specific examples, between the last quarter of 1947 and the last quarter of 1948, the full-employment surplus was reduced by about $12 billion, as the result of a $5 billion tax reduction and a $10 billion increase in expenditures. Surely this highly stimulative fiscal policy should have produced a sharply accelerated increase in total spending and output. As you know, however, the contrary was true; the economy experienced a sharp recession beginning in November 1948.

Currently, the favorite example of fiscal impact on the economy offered by the advocates of frequent tax changes for stabilization purposes is the tax reduction of 1964. It is perfectly true that aggregate demand increased strongly following the tax reduction. It is conveniently overlooked by fiscalists, however, that aggregate demand had also been increasing sharply for a year before the tax cuts went into effect.

In summary, the postwar experience affords no evidence upon which one could objectively conclude that income tax increases or reductions, per se, act promptly to curb or stimulate total demand in the private sector.

Failing the assumption that private spending will change quickly in response to a temporary change in the private sector's disposable income, the case for tax increases now, in order to slow the rate of expansion of total spending during the remainder of this year and the first half of next, is very weak, indeed. Even more feeble, on anti-

inflation grounds, is the case for acceleration of corporation tax payments. Whatever the other merits of putting the corporate business community more completely on a current payment basis, the mere fact of acceleration of corporate tax payments can hardly be deemed to be significant for the volume of corporate spending.

The income tax surcharge and the financial markets

One of the arguments advanced on behalf of the surcharge is that, in its absence, Federal borrowing requirements will place extraordinary burdens on financial markets, will send interest rates higher and higher, at the expense of housing, State and local government, and small business expenditures. Last August, the Secretary of the Treasury and the Director of the Bureau of the Budget predicted that failure promptly to enact the tax increase would send "interest rates sky high * * * shutting off the flow of credit to sectors such as the home mortgage market and small businesses." As Dr. Schultze put it, "The recovery in homebuilding from last year's setback would surely be choked off, and indeed, reversed."

Interest rates, to be sure, advanced strongly, particularly in the second half of the year. But residential construction, as already pointed out, also increased strongly through the year, substantially exceeding the Council's forecast. And State and local government outlays also rose more than the CEA had anticipated. Since the end of 1967, parenthetically, the upward movement in yields has slackened. Indeed, many of the rates have been drifting downward, at least into mid-February.

But if the tax increase had been enacted, as requested, would interest rates have risen less? Will its enactment now prevent further increases in interest rates?

The affirmative response is based on the assumption that the reduction in the Treasury's borrowing requirements consequent to a tax increase will not be offset by an increase in credit demands by others. But this, in turn, supposes that households and businesses will respond promptly to the tax increase by curtailing their spending. If this does not prove to be the case, and the burden of my argument is that it won't, then the likely result is an increase in private-sector demand for funds beyond the amounts which would be sought in the absence of the tax increase. In short, the reduction in the Government's financing needs probably would be matched by an increase in the private sector's. In the near term, say over the next year or so, the tax increase may well primarily serve to change the composition of credit demands; it is much less likely to change the total amount of financing sought by any significant amount.

Efforts to justify the tax increase as a means of holding back interest rate increases rest on very shaky theoretical grounds. On the basis of the evidence of the postwar years, the case is just as feeble. Presumably, greater fiscal constraints, either with the same or with a greater degree of monetary ease, should result in reduction in interest rates. By the same token, easier fiscal policy and tighter monetary policy should result in higher interest rates. Using changes in the full-employment surplus as the measure of fiscal constraint, one finds, in fact, that interest rates changed as would be expected on only one occasion in the postwar years when fiscal and monetary policies moved

in opposite directions. One also finds that interest rates rise after a significant acceleration in the growth of the money stock and level out or decline after a deceleration or contraction in the money stock, irrespective of fiscal developments. The administration's contention that tax increases are needed to hold back interest rates is not validated either by theory or by experience.

The surcharge and the balance of payments

It is always nice to have allies. When the domestic economy arguments in favor of the surcharge failed to gain enthusiastic acceptance, it was predictable that the old standby, balance-of-payments deficits and gold outflow, would be called upon to come to the rescue. The Nation is now assured that the temporary income tax surcharge is needed to preserve the strength of the dollar and to mollify our European critics. Let me grant that the latter's confidence in the international purchasing power of the dollar may be temporarily strengthened, on the same analytically and empirically unsound grounds as are adduced domestically, by a temporary income tax surcharge. It strains the credulity, however, that anyone who has observed the continuous deterioration in our balance of payments and shrinkage in our gold stock will believe that a longrun solution to these problems is to be found other than in a fundamental revision of our international payments mechanism. Fiscal jiggling, except insofar as one believes it will result promptly and more or less permanently in a significant disinflation—at least relative to our trading partners—is no substitution for freeing ourselves from the straitjacket of a pegged-dollar price for gold.

In brief, the argument advanced by tax-hike advocates is merely an extension of that offered with respect to the domestic economy. A temporary income tax hike presumably will so significantly depress the expansion of aggregate demand as materially to reduce the growth in our imports and will so significantly abate upward pressures on the prices of the goods and services we sell abroad as to materially increase our exports. I have already dealt with the frailty of the argument with respect to the near-term impact of a temporary income tax hike on household and business spending and will not trouble you with a restatement. The balance-of-payments argument for a tax increase is, at best, no better than the domestic economy argument. In fact, it is not as good, since it also relies on the assumption that both imports and exports are highly and promptly responsive to changes in the pace of expansion in aggregate demand, which in turn must be deemed to be highly and promptly responsive to temporary income tax increases.

In fact, the more proximate short-term relationship is between the trade surplus and changes in our prices for goods in international commerce relative to the prices for those goods among our trade partners. These relative price movements are not closely correlated in the shortrun with changes in fiscal magnitudes in the United States.

Surely nothing better illustrates the difference between a deliberate, carefully ordered, long-range approach in public policy and an ad hoc, fits-and-starts approach aimed at dealing with shortrun disturbances than the present proposals in connection with our balance-of-payments difficulties. The former public policy approach be-

gins with determination of policy goals. It seeks their clearest possible delineation, in order, among other reasons, to be able to assess their realism. It rejects those objectives which, no matter how gloriously labeled, lie beyond our present and prospective capabilities. Moreover, it appraises them in terms of their consistency with other aims of public policy and private aspirations. It then proceeds to the consideration of means, aiming always at maximizing results relative to costs, but always subject to the constraint that these means are consistent with society's values and preferences. Having determined aims and means for seeking them, the policy is not then subject to frequent suspension and reinstatement. This surely doesn't mean it's ignored nor that it is never modified, but stability is assuredly a great virtue of viable policy.

How would this prescription be applied today? The long-range balance-of-payments policy goal, which should assume precedence over more immediate concerns, is to achieve an international payments mechanism which (1) facilitates rather than impedes international commerce in goods and services and in resources; (2) allows for speedy adjustment to temporary monetary disequilibrium without requiring extensive shifts in real-resource use or extraordinary adjustments in total employment and output; and (3) facilitates rather than impedes resource adjustments to real- and basic-resource misallocation. Few economists, I am confident, would regard a national policy oriented to pegging the price of gold at $35 per ounce as meeting these criteria.

It is difficult to understand how the goals of a sound international payments system can be attained by (1) the attempt to impede international capital movements by direct controls over U.S. foreign investment; (2) inhibiting tourism through a ponderous, redtape-laden tax; and (3) imposing discriminatory taxes on imports.

I am also confident that most economists would concur with the view that attaining the longrun objectives of our international trade policies requires a fundamental revision in our payments mechanism, not repressive stopgap measures which are inconsistent with our recent efforts toward freeing international commerce and which can only defer the time of decision. A wholesome first step toward achieving that necessary and inevitable revision would be for the Government to consider objectively and fairly the major alternatives to the present system, instead of rejecting out of hand any approach that would imperil rigid adherence to $35-an-ounce gold.

A stable monetary policy

This committee, in its 1967 Economic Report, gave abundant evidence of its preference for stability in public policies oriented to long-term objectives in urging that the monetary authorities eschew erratic shifts in policy and aim instead at a steady growth in the stock of money. The wisdom of this prescription can hardly be better illustrated than by reference to monetary policy developments in the last few years. If we are seeking sources of the recent instability in the economy, why don't we at the least begin with the 2 years of extremely rapid expansion of the money stock, at an annual rate of 4 percent from June 1964 to April 1965, and then at an even more rapid pace, 6 percent, from April 1965 to April 1966. If one seeks a proximate

explanation for the extraordinary $63.2 billion, or 9.7-percent increase in GNP between the first quarter of 1965 and the first quarter of 1966, why not start with this zooming money supply? If one seeks an explanation of the slowing pace of expansion of GNP—indeed, of the virtual leveling out of real GNP—from the last quarter of 1966 through the first half of 1967, why not look first to the screeching halt on monetary growth beginning in April 1966 through January 1967, when the money stock declined by 0.2 percent? And if we are now in for an excessive surge of aggregate demand and further inflationary developments, as we may well be, why not assign a substantial share of the responsibility for these unhappy prospects to the 7.3-percent increase in the money stock between January 1967 and January 1968—or the incredible 9.3-percent growth between January and July 1967?

Developments of the past year in monetary policy should confirm this committee in its preference for a rule of stable growth in the money stock. May I urge consideration for a parallel approach to fiscal policy?

A stable fiscal policy

That approach, I submit, calls for initiating the effort to get Federal Government activities and programs on a stable, long-term basis. Here, too, the longrun goals of these activities should be clearly delineated and rigorously appraised for their realism. Properly defined, the long-term trend requirements of these programs can be estimated and it is on the basis of such amounts, never on the basis of their first or current-year costs, that these programs should be authorized, rejected, or modified.

Given these long-term trends in expenditures, given the trends in the major components of national income, and given the tax structure, trends in revenues can be estimated. If the trend values of Federal expenditure programs, realistically estimated, accepted, and approved by the people of the United States and their congressional representatives, should be estimated as exceeding the trend amounts of revenues, then taxes should be increased deliberately, carefully, with due regard to fairness, simplicity, and in line with the economy's requirements and preferences for encouraging private effort and capital accumulation. If the trend growth in expenditures is estimated as falling below that of revenues, regular reductions in tax rates should be scheduled and implemented without interruption for meeting short-term deviations from trend.

Of course, conditions change and so, too, would the trend values of expenditures and revenues. When such changes rather than temporary deviations from trend "can be established," corresponding changes in expenditures and/or revenue programs would be called for. This is, in other words, no call for a straitjacket on Federal finance.

