THE 1968 ECONOMIC REPORT OF THE PRESIDENT

409

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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INVITED COMMENTS

PART 3

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THE 1968 ECONOMIC REPORT OF THE PRESIDENT

The letter appearing below was sent to the following organizations: American Bankers Association, American Federation of Labor and Congress of Industrial Organizations, American Iron and Steel Institute, American Life Convention, Chamber of Commerce of the United States, Committee for Economic Development, Communications Workers of America, Conference on Economic Progress, Consumers Union of the United States, Inc., Cooperative League of the U.S.A., CUNA International, Inc., Federal Statistics Users' Conference, Independent Bankers Association, Life Insurance Association of America, Machinery and Allied Products Institute, National Association of Mutual Savings Banks, National Consumers' League, National Federation of Independent Business, National Federation of Independent Unions, National Planning Association, Railway Labor Executives Association, National League of Insured Savings Associations, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), United Mine Workers, United States Savings and Loan League. These organizations were invited to submit their views or comments on the text and recommendations contained in the 1968 Economic Report of the President. Fifteen organizations and one individual submitted statements and their views were considered by the Joint Economic Committee in the preparation of its report on the President's Economic Report.

FEBRUARY 8, 1968.

DEAR MR. ————: Since our schedule of hearings on the 1968 Economic Report of the President is very full and time is short, the Joint Economic Committee once again is calling upon a number of leaders of banking, business, labor, agriculture and consumer organizations for written statements containing economic facts and counsel for consideration in the preparation of its report.

The 1968 Economic Report of the President, including the annual report of the Council of Economic Advisers, is enclosed. We would appreciate having your comments on the materials and recommendations in this report.

In order that we may have ample time for consideration of these comments, written statements should be received by March 1, 1968. We will need 30 copies sent to G-133, New Senate Office Building, Washington, D.C. 20510, for distribution to committee members and the staff.

Such comments as you care to give us will be made available to the public in a printed volume of invited statements.

Sincerely yours,

WILLIAM PROXMIRE, *Chairman.*

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

By Nathaniel Goldfinger, Director, Department of Research

The national economy's advance, which got underway in 1961, continues to add to employment, incomes, and output. The economic performance of the past 7 years has been a most welcome improvement after the trend of rising unemployment and recurring recessions during most of the 1950's.

Despite this record of achievement, the American economy remains some distance from full employment. Unemployment persists at much too high a level and in 1967 there was no improvement in this important indicator of the American people's economic well-being—3.8 percent of the labor force remained unemployed.

The economic advance, thus far, has failed to provide enough job opportunities for a rapidly growing labor force in a period of radical technological change—particularly for the most disadvantaged job seekers among teenagers, Negroes, and unskilled workers.

Moreover, the benefits of the national economy's much-improved performance in the 1960's have not been shared equitably among the various groups in the population. A disproportionately great share has gone to business and upper income families, even after accounting for last year's small decline in profits.

Unfortunately, the Council of Economic Advisers' Economic Report of January 1968 indicates a willingness to accept a reported unemployment rate of approximately 4 percent as a goal of national economic policy, rather than to continue to press for further reductions of the unemployment level.

As for the lopsided distribution of the benefits of the economy's much-improved performance of the 1960's, the economic report says nothing at all. Indeed, this important issue of economic and social policy continues to be ignored by the Council of Economic Advisers.

The Remaining Problem of Unemployment

The economic expansion of the 1960's boosted employment and incomes and, in 1960–66, it reduced the level of unemployment. As sales and production picked up after the beginning of 1961, weekly working hours were increased following the part-time work schedules that had spread in the 1950's. The continued pickup resulted in the recall of workers, who had been laid off, and, gradually, in the hiring of additional workers.

The rise of employment during the 1960's—and, after 1963, the concentrated increase of factory and construction jobs—finally reduced unemployment after a rising trend during the previous decade. Be-

tween 1963 and 1966, reported unemployment dropped from 5.7 percent of the labor force to 3.8 percent. But in 1967, the level of reported unemployment remained at 3.8 percent.

The economic advance had not gone deeply enough by 1967 to provide job opportunities, at decent wages, for all persons who are able to work and desire employment.

With officially reported unemployment of 3 million or 3.8 percent of the labor force, the actual level of joblessness in 1967 may have been as much as 3.5 million to 4 million or more, after accounting for those jobless workers, particularly among slum dwellers, whom the Labor Department fails to count as unemployed in its monthly surveys.

The unemployed in 1967 included workers who were temporarily between jobs, workers in seasonal industries who were on temporary