Neither is it a policy calling for rigid, annual budget balancing. Indeed, with such a policy, there would be no occasion for concern with whether the budget is balanced in any particular year. On the contrary, a balance in the budget in any year would be considered an uninteresting and inconsequential coincidence. Finally, to repeat, temporary deviations from trend in either expenditures or revenues

would not call for any compensatory action. Persistent deviations, on the other hand, would call for a reassessment and adjustment.

Although not articulated in this wise, the position of the Ways and Means Committee to date on the income tax surcharge may be interpreted, I believe, in this light. That committee's position, it seems to me, is an expression of a desire for conforming the public finances of the United States with the policy prescription enunciated in the early fall of 1963; that is, moderate growth in Federal expenditures coupled with periodic tax reductions.

It may well be that the Nation's preferences in this regard have changed since 1963–64. We may now deem it advisable for the Federal Government to extend and broaden its responsibilities without offsetting elimination or phasing out of longstanding programs. If so, this change in preference can be readily ascertained, if the issue is put to the Nation in these terms, rather than in terms of a budget arithmetic which seeks to assure us that a $10.4 billion year-to-year increase in expenditures is scarcely any increase at all, or is attributable to Vietnam costs, or is required by existing—inferentially, unchangeable—legislation, and which fails to convey to us the costs of existing and new programs over a reasonable period into the future—at least, say, 5 years.

There is scarcely a sadder commentary on the present state of Federal expenditure policy than the fact that the Members of the Congress are each year surprised by the increase in outlays which "are required by existing legislation." Yet, year after year, new spending programs are proposed and their enactment urged without any appraisal of their likely costs over their full lifetime or any significant part thereof.

If there is an occasion for a tax increase this year, then, it is for a permanent addition to Federal revenue potential to meet the Nation's preferences for a permanently increased path of Federal expenditures. Such an occasion, to repeat, may well exist. The real challenge for fiscal policy this year is to determine whether, in fact, it does.

Chairman PROXMIRE. Thank you.

Our last witness is Prof. Fred Weston, who is the UCLA economic equivalent of Gary Beban and Lew Alcindor, the gift of UCLA to this committee and other committees of the Congress. Mr. Weston is an outstanding forecaster and a fine witness. Happy to have you.

STATEMENT OF J. FRED WESTON, PROFESSOR, BUSINESS ECONOMICS DEPARTMENT, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

Mr. WESTON. Mr. Chairman, since my prepared testimony overlaps some of that of the first two speakers, I will summarize it in places. In places it rebuts inferentially the previous speaker, and there would be a temptation to elaborate on this, but I won't, since I presume there will be time during the discussion for this.

REVIEW OF THE ECONOMY SINCE MID-1967

When I last appeared before this committee on June 29, 1967, the committee was also at that time engrossed in the question of the tax increase. The economy had showed a decline in real terms between the

fourth quarter of 1966 and the first quarter of 1967. The growth during the second quarter of 1967 was quite small.

In view of the uncertainties of the economic outlook, many counseled a "wait and see" attitude on the increase. The view was, "Let us wait and see what happens to the economy in the third and fourth quarter of 1967."

Some of us who testified argued that while the past data were not impressive that an analysis of the unfolding trends provided the basis for prediction that the third and fourth quarters of the year would be very strong. On this basis some of us recommended the need for prompt enactment of the tax increase. These views were not persuasive.

The facts of the third and fourth quarters of 1967 are now in. What does the record show? The record shows an increase during the third quarter in the gross national product of $16.1 billion and during the fourth quarter of $16.4 billion. These quarterly increases represent a rate of growth of an order of magnitude of $65 billion per year at an annual rate. This compares with the Council of Economic Advisers' forecast of a growth of $60 billion for all of 1968, from $785 billion to $845 billion, on the assumption of a relatively prompt imposition of the 10-percent surtax.

Clearly, the $65 billion annual rate of growth during the third and fourth quarters of 1967 exceeded the real capacity of the economy to expand output. As a consequence, price increases as measured by the GNP price deflator, which increased only about one-half index point between the first and second quarters of 1967, accelerated to double the rate of price increase between the third and fourth quarters of 1967.

So we missed one boat last year. However, just because we made an error last summer, does not necessarily imply that adopting the correct policy something more than a half a year late, is the sound thing to do. In fact, as the events of early 1968 began to unfold, in my own mind I had been moving to embrace the view that having waited this long to adopt the tax increase, to take any action now would represent a policy of "too much, too late."

THE CASE AGAINST A TAX INCREASE

The case in support of this position is a formidable one, and must deserve the most careful consideration. It begins by analysis of the outlook for individual components of GNP.

One.—Capacity utilization in manufacturing during December 1967, was at about an 85½ percent rate. With the Federal Reserve Index of Industrial Production down slightly for January, indications are that capacity utilization will be down to about 84½ percent for the month of January 1968.

The McGraw-Hill survey, released November 10, 1967, indicated that preliminary plans for capital spending in 1968–1969 were for an increase of 5 percent over the amount spent during 1967. This survey also indicated that business anticipated a 5-percent increase in the prices it would have to pay for new plant and equipment during 1968, so that additions to plant and equipment during 1968, in real terms, was expected to be the same as in 1967.

This is a favorable factor in that with the increase of the level of

the economy generally and in the sales of business firms, with plant and equipment spending at a plateau, the utilization rate would rise somewhat. However, this would represent minimal stimulus to gross national product from plant and equipment investment by business.

Two.—The outlook has also been clouded for consumer spending. Consumer expenditure expectations softened somewhat in January. Auto sales have not held up to the 9.3 million forecast for 1968, but the interpretation is uncertain because of the Ford strike during December and the rolling General Motors strikes during January.

With relatively high interest rates and the tightening money supply, it is difficult to make a case for more than 1.4 million housing starts during 1968. Since so many of the other durable consumer goods are related to new household formation, the outlook for increased spending on consumer durable goods generally must also be subject to reservations.

Three.—Government spending is reduced. The budget estimates for fiscal 1969 indicate an increase of $10.4 billion versus $20 billion for fiscal 1968. This represents an increase of about half the fiscal 1968 rate.

Four.—A strong case can be made that exports will be down rather than up. If the British devaluation is to have any of the results expected for it, one can only expect that U.S. exports to Great Britain should decline. The acceleration in price inflation in the United States during the last half of 1967 does not help our position in export markets, either.

But, even if strong economic recovery in Western Europe, and price inflation in Western Europe, redressed somewhat some of the unfavorable price trends that developed during the past year, no one can seriously make a case that if net exports did not turn down, they would turn up by very much.

Five.—The stimulus from inventory strike hedge buying will be over by midyear. Thus, the standard forecasts for 1968, for the year as a whole, of about a $60 billion increase in gross national product allocate a considerable portion of the $60 billion to the first two quarters of the year and less to the second two quarters.

Thus, it is argued that the major impact of any tax increase would come when the stimulus from inventory investment had subsided, in fact, would come when business would be faced with the necessity of working down inventories. In short, the tax increase would come when the inventory impact on the economy would be negative rather than positive.

Six.—Monetary policy during most of 1967 had been relatively easy. Hence, monetary policy could be tightened thus doing whatever job needed to be done during the first half of 1968. Indeed, some argue in more general terms that the mix of U.S. monetary and fiscal policy must parallel that of Europe. In Europe, when meaningfully measured, it is argued that fiscal policy has been relatively easy and monetary policy has been relatively tight.

Thus, particularly in relation to balance-of-payments considerations, monetary policy should be relatively tight so that we do not have adverse money market flows in response to interest rate differentials between the United States and Western Europe.

Seven.—It is argued further that if it is judged that fiscal policy

is relatively too easy, if a projected deficit of $16 billion to $18 billion without the surtax imposition constitutes too great a stimulus to the economy, this can be avoided by reducing Federal expenditures. This view holds that the spending side of the budget can and should be cut, that Government expenditures have been increasing at too fast a rate, anyhow.

Eight.—Finally, the clincher in this case refers to the fact that despite price increases of about 3 percent during 1967, the public is generally opposed to a surcharge imposition at the Federal level in the attempt to restrain price increases. Congressmen receive reports from their constituents indicating that State and local taxes are already up, and their constituents indicate they are opposed to a Federal tax increase on top of the tax increases taking place at the local level.

It appears that with the uncertain economic and international outlook, consumers have postponed purchases of autos and other durables and have increased their savings rate. It appears that consumers would prefer to readjust their purchases and standard of living in the face of rising prices.

Consumers would appear to prefer to control their destiny. Consumers feel that somehow they can adjust to price increases that have been taking place by perhaps changing the mix of the purchases and making some durable items "do" longer. A tax increase, however, provides the consumer with no such discretion. This is an extra burden of outlays that he must bear.

This set of reasons opposing the tax increase at this time at the Federal level presents a very formidable system of logic. Both economic and political considerations appear to be overwhelmingly against a tax increase at the present time.

Yet, as I analyzed the data and trends and reasoned about economic developments in preparation for this presentation, some disquieting and persistent reservations continued to gnaw at me. I began to feel that Congress sometimes acts like some business firms. Sometimes both Congress and some business firms are too much influenced by events of the recent past, the present, and the prospective immediate future. Furthermore, in the world in which we live there is always uncertainty. And when the stakes are so great, uncertainty must be assessed in terms of minimizing the most unfavorable set of possibilities.

Like some businesses, Congress tends to adopt policies based on events that appear to be at the moment the most likely, or on actions that in the near term, appear to involve efforts that are less unpleasant or strenuous.

But intermediate and longer term developments may bring in their train consequences that are the opposite of current expectations. An effective Congress, like a successful business, must anticipate developments, not react to events after they occur.

Possible Additional Requirements for National Security

Let us, therefore, look at some of the realities of life in connection with economic developments. The forecast of $8 billion for fiscal 1969 was based on the assumption of raising $10 billion from the surtax. If no surtax is imposed, the deficit rises. The increase would be less than $10 billion, considering the stimulus to the economy.

On the other hand, costs to the Federal Government would go up with the greater price inflation resulting from not having the surtax. Therefore, a reasonable assumption is that the deficit would be in the range of $18 billion without the surtax.

Now we come to the crux of the matter. We are waging a war on many fronts, both internationally and domestically. Internationally, it is only necessary to mention Vietnam, North Korea, continued tension in the Middle East, revolution and the threat of revolution in Latin America, the Berlin situation in Western Europe which, for the moment, appears to be quiescent, and problems of working out an effective NATO in Western Europe.

In such an environment of international tension, the only conclusion that can be drawn with confidence about the outlook is a considerable range of uncertainty. Any sober assessment of the world today must allow for a $3 billion to $7 billion increase in defense and security expenditures. To do otherwise is to read news events with one eye closed at a time.

Besides, the uncertainty factor does not even take into consideration some of the very important longer run considerations in the U.S. national position. Before Vietnam erupted, we were quite concerned about the row-of-domino effect to U.S. prestige if the U.S.S.R. made achievements in space that were dramatically superior to our own.

And, in addition to prestige considerations, the military potential of orbiting space vehicles must also give us pause. Even the implications of space expenditures for their technology fallout and implications for longrun productivity growth in the American economy deserve more careful assessment than they have received.

These developments, which for the moment tend to have been ignored to the point where space expenditures for 1969 have been cut by almost a half billion dollars, will have greater significance in the long run than whether or not we make a successful stand at Khe Sanh.

The point is, in such an uncertain world, not to consider the strong possibility of an increase in defense and security requirements is unrealistic. Furthermore, with at least one active war going on, the requirements of war are inherently unpredictable and uncertain. And when the choice becomes one of reverses for lack of necessary manpower and equipment support versus maintaining a target budget situation, the target budget situation must become a war casualty.

Analysis of Budget Allocations for Domestic Programs

That is the international aspect of the outlook. Now, let us turn to the domestic side. We have many struggles going on in our domestic economic, political, and social cultures. Many of these are inherent in the urbanization, impersonalization, and loosening of family ties in our society.

This Congress has responded to the need for alleviating insecurity associated with old age and with the increased medical care requirements of increased longevity. We have recognized the economic and social necessities of providing disadvantaged groups with more equal opportunities.

An important aspect in this area is aid which may raise the abilities of the low-productivity groups. Such expenditures have significant

longrun productivity contributions to make, both in terms of contributing to the greater rate of growth of our economy as well as to social and political progress and stability.

The relevant numbers in this regard are quite revealing. Of the $7.1 billion projected increase in nondefense outlays for fiscal 1969, $4.2 billion represent increased social security and medicare payments. This leaves $2.9 billion. Of this, interest and pay increases amount to $2.5 billion, leaving less than half a billion to be accounted for out of total Federal outlays of over $186 billion.

And of the almost total $7.1 billion nondefense budget outlays we have accounted for, almost all of these increases and outlays are caused by the past price rises that have taken place in the economy and represent an attempt to maintain the position of these various groups in real terms.

Furthermore, cuts and reforms from the original budget proposals of last autumn represent reductions of $2.9 billion including cuts of roughly a half billion for NASA, atomic energy, and other advantaged technology-, space-, or defense-related activities, and another half billion in connection with support to education.

I will not dwell upon the former, since I have already discussed its implications, nor will I discuss the latter since I am debarred by potential vested interest considerations.

But, the numbers alone, and their rough breakdown, provide a clear outline of the basic relationships. Certainly a cut in the budget is theoretically better than a tax increase of the same magnitude. But my careful reading of the August budget review hearings indicated to me that it was the representative of the Bureau of the Budget who was carrying the load of analysis and response to general challenges.

I have not heard nor seen from this Congress or this committee, or any other committees of the Congress, specifies as to where the budget cuts could be made. I have not seen a list of items for cuts that have been recommended or proposed to the Bureau of the Budget and which proposals have been turned down or not followed.

The rituals that I have observed being performed remind me of the hostility games that I see in the toy shops. The hostility games provide the opportunity of throwing darts at your favorite public figures. Various committees of the Congress have been playing their own hostility game. There are two groups of players engaged in the game. Those whom I shall designate wearing the blue jerseys continuously ask for cuts in the budgets but do not specify where, how, or when. The other group of players, whom some see in green jerseys, criticize the administration for not spending more on its Great Society programs.

And yet, these have not provided responsible leadership in helping to make a case for a tax increase that would be necessary to finance the expanded programs which they are urging.

The hostility dartboards in the toy shops may perform a useful function in relieving some frustrations growing out of a complex urban society and uncertainty in a world in which the growing pains of readjustment of power distribution take place in international society. But the Congress runs some great risks in playing its own dart game. These risks are economic and security risks for the Nation, and represent political risks for Members of Congress.

Potentially Explosive Economic Expansion Products

To explain the basis for the foregoing general propositions, let me depict briefly an alternative analysis of the outlook in contrast to the eight-point analysis previously outlined.

One.—During the first half of 1968, heavy inventory buying will accelerate as strike deadlines approach.

Two.—Plant and equipment spending plans were formulated when the outlook for 1968 continued to be relatively uncertain. The initial impact of rising sales with no real increase in capacity will be to reduce unused capacity.

Yet, there is little excess capacity outside of the manufacturing sector, which accounts for less than one-third of GNP generated. With greater capacity utilization, with a leveling in the rate of increase in unit costs, corporate profits during the first half of 1968 could continue their fourth-quarter recovery. It is easy to visualize, under such circumstances, a spurt in plant and equipment spending by business.

Three.—With an increase in plant and equipment outlays, with a Government deficit of some $18 billion, without a surtax, and with a continued labor shortage, it is difficult to envisage the growth of aggregate demand not resulting in continued price increases.

With a continuation of price rises, consumer anticipatory buying of automobiles and other durables, could be triggered as price increases accelerate during the first half of 1968.

Four.—All of the above was within a domestic economy on the assumption of no change in required spending on international wars and domestic programs.

(A) But international security requirements could potentially cause increases in spending of $4 to $7 billion, as indicated above.

(B) In addition, additional financing for programs dealing effectively with urban unrest and related problems, may be viewed with increased urgency as time goes on.

(C) Furthermore, with tightening of the financial markets, the pressures to "do something" for sectors adversely affected.

If all three of the eventualities listed under (A), (B), and (C) occur, the forces on the economy may at that time be recognized as leading inexorably to price increases of a magnitude that cannot be countenanced. In such circumstances, a tax increase might then come, but it would clearly then be too late to undo the damage underway.

Even if points (B) and (C) are discounted and only point (A), the international aspect is considered, the consequences could be serious. General price increases in the magnitude of 5 to 6 percent annual rate would be inevitable. There would be a worsening in our balance-of-payments position, both in the short run by stimulating imports, and in the long run by worsening relative price trends in the United States versus the other developed nations in the world.

Recognition of these adverse developments would, because of the well-known lags, undoubtedly require an over-reaction to reverse the process. Another financial crunch would be unavoidable, its dimensions uncertain. The worsened balance-of-payments position would undoubtedly bring in its train a further quickening or rising protectionist sentiments.

Protectionist actions would certainly invite defensive actions by foreign countries, retaliation, an increase of world tensions, with further dissipation of the valuable benefits of international exchange and the efficiencies and economies of a world division of labor.

In the domestic economy, there would even be more proposals for direct price and wage controls. Such further interferences with the operation of the price system which is one of the great strengths of our enterprise economy would be catastrophic. The imposition of direct price and wage controls would also be economic nonsense in the face of the inadequacy of fiscal and monetary measures during late 1967.

Political Repercussions

And, what would consumer reactions be to continued price increases of an order of magnitude of 5 to 6 percent as compared to the sporadic 3-percent increases experienced during recent years? The public cannot blame business and labor forever for such price increases. At some point, the central responsibility of the Congress and its powers in influencing aggregate demand through fiscal policy will receive recognition.

Congressmen face a very great risk that the same public which has been urging against a tax increase in recent months will turn against their representatives for failing to anticipate the developments described. They will regret that their representatives did not provide leadership in avoiding developments that resulted in the highly regressive tax of inflation.

Such price increases would doubtless lead to further pressures for wage increases. In addition, such a price inflation represents increased costs to the Federal Government and increases in spending that exceed the increments to Federal spending increases of the type to which vociferous objections have been made in connection with the budget proposals for fiscal years 1968 and 1969. The resultant is certainly a very unattractive spiraling.

Have I overstated the case for the tax increase? I think not. The undesirable consequences are so great and the existing margin for error is so small, that the resulting risks to the economy are greater than Congressmen may appropriately expect their constituents to bear.

Leadership must be exercised to persuade our constituencies that the risks of no tax increase are too great to be continued to be carried. We must persuade them that it is in their own self-interest to make the difficult, but realistic choices at this time. If we wait until the facts are upon us, the actions will then be too late.

A War Tax and a War Economy

Must we give pause because of fears of recession after midyear? I do not believe that it is credible that a recession can develop in an economy on a war footing carrying on a $35 billion to $45 billion war in addition to other defense expenditures of the same order of magnitude.

If there were such indications of a softening of the economy after midyear, the war tax surcharge could readily be removed by Congress.

This is a limited war economy and it calls for a limited war tax. This war tax is required not just to deal with the power readjustments east of Suez, but, in addition, to maintain social equities in a democratic society and to contribute to longrun economic growth and stability.

Chairman PROXMIRE. Thank you very much, Mr. Weston.

We convened at 1:45 p.m. because Mr. Saulnier has to catch a plane. For that reason, I am going to give up my time to the minority for questions. Professor Saulnier will have to leave shortly. Then I will yield to Congressman Bolling.

Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Gentlemen, may I express my appreciation to you for your fine discussions and statements that you have made here this afternoon which render a real contribution to the effort that we have to put forth to do our job here.

Mr. Saulnier, I regret I did not hear your statement. I glanced through it hurriedly, but I do have some questions that I would like to ask you dealing with the balance of payments.

Would you support imposition of a temporary import surcharge or a system of border taxes?

Mr. SAULNIER. I would very much hope, Senator, that any system of border taxes could be avoided. I can say this: In Europe today, rightly or wrongly, the thing that is regarded as important in signifying whether we are going to do the things that will make our balance-of-payments program work is the tax surcharge.

Now, one may say this is not sound reasoning on the part of our European friends. But, it is their point of view. I think I can say without any hesitation that a continuation of this impasse which we have now, a failure to act on taxes, will be interpreted in Europe as meaning that we are not prepared to do the things that are necessary to correct our balance-of-payments problem and will expedite the day when a new drain on gold will put the fat in the fire.

Senator JORDAN. Thank you.

To what extent do you believe that the present balance-of-payments program would adversely affect countries already in weak payment positions, and is it not likely that the program will further weaken the British pound and thus indirectly put more pressure on the dollar?

Mr. SAULNIER. I don't think there is any question but what our program will complicate the British problem. And, I don't think there is any question but what it means that certain things have got to be done abroad, specifically, on the continent, which might not otherwise be done.

I mean by that that the major countries there are going to have to stimulate their economies rather more than they might otherwise do, considering that they currently have cost and price inflation problems of their own.

But I can tell you this, Senator, in my observation, and I was in Europe for 2 weeks up until about 10 days ago, and I am leaving this room today to go back there tonight, that in Europe there is full and complete readiness on the part of central banks and governments to do the things that will make our program work. All they expect is that we give the right signals, ourselves.

And the right signal, from their point of view, as they see it, has to do with taxes. We can argue this as long as we want, but that is a fact of the situation.

That is why I have made the suggestions outlined in my statement. They are, shall I say, tactical suggestions. They are suggestions on how to break the impasse we are in and get some action on spending and taxes.

Senator JORDAN. Primarily based on the necessity for a surtax at this time?

Mr. SAULNIER. That is correct.

But, what I am suggesting here calls for both expenditure limitation and tax increase.

Senator JORDAN. The proper blend of both.

Mr. SAULNIER. That is correct.

Senator JORDAN. Doctor, the American program to curtail new U.S. investment outflows to Europe will probably lead firms to make heavy demands on European capital markets.

Do you see the possibility that European funds now invested in the United States might be returned to Europe to help satisfy these and other demands for funds, thus offsetting the gain from the investment curves?

Mr. SAULNIER. I do not see that, Senator, as an immediate problem. My reason for that is that I believe the Western European central banks are going to take steps to ease their credit markets over there which will obviate this capital movement that you mentioned, and indeed they have already done so.

Senator JORDAN. Mr. Chairman, I believe I had better share the time with my colleagues here because of the shortness of Dr. Saulnier's time.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. I thank my distinguished colleague.

I am very happy to welcome Dr. Saulnier.

Dr. Saulnier, if taxes are raised, what would be appropriate monetary policies for this country? Should the growth of money and credit be about the same? Should it be less or greater than it is now?

Mr. SAULNIER. I would hope, Senator Percy, that given agreement here on an expenditure policy, and given a tax increase, and given also no need to take this budget apart and put in a good many more billions of dollars with some more taxes to meet a situation in Vietnam, which I grant is giving quite a lot, but given these things, I would hope that as the budget deficit is reduced, with Treasury financing requirements lower, the Federal Reserve System will find itself in a position to move money supply increases back from the present 7 percent level to a level consistent with stable costs and prices.

However, I hope they do not undertake to do this overnight. They have got to do it over a period of time, and I would be prepared to see them take 2 years to do it.

It is just that I would like to see them get back on a trend of money supply increases that is consistent with stable prices.

Senator PERCY. Dr. Saulnier, the President's economic message virtually overlooked or avoided any detailed discussion of the effect of the war in Vietnam on the economy of this country. In fact, the first 26½ pages it was not mentioned. Only in the last paragraph, and

a couple of lines, was the war mentioned and then it was to deemphasize its effect by saying that it only constituted 3 percent of our GNP.

Do you feel that part of our inflationary problem, part of our prosperity, full employment that we are enjoying now is attributable to Vietnam and, if so, how significant a factor is Vietnam in stimulating the present economy?

Mr. SAULNIER. I don't think there is any question, Senator, but what it is an enormously important factor.

Layered on top of a Federal program of expanding nondefense expenditures, it has produced a condition of obviously excessive aggregate demand.

Now, whether the excessiveness of demand is due to Vietnam or to the nondefense expenditures is really, it seems to me, not something that it is very profitable for us to debate at this point. The two things are there. We have these deficits. They are causing all kinds of trouble. I think they are going to cause more. I would just like to see us move to eliminate them.

Senator PERCY. On the balance-of-payments problem, the Government has asked industry to forgo investment abroad, which we know is going to be, in the long run, exceedingly harmful to our competitive position and our worldwide position and to our balance-of-payments position, eventually, asking the American people or the American public to, for the first time in our history, really, in relatively normal times, to restrain their travel abroad, and yet a great part of our balance-of-payments problems to a degree today comes from, let us say, the possibility of a steel strike, steel imports in anticipation of such a strike that are dramatically increasing, a copper strike which is now costing us a billion dollars of gold at an annual rate. The strike is continuing, which is crippling to our national interest.

If we are in such a critical stage with our balance of payments, and we certainly are, we must ask this country to forgo its future because of the crisis at the present; isn't there something we should do to take extraordinary measures in appealing to labor and industry to stop these crippling strikes that are so dangerous to the national interest now?

Mr. SAULNIER. I could not agree with you more.

As I have indicated in my statement, Senator Percy, I was really very much disappointed in the Economic Report's treatment of this problem this year. I would be the last to argue that all of this vast stockpile of problems which we have accumulated is going to be solved if we were just to raise taxes. It is not going to be. There is a lot more on the agenda. Some of the things you have mentioned would be very high on my agenda.

Senator PERCY. Lastly, do you think it would be wise for the President to request voluntary arbitration in such cases which are in the national interest and which have such an effect on our balance of payments just as if it would be a matter of war production which is the same degree of importance?

Mr. SAULNIER. Well, we have a statute on the books, the Taft-Hartley law, which allows us to act in the case of work stoppages that are damaging to the national interest. I am not altogether happy with that statute. I had to live with it, if I may say so, for 116 days when

I was chairman of the Council of Economic Advisers, when the steel industry was shut down tight.

It was not until then that we could prove that there was a national emergency. I think it would be a good deal easier now, with half a million men fighting in Vietnam, to prove some of these things. I would like to encourage the administration to make an effort to prove them.

Senator PERCY. Thank you very much, Mr. Chairman, and Dr. Saulnier.

Chairman PROXMIRE. Congressman Bolling?

Representative BOLLING. I understand Dr. Saulnier has to leave.

Mr. SAULNIER. I am embarrassed, Mr. Bolling, by the fact that I do have to, but I have a connection to make in New York.

Representative BOLLING. I understand that very well. I appreciate your being here because I have valued your testimony for many years.

Mr. SAULNIER. Thank you.

Chairman PROXMIRE. I want to say, as chairman, too, we very much appreciate your coming, Dr. Saulnier. You have made a fine contribution. I haven't had a chance to question you because I thought I would defer to the minority.

Mr. SAULNIER. Thank you very much.

I hope that the committee will be able this year to produce a unanimous report on the key issues.

Chairman PROXMIRE. We will try.

Mr. SAULNIER. I honestly think this might be the key to breaking the impasse, thank you.

Representative BOLLING. Mr. Chairman, I have a rollcall going on that I have to get to but I should like to make a couple of comments before I leave.

I have never heard a more stimulating panel. I think all the papers have been excellent and I very seldom say that. I particularly enjoyed Dr. Schultze's comment on the game of chicken.

I particularly enjoyed your comment, sir, on the political risk of inaction by politicians. I happen to be one who favored a tax increase long before the administration indicated it was for one. I was for one in January 1966.

To Mr. Ture I would like to say that one of the things that disturbed me greatly when I found myself still for a tax increase—and I learned that he was the one of eight before the Committee on Ways and Means who opposed the tax increase—was the fact that he was the opponent but he is a long-time friend and associate.

I also remembered another thing that disturbed me even more than his position and that was that at the time when the present chairman of the Committee on Ways and Means was getting—I would hope—an education, as all of us do on this committee, in general economics by serving on the Joint Economic Committee, that the tax expert for the Joint Economic Committee was Norman Ture. But, now I understand your position and the reason for it, I believe, that I have no desire to argue with your technical data except in one small respect.

I happen, as you may remember, to have been well aware of the fact that the late President Kennedy was a member of the Joint Economic Committee, that while he was not a very regular attender he knew more about what went on before us than most of the other Members and that

he very consciously knew what he was doing when he made the recommendation that you commend and with which I agree and which is the last part of your paper.

The reason that I am so relieved by your testimony is that I now understand what I conceive to be a miscalculation in it, a major one, but a legitimate one. The one kind of expenditure that the Congress finds totally uncontrollable is the expenditure for any war to which the United States has committed itself.

There has never been a time in our modern history when the Congress of the United States has cut a dime, to my knowledge, out of the request by a President when we have troops in the field fighting, and the shift that has taken place has been a shift in domestic spending.

If we did not have the extra $30 billion roughly that the figures would indicate is involved in Vietnam on an annual basis, we would not only have a balance, we would be having the tax decrease that you suggest was implied in the 1963 policy. So, I find myself largely in agreement with much of what you say but for that one reason in disagreement with your conclusion except for the fact that I heartily agree with the last three pages of your statement. I am a very relieved man for from my point of view all of the experts were then unanimous.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Would you like to reply?

Mr. TURE. Before Mr. Bolling leaves, I want to thank him for his commendatory remarks. I think there is scarcely any misapprehension but for a shade, perhaps.

I would agree wholeheartedly, Mr. Bolling, with your proposition as to the Vietnam expenditures. They do account for a substantial part of the total Federal expenditures.

I have no basis, however, for disputing your opinion as to whether or not it is possible for us to repress the growth of other Federal expenditures. But if, in fact, it is the preference of the Congress and the country not to do so, then we ought to finance these expenditures, not because we are trying to even out a short-term deviations——

Representative BOLLING. I do not even disagree with that.

Chairman PROXMIRE. Congressman Bolling has to make that rollcall.

Mr. Ture, I would like to find out first if I properly understand your position which is somewhat different than I anticipated it was before you appeared today. You feel, as I understand it, that it is a mistake to use taxation, or indeed fiscal policy, as a device for economic stability; that is, as a conscious device, we should not temporarily increase or decrease taxes or temporarily increase or decrease spending in order to achieve stability. Is that correct?

Mr. TURE. Shortrun stabilization, yes; precisely. I think the Federal Government should get out of the business of trying to stabilize the economy in the short run.

Chairman PROXMIRE. You do feel that nondefense spending has been rising too rapidly and that it should be retarded. Without going into all the details of the budget, this is a matter of longstanding commitment.

Mr. TURE. Let me modify that statement, sir.

Chairman PROXMIRE. Yes.

Mr. TURE. As an economist, I have no opinion to offer. I point out merely the fact that nondefense expenditures have been rising very

rapidly. Personally, not in a professional capacity, but in terms of preferences of how I want the world to work, I am concerned about the rate of expansion of nondefense items.

Chairman PROXMIRE. No. 3, you take the position that a temporary tax, announced as a temporary tax—it might go into effect July 1, 1968, expire July 1, 1969—is not going to have much effect on spending anyway and it is not going to have very much effect on inflation or interest rates; in your view, is that correct?

Mr. TURE. That is correct.

Chairman PROXMIRE. That does change from what I thought was your position and I think it is a very sensible position although it is not mine.

I would like to ask you to see if you can put on another hat temporarily, hypothetically.

If you did believe in using fiscal policy for stabilization purposes, would you under these circumstances feel it would be sensible now, given all the economic data, to pass a surtax? Would you vote for a surtax under those circumstances, for the kind of surtax which has been proposed, a temporary surtax?

Mr. TURE. With that very rigorous constraint you impose, sir, I think my answer would be "Yes."

Chairman PROXMIRE. You would?

Mr. TURE. Yes.

Chairman PROXMIRE. I am sorry to hear it. I have been trying to elicit somebody who agrees with me since these hearings began and I struck out.

Mr. TURE. Let me elaborate the answer just a shade.

If I, in fact, believed in the efficacy of fiscal policy in affecting the pace of expansion of aggregate demand in the short run, I have a feeling that the outlook for 1968 is probably on the exuberant side and this would follow several years of an extremely rapid pace of expansion of total demand in excess of production capability as is evidenced by the rate of increase in the general level of prices, and again if I were such a believer I think I would find it appropriate to try to curb the pace of expansion for the remainder of this year.

Now, I infer from everything I have heard today and read in the newspapers and heard in repeated statements from the administration and from Members of Congress that it is not feasible to try to curb Federal expenditure growth, to use the expenditure side of the budget as an efficient fiscal device for that purpose. So, if I were a fiscalist and did have this judgment about the pace of expansion——

Chairman PROXMIRE. I want to relieve you of any feeling you cannot cut any spending.

Would you like to do that?

Mr. TURE. Yes.

Chairman PROXMIRE. And you think that you could recommend a reduction in the budget which would be, in effect, a substitute for the surtax as far as economic consequences are concerned?

Mr. TURE. Surely.

Let me elaborate that reply, too. I would have to profess that my answer would again be not as an economist but as a citizen. I would

express preferences for reducing or eliminating particular programs I do not care for.

Chairman PROXMIRE. Thank you.

Now, I would like to ask both Mr. Schultze and Mr. Weston the following:

It seems to me that both of you gentlemen are expecting a surtax to do too much; that it will cure everything from falling arches to dandruff, as they say. It seems to me that it is going to do one of two things, at best.

It will either reduce the gross national product, reduce the number of jobs, reduce income and in doing so reduce prices, in which case it will not reduce interest rates very much and it will not reduce the deficit very much. If it does these things, it reduces income and prices and so forth, and it is not going to bring in as much revenue.

Or, on the contrary, it may reduce interest rates and stimulate housing and get about the same effect in the GNP and we had two very competent economists this morning who thought this is what would happen; it would not make any difference in GNP if you had an increase in taxes, but you would have a different mix; you would have more housing and less of other things.

If you did that, it would reduce the deficit because you would raise more money with it and it would reduce interest rates, as I say, but it would not accomplish what the President indicates is his principal purpose, which is to reduce prices.

Mr. SCHULTZE. The first thing I would like to do is disassociate myself from any belief that the surtax is as much magic in the fiscal field as a lot of people seem to think with regard to the rate of expansion in the money supply.

Admittedly, it is not going to cure warts. There are a lot of things it won't do. If I have been overenthusiastic, sobeit. It is not magic medicine.

I think it will, nevertheless, accomplish major public policy purposes.

Let us start, for the moment, whether you accept it or not, start as a base from which we can make changes, with the Council's forecast of the economy without the surtax in effect—a $60 billion-odd rise in GNP between 1967 and 1968. What would happen if you did not have the surtax?

Mr. Ture will quarrel with this, but for the moment I will forget that, and give you my two options.

They in a sense come out fairly close to yours, Senator, but the meaning is different.

One possibility is a very permissive monetary policy, such that without a tax increase you would maintain housing construction fairly close to what it would be with a tax increase by extremely permissive monetary policy.

This would mean a much more than $60-billion expansion in GNP, a larger rise in prices, et cetera. So, one consequence of this would be a very large rise in the economy over and beyond the $60 billion forecast by the Council. In turn, this would mean the deficit would not increase by the same amount as simply the amount of the tax.

In other words, you would not go from an $8 billion deficit to an $18 billion deficit, because you would have had expansion in the economy.

That is one alternative line of development in which failure to enact the tax would mean substantially higher prices and incomes. Or, to put it conversely, the tax increase would have reduced prices and incomes from what they otherwise would have been.

Chairman PROXMIRE. The failure to enact will increase prices and incomes and revenues.

Mr. SCHULTZE. And revenues. You would not have had the deficit equal to the $8 billion which you would get with the tax, plus you would not lose the full $10 billion of the surtax, because the impact of failure to pass the surcharge would percolate through the economy in higher income.

Chairman PROXMIRE. Conceivably, if you have the reverse of the 1964 tax cut, you might even get a revenue situation which would be the reverse. You might, without increasing taxes, get more revenue than if you did increase taxes.

Mr. SCHULTZE. I doubt that; but let us assume it is a possibility. You would do it at the price of inflation.

If you kicked off a big enough inflation, yes, it could happen. I don't think you would kick off that big inflation. The only reason you would get back those revenues that the tax would bring in is that you have had a big enough expansion and inflationary expansion in the economy to generate inflationary rises in incomes and higher tax revenues.

So, you might end up with the same deficit with or without a tax, but at a heck of a lot higher price level.

I don't think that would happen; but this is what would be necessary——

Chairman PROXMIRE. This would be one possibility. It makes a pretty enthusiastic assumption on what this temporary 10-percent surtax is going to do to spending.

Mr. SCHULTZE. May I come back to that in a moment?

The second alternative possibility is that without a tax increase, Federal Reserve policy would be very much more restrictive, housing construction would fall off very substantially, you would not get a significant inflationary push of the economy as a whole, because you have taken your major adjustment out on housing.

That is the other extreme of the two possibilities.

The actual world would probably fall somewhere in between. One possibility would be a much larger rise in income and a very permissive monetary policy. The other would be not much more growth in GNP, because a very restrictive monetary policy would have pulled down housing.

I think the essence of Mr. Ture's point is, if I may express it, that the spending of consumers and business is very insensitive to temporary changes in income.

Now, I would fully agree that spending of consumers and businessmen is not anywhere near as sensitive to temporary changes in income as to permanently expected changes in income. I agree with that.

Where Mr. Ture and I disagree is that he pushes it to an extreme point.

I would make one other proposition with respect to this. Between 1964 and 1965 and 1969, Federal expenditures, including Vietnam, as a percentage of GNP rose by about 2 to 3 percentage points. They went from something like 19½ percent GNP up to 21½ percent of GNP.

I suspect that Mr. Ture, himself, had this been presented to him as a possibility, would have indicated, yes, you do need a tax increase under these conditions.

The difficulty is whether you have a long-term increase in Federal expenditures as a percentage of GNP, substantially of the order of 2 percent, 2½ percent. Now, the difference here is that the increase, this 2 to 2½ percent, it attributable to Vietnam, and we say—God hope that we are right—that it is temporary.

Query: You have an increase in expenditures relative to GNP of a substantial magnitude, which you think is going to be temporary.

If it is going to be temporary, then, according to Mr. Ture, don't have a temporary tax increase to get after it. I think that is where the difference comes down to.

Chairman PROXMIRE. My time is up.

Senator JORDAN. Please go ahead, Mr. Chairman.

Mr. TURE. Shall I respond?

Chairman PROXMIRE. Yes; then, Mr. Weston.

Why don't you respond, as long as you were directly asked by Mr. Schultze? Why don't you reply, clarify your position?

Mr. TURE. Very briefly, Mr. Schultze, I think your point is well taken.

My case is, fundamentally, that the occasion for a tax increase at this point is not being properly stated. I don't know whether there is such a case, because I cannot forecast the likely course of Federal expenditures over a period of time sufficiently long to make a major change in the revenue structure desirable.

If we forecast that expenditures should and will continue to rise during that period, I think that is a reasonable basis for requesting a tax increase.

I wish the President would put it to the country exactly that way. I wish that he would state that since Congress has voiced approval of a wide range of programs, defense and nondefense and since the prospects for quickly terminating the conflict in Vietnam and not getting into similar conflicts elsewhere so that we will be able to reduce our defense outlays, is remote, the likely course of Federal expenditures, given these assumptions over the next 5 years or so, is such that we will not be able to finance them with the present tax rates and will run huge deficits.

That, I think, would be a perfectly reasonable way for him to go to the country. I think it would then be a reasonable way to state the issues.

Do we want the other nondefense programs curbed, or do we want them, and are we willing to pay for them?

Mr. WESTON. That leads directly to what I wanted to say.

It seems to me that it is unfortunate that the basic policy decision hinges on how you label the policy change, temporary versus perma-

nent. It seems to me that in one sense it is impossible to describe whether it is going to be temporary or permanent.

The point is that you have in fact had some fundamental changes in spending policy with regard to the aged, medicare, the disadvantaged, in terms of the Economic Opportunity Act. But Congress passed these things. You have this legislation. It is a fact.

I think even within Mr. Ture's framework, he may not agree with them as a private citizen, they don't fit into his value system, but they do represent, it seems to me, fundamental changes in spending policy which have been enacted by Congress.

In addition, you have a world in which, as I indicated, there appear to be fundamental power shifts taking place. At least we are involved in a war in Vietnam, whether we want to call it that or not, whether we like being there or not.

But, given these as facts, they present us with an economic outlook that we are all in agreement with here, involves the necessity for something on the revenue side.

Again, regardless of what you say about monetary policy, it involves the necessity of something more on the revenue side.

To disagree with this policy because it has been labeled by some as temporary, seems to me irrelevant. I think it is impossible to put that kind of label on.

The point is, you need it, and we delayed having it for some time. Whether it has been justified in the past, in terms of fine tuning or not, the point is that there is at least an intermediate term change in the level of spending taking place.

The second point, the point, Senator Proxmire, that you apparently keep coming back to, is that it would be better if we cut expenditures.

What you are saying is that it would have been better if the Congress had not passed these other forms of legislation.

As I say, realistically, I do not see it at all feasible to reduce spending of the order of magnitude required to do the job.

Chairman PROXMIRE. I sure want to come back to that, but my time is up.

I yield to Senator Jordan.

Senator JORDAN. Thank you, Mr. Chairman.

Well, it is quite obvious and refreshing, I believe, to observe that economics is not yet an exact science.

Mr. Schultze, it appears that in this year, 1968, we might have serious labor disputes; several contracts are coming up for renewal. If this occurs, how do you believe it will affect the economic outlook and desirability for a tax increase, and, second, how close are we to wage and price control?

Mr. SCHULTZE. Answering the second first, I hope we are a very long way from it.

You know, one has to pick one's evils, and I would put wage and price controls pretty high on my list of evils. I would stand a lot of others before that.

That does not mean under no circumstances would you want them, but I would say you would have to have an awful lot of evils facing you before you picked that.

Point No. 2, with respect to how a steel strike would affect the economy, I hesitate to be very precise with the committee on it. It seems

to me it is the kind of thing that to give a very meaningful, shortrun answer, and that is what we are dealing with, you need to do a lot more work on what the implications are than I have done.

I will say this, that barring a catastrophically long strike—and I don't know what time period I would put on catastrophic—I think experience would show it primarily would affect, giving everything else in the economy, the timing of developments within the year, rather than the fundamental strength with which you end the year.

Some years ago I did a little work on looking at the impact of steel strikes in particular on the economy, taking periods when we had them. As a general proposition, I would say they tended to effect very short-term changes, not longer term changes, when you end up.

So, from the point of view of the domestic economy, it clearly would affect the pattern of the year. You would be very strong for a while, in anticipation of it, very weak for a while, during it, and then make up.

From an international standpoint, from the point of view of the balance of payments, it could be, at least a relatively long steel strike could be, I think, very damaging, because it would, I think, switch long-term procurement from domestic to foreign steel on the grounds, strangely enough, of security of supply, which we might not be able to get back again.

So, in short, from the domestic standpoint, it would affect the pattern of the year, not the way you end the year up. From a national standpoint, I think it could be fairly difficult. I think it could hurt.

Mr. WESTON. I would like to add a comment to that.

Senator JORDAN. Please do.

Mr. WESTON. To go back, in connection with your question to Mr. Saulnier, about in circumstances such as this, where it is difficult to reach decisions in negotiation by voluntary arbitration, it seems to me again this takes specific things out of perspective.

In an environment where you have excess aggregate demand, and workers seeing their real income position eroded by substantial price increases, this does in fact make it very difficult to negotiate an appropriate wage settlement, because the counterpart is if you get wage increases that protect the real income position of workers, the consequences of this is that if they are not passed on in various degrees, that business firms in turn don't earn their cost of capital, so you get pressures on prices as a consequence.

It seems to me that it is inappropriate to take out of context the difficulties of reaching viable settlement in an atmosphere of excess aggregate demand.

It seems to me that you work first at the remedy at its source, and that is to bring aggregate demand into balance.

This is a necessary first step before considering a range of specifics, like voluntary arbitration and wage and price controls and other interferences with the operation of the price system.

Senator JORDAN. Thank you.

Mr. Ture, I would like to hear especially from you on this.

Mr. TURE. I simply would like to make a comment on what Professor Weston observed.

That is, it is first clear in this discussion among the three of us—I regret Dr. Saulnier is not here to participate—it is perfectly clear that what distinguishes among us here is that Messrs. Schultze,

Weston, and Saulnier happen to believe in the effectiveness of changes in taxes and expenditures in the short run in determining the level of gross national product and economic activity.

I used to believe that, too.

I think that is what Mr. Bolling was alluding to.

I do not find factual support for that belief. Therefore, it is an article of faith, it seems to me, unsupported by the data about the economy in the postwar period.

There have been numerous attempts to examine changes in fiscal magnitudes and see what happens to changes in the economy. Those tests always come out the same way. There is no close relationship.

Now, I think that is what is meant when Professor Weston says that an economy in which aggregate demand is excessive, we have to bring it back in line in order to make any kind of incomes policy viable.

I think the latter part of his statement is correct. That is to say, in trying to impose wage-price guideposts with a wage rule of 3.2 percent when prices are rising at the rate of 3½ or 4 percent per annum, is just foolish.

Indeed, the guideposts could be made to work, it could only be in a context where they don't have to work, where it is not necessary, where you don't have to rely on them.

The dispute I would have with Professor Weston——

Senator JORDAN. They only work when they are not needed, when the pressure is not on. That is what you are saying?

Mr. TURE. That is right.

Mr. WESTON. I would like to comment on that, too.

In terms of the evidence that Mr. Ture presents in his paper, a portion of which he gave orally, as well, his tests of the efficacy of fiscal policy were sorely inadequate in that he simply related some changes in fiscal policy to overall economic magnitudes.

There are large numbers of other factors influencing GNP than fiscal policy. To ignore these, and to attribute causality, one to one causality, when you measure the influence of one factor and not holding a large number of other factors constant, it seems to me is not a valid test, and is not a sufficient basis upon which to draw the conclusions which he drew from the evidence that he presented.

The second point is really a part of the first.

I am anticipating, of course, what he is going to say about the first.

I want to say, with regard to the second, that I think he is incorrect in characterizing my position, and I think a number of other positions, that changes in tax and expenditure policy in the short run can provide an exactly counterbalancing influence in the economy.

The argument that I have made is that these changes certainly have not been temporary. They have not been half-year or one-quarter changes. This has been a persistent excess demand situation that we have been facing since Congress passed laws reflecting a different expenditure policy toward old age, medicare, et cetera, and since Vietnam defense expenditures have been rising.

This has not been one quarter or half a year. This has been a persistent pattern, and it is about time we do something on the revenue side in response to it.

And second, that even when you have expectations of quarter-to-

quarter changes, it makes sense to adopt policies in the right direction, in the face of the outlook that you perceive.

Again, here, I think that the evidence he presented on the Council's ability to forecast the future was not really a fair test.

Senator JORDAN. Now, Mr. Ture, for rebuttal.

Mr. TURE. Let me first concede fragmentary points wherever I possibly can.

Indeed, the tests that I refer to do not establish a case, nor are they intended to. The burden of proof rests upon those who advocate that certain actions be taken because they confidently expect certain results will follow from those actions.

All I say is that if in fact you test whether or not with those actions that have been taken in the past, the results that are expected follow, you find that the evidence indicates there is no reliability in the outcome at all.

So you may build econometric models from here to Sunday, and indeed that is what you generally do in order to establish this point. The very fact is that if you make a scatter diagram showing changes in the fiscal parameters, and either lag one quarter, lag two quarters, lag three quarters, lag four quarters, changes in gross national product, it looks to you as if you are seeing a snowfall, no relationship exists.

Let me say on the contrary, I don't want to then be put in the position of saying that there is indeed a simple explanation for changes in aggregate demand. I make that statement as a precautionary observation, because I am now about to adduce a relationship as a substitute.

If in fact you plot changes in the stock of money, and lag the changes in gross national product, you see a very close fit in the data.

Senator JORDAN. Mr. Chairman, my time is up, but it looks like Mr. Schultze wants to get in on this.

Mr. SCHULTZE. My only point is on the business of testing fiscal policy against subsequent changes in GNP.

It is like the doctor giving antifever medicine, and it is not quite fully successful. Every time he gives the medicine, you notice that the patient's fever comes up.

Mr. TURE. You have to have exactly the right dose?

Mr. SCHULTZE. No, not the exact, right dose. What I am saying is all you have to do is posit the point that the fiscal policy in general has been applied during the periods when it should have been applied, but not quite enough, and you get precisely the results Mr. Ture got.

Point No. 2, with respect to the stock of money, the basic problem is the cause and effect problem, whether the stock of money is rising because other elements in the economy are causing it to rise, or vice versa.

I might point to the last time we had a problem somewhat like this. The only time in the postwar period where it appeared to be necessary to raise taxes was during the Korean period. This is the only tax increase we have had in the postwar period, since 1948, anyway.

It turns out at that period of time you had the situation in which the stock of money was rising at a very slow pace, and you had a big inflation, followed by the fact of an increase in the rate of growth in

the stock of money. Yet, inflation was cut off because you introduced some substantial fiscal policy.

That is the one other time in the postwar period where taxes were actually raised. You can see the impact on the economy, where you can't with the stock of money.

Mr. TURE. Mr. Chairman, may I comment very briefly?

Chairman PROXMIRE. Very interesting colloquy.

Mr. TURE. I will comment by calling your attention to what I think is an extremely interesting and enlightening editorial in this morning's Post.

I think, one, that editorial clearly suggests the absence of the kind of relationship between changes in fiscal magnitudes and changes in GNP which fiscalists assume.

Chairman PROXMIRE. I am so glad you referred to the editorial. We put it in the record earlier.

I see Mr. Schultze wants to comment, also.

Mr. TURE. I would like the opportunity to check your observation of fact, Mr. Schultze, but I think the rate of increase in the money stock during this period was——

Mr. SCHULTZE. I got my source of the money stock from Milton Friedman's book. I dug into the book to see his comment during that period.

Let me give you the numbers, first.

The point is made in the editorial, if I might borrow it for the moment, that—

> The evidence suggests that fiscal policy had little if any effect on prices during the Korean War. What was relevant was monetary policy. In 1950–1951, the stock of money was permitted to expand very rapidly—at an annual rate of nearly 5 percent—and it was only after the growth of the money stock was slowed, at the end of 1951, that the inflation abated.

From June 1950 to June 1951, the stock of money rose by 4.4 percent. Consumer prices rose by 8.8 percent.

During the next year, the stock of money rose by 5.7 percent. Prices, on the other hand, slowed down substantially, to 2.4 percent.

As Professor Friedman himself in the book points out, when he is discussing money, it was the rise in velocity associated with the speculative boom which meant that even the relatively modest increase in the money stock was accompanied by a rapid growth in income.

This is one period when the money supply relationship does not work. This is the other period in the postwar years when you needed a big tax increase, when it did work, and when as a matter of fact the very modest growth in money stock was accompanied by big inflation, precisely because you had a big pouring in of defense orders and a speculative boom.

You did not see it in the deficit. It did not show up in expenditures for some time.

Mr. TURE. The assertion that it did work is not to be found in the facts.

I don't know what it was that impelled me last evening to ask my research associate to draw up a graph showing the quarterly money stock, using the conventional measure of money stock, figures that come out of the Federal Reserve Board, for the years 1947 through 1967.

I am sure you would not be able to see this, sir, but this represents the last quarter of the year 1949. Each one of these intervals is a full year of four quarters.

It seems to me, Charlie, that you get a very rapid rate of expansion in money stock during this period.

Mr. WESTON. May I comment on this as an impartial observer?

Like Mr. Ture, I was trained at the Chicago school, but I guess it did not take completely. To try to draw a conclusion about rates of change from material plotted on arithmetic paper seems to me is fruitless, No. 1.

No. 2, the money stock growth is the resultant of demand-and-supply influences.

The Fed does not determine the growth in the money stock unless the Fed is able to anicipate, with a degree of economic prescience not given, that would not be admitted by the people who generally argue for monetary policy; that is, for example, the increase in the rate of reserve availability by 3 to 4 percent a year during the Korean War period would certainly result, because of the velocity factor referred to, in a greater impact from the money side than the 3- to 4-percent increase in the reserves made available.

So that applying the money supply approach involves a much greater degree of forecasting, but it seems to me it would be unfortunate if we let preoccupy us this argument between the relative validity of monetary policy and an exaggerate demand approach to the efficacy of economic policy.

Realistically, for either to work effectively involves some ability to forecast economic future.

I think the fact that is so clear here is that we have had a fundamental shift in spending policy by the Federal Government, both in domestic programs related to the aged and the disadvantaged and in response to heightened international tensions.

These call for a response on the revenue side. I think it is impossible to characterize whether the response on the revenue side is going to be temporary, or what degree of permanence.

But I think the aggregate demand impact of this behavior, these fundamental changes in Federal spending policy, are very clear, and the appropriate countermeasures are called for.

Senator JORDAN. Mr. Chairman, my 10 minutes are up.

Chairman PROXMIRE. I would like to come back later to that notion that the increase in spending is something written in the sacred laws of the land now, and that there is nothing we can do about it.

I do not think Members of Congress accept that.

I think it is not throwing darts at a board, or being politically opportunist, to suggest that there are specific areas where we can cut, and cut deeply.

Before I do, however, I would like to ask both Mr. Weston and Mr. Schultze if you would not agree that there is a distinct possibility that in the latter half of 1968 the economy may not expand at the rate which you projected for the whole year.

This morning we had a very eminent forecaster from Edie & Co., Mr. O'Leary, highly respected, who projected a $61 billion increase in the gross national product for the whole year, without a surtax.

It was interesting how he broke it down, however; $19 billion in each of the first two quarters; $14 billion in the third quarter; and $13 billion in the fourth quarter.

Now, I calculated that the increase in the last half of the year, therefore, would be at a 2½ percent rate, in real terms, because he assumed that there would be a 4 percent increase in prices.

Now, this obviously is going to mean that the economy is going to slow down. It is going to mean that we are going to have increased availability of manpower and factory capacity.

Under these circumstances, and in view of the politically realistic fact that Mr. Schultze recognized the other day, when he said, as I understand, that probably the best hope for a surtax from the political standpoint is the first of July—would this not hit us at exactly the wrong time?

You make the case that we are a little overheated now—the figures for January suggest we are not, but at any rate, we are more overheated now than we are going to be in the last half of the year.

So, aren't you gentlemen who advocate a surtax proposing a policy measure that is going to increase unemployment, slow down the economy, reduce growth at the wrong time, at the time when we don't have an excess of demand, indeed, we have a deficit?

Mr. WESTON. I would like to respond to that.

I considered that possibility in my statement of eight points.

As I indicated in my presentation, I think this is a formidable set of arguments, and does deserve very careful consideration. My answer would be that, given a sustained period of excess demand, which is broad in its train, price increases of a magnitude that would cause a number of problems——

Chairman PROXMIRE. May I interrupt?

Do you really argue there was excessive demand in 1967, the whole year, with the growth at 2½ percent, far below any economist I have heard say we should have?

Mr. WESTON. Again, it is the same situation. The first half of the year, you had very little growth. It all came in the second half.

It was the same argument presented against the tax increase in June: The first half was weak, and, therefore, let us not have the tax increase, because the second half might not recover enough.

So, now, here we are, the second half was very strong, the first half of 1968 looks very strong, but let us not do anything because the second half of 1968 might not be as strong.

My answer there is that in a period when you have persistent excess demand, that you should take some action. This is a risk that you can run——

Chairman PROXMIRE. You did not have excess demand in the first half, of 1967. It is not, as you say, a long-term excess. You earlier said in the first half of the year we had a weak economy. Now we don't.

Federal spending was reduced sharply in December of 1966. In March, the President restored that spending, on the ground that the economy was slowing down. In that first quarter we grew at the rate of 1 percent.

There was not excess demand then; was there?

Mr. WESTON. No.

Chairman PROXMIRE. You can hardly argue that this is a permanent excess demand. Permanent for 6 months; most forecasters argue you are not going to get excess demand at the end of the year.

Mr. WESTON. Both monetary and fiscal policy have impact on the economy. You have a monetary policy that went into effect particularly in the second half of 1966 that produced the crunch of August 1966.

Chairman PROXMIRE. We always have all kinds of things.

I am saying as a matter of fact we had deficient demand from January to May and June 1967.

Mr. WESTON. Excessive demand in the first half of 1966, and deficient demand in the first part of 1967 was in response to the excess demand in the first part of 1966.

The only thing we are arguing for here is that it would have been better to have had a better mix with better monetary-fiscal policy during 1966, which would not, therefore, produce the fear of softness in 1967, which produced in action in the face of excessive demand that came upon us in the second half of 1967.

I do not think it is necessary to argue whether monetary policy is more effective than fiscal policy. I think either will work, if you appropriately measure them in terms of the environment in which they are promulgated at the time.

My point is that certainly it is true that because of the very tight monetary policy that you had dramatized in August 1966, you had an impact in early 1967.

Here again, in part because of this, you had relatively weak monetary policy in the latter half of 1967, because of the fear of producing another situation as had been, produced——

Chairman PROXMIRE. Of course, I would argue you have much too loose a monetary policy—an excessively loose monetary policy—throughout 1967. It is monetary policy that should be corrected.

Monetary policy has been so loose they have been pumping money into the economy at a 7-to-9 percent rate. So you come back and say this is an indication of excessive demand that has to be cured by fiscal policy.

Mr. WESTON. I agree. I referred to that in my presentation, both monetary and fiscal policy in the latter half of 1967 had been puny, really, in comparison to the aggregate demand situation.

The basic point is, however, that on the fiscal side, given that you are in at least one war, and given the state of international tensions, and given this in relationship to domestic programs that have already been enacted, and to which we are committed, unless Congress changes this, that the risks are all on the side of inaction, if you do not do anything about the surtax.

Chairman PROXMIRE. The fact that we are in war seems to me is a significant moral argument. But not an economic argument.

We pointed out this morning that the impact of defense now in terms of GNP is less than in 1956, less than in 1958 or 1962. In an economic sense, we are not in war economy. The war is not taking so much production out of the economy that we have to impose a tax to balance that.

It is true in World War II, and the Korean War, but it is not true at the present time.

Mr. WESTON. If you put the total budget together, as Mr. Schultze

indicated, there has been a rise of defense and nondefense expenditures in total.

Chairman PROXMIRE. This is why I wanted to mention that although Mr. Schultze, of course, disagrees with me, and he is the ablest advocate, I am sure, that one could find—I feel very, very strongly that we could cut a billion dollars more out of the space program.

I think we can cut $5 billion or $6 billion out of the public works program, including cutting the roadbuilding program, sharply. I do not think this would be a bad thing. I think it would be a good thing.

We have done this kind of thing before. The President slowed down the public works program very greatly in December 1966 to March 1967, and he can do it again.

I think we can withdraw four to six divisions in Europe.

These are specific cuts, not a matter of throwing darts. These are matters that I think could be cut without hurting our antipoverty program, or educational effort, our investment in human resources that pays off so fast.

The public works program is so fantastically inefficient in our Government.

Let me give you one quick example. The Defense Department requires a return or discount rate, depending on how you want to figure it, of 10 percent on all their projects, except the Corps of Engineers. There they are only required to have a 3¼ percent or one-eighth percent return.

It is a mistake. It is wrong. What can you do about it? The President can do what President Roosevelt did, what President Truman did, which is to say we are going to stop this kind of program at the present time.

This is the kind of thing that you can shift rapidly.

Mr. SCHULTZE. I just wanted to make one technical point.

Whatever one feels about public works, and as a Budget Director I have had my feelings, too, you are not going to cut them sharply in a hurry unless you literally want to leave dams half built.

Chairman PROXMIRE. I would.

Mr. SCHULTZE. There is a difference in judgment.

Chairman PROXMIRE. How did the President do it from December 1966 to March 1967? He saved $3 billion at an annual rate.

Mr. SCHULTZE. Looking at the total amount of the expenditures, the expenditure cut of the $3 billion was relatively small in public works.

Moreover, I think in all realism, I would insist whatever success you are going to have in reducing the impact of this program, it is going to be ruined by trying to go at it by leaving projects half built.

I think that would politically ruin any good you might do in terms of stricter criteria on your new projects.

Chairman PROXMIRE. We did this in World War II.

Mr. SCHULTZE. Sure, in World War II. I admit in World War II, you would do it, but this is not World War II. There is a big difference.

Chairman PROXMIRE. Did we slow down in the Korean War? We are slowing down now.

Mr. SCHULTZE. Are we slowing down?

Chairman PROXMIRE. We are being asked by the President for $10.2 billion for public works for fiscal 1969 which is more than we spent last year. It has gone up each year in the last 3 years.

Mr. SCHULTZE. In the first place, it is what you define as public works.

Chairman PROXMIRE. It is 10 times what it was 30 years ago.

Mr. SCHULTZE. In every case, the rate of construction is being held to the minimum without stopping work in process.

The key thing I want to get across is that the real place you can get at public works is in the new starts, and politically speaking, if you want to get some restraint on the economy, I don't care whether you agree with that or not, you will not. Every year, in the last 3 years, the President has sent up a very, very thin new start public works bill, and every year it is doubled, tripled, or quadrupled.

I am not putting blame on anybody. I am saying if you are looking for a realistic way of putting restraint on the economy, however desirable it might be to keep pressing at this one or the other, it is not going to do it.

I am not arguing you could not cut technically. Of course, you could.

Chairman PROXMIRE. This is asking a lot of the President. This is a sensitive area. It is an area where Senators and Congressmen are elected or defeated.

I think if the President takes a firm position, we are going to cut back on public works. We must stop everything we possibly can. I think it is going to be respected, in the present atmosphere. That is the attitude of the chairman of the Ways and Means Committee, the attitude of so many people in the Congress.

Mr. SCHULTZE. My comment is that you would not get much expenditure reduction right away. No matter how the President has pushed on this in the past, and he has on the new start end of it, it has not done any good.

Mr. TURE. Mr. Weston a few moments ago made reference to the policy mix question.

Referring to the monetary crunch in 1966, he uses that for the explanation for the slowing down of economic activity in the first half of 1967, in response to your probing. In the same period of time, during which the monetary crunch was going on, that is to say, a zero rate of expansion of the money stock, in fact, some very miniscule decline. this was a period when the national income accounts surplus moved from a surplus of 3.2 to a deficit of an equal amount, and the full employment surplus change was about the same.

It is obvious in that period of time that highly expansionary development in fiscal policy did not preclude, did not prevent a material slowing down in the basic economic activity.

I do not want to offer any of these things as really strictures, as absolutely firm precepts about what does what in the economy.

Part of the exchange we had a few moments ago was attributing to me a firmer view about the nearness of the relationship between changes in the money stock and changes in GNP that I would really subscribe to.

Let me simply say on the basis of the entire war experiences, including this nice recent chunk of it, do not predicate the surtax that is proposed on the basis of a short-term constraint on the increase in aggregate demand.

Chairman PROXMIRE. You see, Mr. Ture. what you are suggesting to the committee, which is very interesting, and I just wish other mem-

bers were here—I will do my best to discuss it with them—is so far-reaching that I am very skeptical that I will be in a position to persuade a substantial number to accept it.

We have a modified Friedman approach on monetary policy, 2, 3, and 5 percent for the Democrats, and 2 and 4 percent for the Republicans.

Now you are suggesting a Ture approach on fiscal policy which would neutralize fiscal policy the same way.

The trouble is, you make us feel so impotent to cope with whatever may happen in the economy. In other words, you are telling us that we ought to simply rely on automatic stabilizers, but it is hard for the Members of Congress to sit by and watch people be thrown out of work, or watch inflation ruin too many people without any action at all, saying there is nothing you can do about it.

It is a kind of Herbert Hoover approach.

Mr. TURE. We might see how good the past performance in economic stabilization policy has been.

Chairman PROXMIRE. Maybe Herbert Hoover was right.

Mr. TURE. I think the problems you would have to cope with under what I am posing to you are vastly greater, vastly more serious, and vastly more deserving of your attention than the shortrun economic stabilization.

Chairman PROXMIRE. That is right, but shortrun economic stabilization is important, too.

Mr. SCHULTZE. During this period when fiscal policy was ineffective, we had an $18 billion drop in the rate of inventory investment, and $5 billion drop in rate of consumption spending caused by a change in the consumer saving rate.

In that same period, the economy did pause, but to say that facing an $18 billion drop in rate of inventory investment in two quarters, and a $5 billion autonomous drop in consumer spending, which is a $23 billion drop, and all you got out of it was essentially a pause. to say that this, therefore, shows that fiscal policy which was expansionary was ineffective, seems to me to miss the point.

I am not saying this automatically indicates this was the fiscal policy, and not the monetary policy. This does not allow you to change between the two. You cannot use the fact that the economy did slow down during the period when fiscal policy was becoming more expansive.

Mr. TURE. Following the period. The slowdown in economic activity was not coincident with the change.

Mr. SCHULTZE. It was coincident, and one quarter late.

Mr. WESTON. A minor theme on this musical number.

We seem to be playing a number of themes that do not all come at the same time.

With regard to the three areas where you suggest tax expenditure cuts might be made, Mr. Schultze has already commented on public works, and indicated this really boils down to being a decision on which Congress bears at least a considerable measure of responsibility.

Chairman PROXMIRE. I agree with that.

Mr. WESTON. With regard to cutting down military expenditures in Western Europe, I certainly agree with this proposal, except that it is the whole complex of military-diplomatic considerations, and again

it is outside the control of a single group, and it is something which has been proposed. I proposed it myself for years.

Chairman PROXMIRE. We have to persist in these things. After all, this is not all congressional decision. Congress did pass a resolution in 1950 raising the number of divisions from two to six.

We have a resolution pending in the Senate that some of us are co-sponsoring to reduce it from six to two divisions.

It is a proper recommendation of this committee, as a matter of balance of payments, and the budget, to support a reduction.

Mr. WESTON. With regard to the space expenditures, my own feeling is that the longrun productivity is very substantial, but that is debatable.

Let us concede in the second and third areas I would say fine; let us continue our efforts to cut there, but since we have had persisting aggregate demand, aside from a pause, and with the outlook being one where the risks are very great of continued excess demand, of really greater proportions, particularly when the international situation calls for an increase of more than $3 billion in 1969, in defense outlays, that success in the second and third areas would help make any surtax imposition relatively more temporary than it otherwise would be.

It does not mean that efforts in this direction should be diminished in any degree.

Chairman PROXMIRE. I wish you were right. I wish we were all that logical.

We concede that the surtax should be repealed. I ask you three gentlemen. I asked witnesses to come up and give me an example of a tax that had been repealed before its expiration date. No one has been able to find one, or communicate with me after they appeared. Apparently there has not been such a case.

If the surtax is needed, if the restraint on the economy is enough, it will continue, it will be reenacted.

If we have a combination of rising prices, which could very well be because of the cost-push situation, I think we have had much of that in the past, and increasing unemployment, it might still be very difficult to persuade Congress, under these circumstances, especially if we have a deficit, to repeal the surtax, in which case it would be a perverse element in our economy, and would slow growth and create unemployment.

It would be very, very hard to get rid of it.

Mr. WESTON. This is equivalent to the argument; let us not do something that is needed now because we might keep it when it is not needed.

Chairman PROXMIRE. We are not going to do it until July 1. We will not do it on the 1st of March, or 1st of April or May.

You have not tried to rebut the argument which Mr. O'Leary made, that the economy is going to slow down the first of the year, when the inventory accumulation of steel is worked off.

Mr. SCHULTZE. No. 1, it is always more difficult to see the further out you go, not all the time, but very often, in forecasting, that "second half."

Second, and more importantly, if GNP rises by $19 billion a quarter,

as Mr. O'Leary would predict, then you need a slow rate of growth thereafter for a short period of time.

That is a $76 billion increase. You would need some slowing down thereafter.

Finally, it seems to me there are two other points:

One, we are in a particularly fortunate position to hedge our bets. All of the demographic and income statistics that I have seen, as they relate to housing, would indicate there is substantial room for expansion in housing demand, given the situation where you could pursue the monetary policy and make it possible.

If you are wrong on the surtax, you do have an out here to keep the economy moving, which at other periods of time you might not have.

You are particularly fortunate so that you can hedge your bet, and it does not cost you very much. You have a good bet hedger here.

Finally, without attempting to forecast individual items, to continue this $15 billion deficit for 2 years in a row, even if you can't pick out precisely how it is going to hit particular sectors of the economy, it seems to me the burden of proof must be on those who say the private economy is so weak that you need this kind of deficit for 2 years in a row.

Chairman PROXMIRE. As you know, I prefer to reduce spending instead of a surtax.

Mr. Brock, would you like to ask some questions?

Representative BROCK. No. I am sorry. I have been involved in the gold-cover debate which we just passed.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. No, Mr. Chairman.

This has been a very stimulating panel. I think I should not impose on them more. I have many questions. Indulge me just one question.

In order to attain full employment and reasonably full utilization of plant capacity, what do you regard as a tolerable degree of inflation?

Mr. SCHULTZE. I am not sure.

I got into an argument about this last night, as a matter of fact. I don't think that is a question that can be answered in the abstract. I think you have to ask in a given year, and in a given situation, in a particular situation.

Right now, I would say 3½ percent, because I know that just for the next 9 months to get the rate of price increase much below that would take very drastic unemployment.

Senator JORDAN. Do you regard it as tolerable in these circumstances?

Mr. SCHULTZE. In these circumstances, mainly because the actions that would have to be taken to pull that down substantially are a lot greater now than they might very well be under other circumstances.

If you ask me in 1969, or 1970, however, given time to gradually taper off, then it seems to me you could then have reasonably high employment with a much lower rate of price increase, not zero, but maybe 2 percent.

It depends on the particular circumstances of the particular time, exactly how much inflation it seems to me will go with it.

We have a bit built in right now, and even a more restrictive fiscal policy than the President proposed, even a more restrictive fiscal policy would not affect the rate of price increase that much, in the next 6 to 9 months.

Therefore, you have to put up with it for a short period of time, unless you want to take very drastic measures increasing unemployment.

Now, the further out in time you go, the more nearly you can have your cake and eat it, even though you will get some inflation, I suspect, with high employment.

I can't give you an easy answer to it. It depends on the circumstances of the time.

Chairman PROXMIRE. Mr. Ture?

Mr. TURE. I would associate myself with fragments of what Mr. Schultze has stated.

One fragment is to the effect that prices today are lagged responses to events that occurred in the past.

Chairman PROXMIRE. How much of a lag?

Mr. TURE. I do not know if they are systematically distributed. I don't have the remotest notion of how to answer your question, sir.

I think from one sector to another——

Chairman PROXMIRE. Can you give us a variation, 3 months to 6 months?

Mr. TURE. Some prices are much more quickly——

Chairman PROXMIRE. Overall, they lag by how much? Can you give any esitmate at all?

Mr. TURE. I could give you an estimate, but it would have no worth at all.

I would say a year and a half. Please don't rely on that for anything whatever.

Chairman PROXMIRE. Is it more than a year, less than 2 years?

Mr. TURE. You asked about an index that is peculiarly weighted, a structure that consists of all sorts of in-puts. I am not qualified to respond.

But there is a lag. Given the fact that there is some substantial lag between events and their reflections in the level of prices, that is one fragment of Dr. Schultze's statement I certainly would agree with. I don't think you can do anything at all about it in the next 3 months, or 6 months, or 9 months, short of actions so ferocious and so drastic, so vigorously changing the anticipations of the economy that you would not reasonably say it is worthwhile to do that.

To project in the future, I don't know what the relationship is between the rate of increase in the general level of prices and the rate of resource utilization. What your question provoked was a searching around in the cobwebbed recesses of my mind, to see if I can bring out anything by way of a hypothesis, a really good, reliable, appealing hypothesis, about any kind of stable relationship between rates of resource utilization and rates of increase in the general level of prices.

I know that there are people who think that there are such rela-

tionships. They don't hypothesize them. They simply describe them statistically.

Chairman PROXMIRE. Doesn't the overwhelming majority of the economic profession think it has something to do with the Phillips curve that describes this phenomenon, or not?

Mr. TURE. I haven't taken a poll, sir, but I am sure that your impression is correct, that a great number of economists do in fact believe that there is some hidden functional relationship between the rate of resource utilization and the rate of increase in wages and unit labor cost and in prices.

I find the hypothesis behind that relationship is scarcely articulated. I find it an enormously unappealing notion.

Mr. SCHULTZE. I suspect that economists would generally agree on either extreme of the Phillips curve.

By that I mean with very substantially excessive demands, a combination of the level and rate of change, you get significant price increases. With very excessive unutilized capacity, you are very unlikely to get price increases extending over any period of time. But, it is the whole area in between these extremes about which we don't know too much.

Mr. TURE. But, you will have price increases from the past.

Chairman PROXMIRE. It seems to me that underscores the point that the surtax is not going to affect demand sufficiently to get much of a change in prices. The whole point of the surtax, as the President described it, is to stem inflation. Now you say there is a lag to it, so there is serious question whether it has any effect or not.

Mr. SCHULTZE. One-half of that statement I would subscribe to. Namely, it wouldn't have much effect for the next 6 to 9 months. That is not awful important.

The other half, that I would not subscribe to, is that it would not have any effect. I do agree the effect will be a lag effect.

Chairman PROXMIRE. At any rate, it will be after the election, which explains perhaps Republican enthusiasm for it.

Gentlemen, thank you very, very much for a spirited and exciting and interesting presentation.

The Joint Economic Committee will stand adjourned.

(Whereupon, at 5:10 p.m., the committee adjourned, to reconvene at the call of the Chair.)

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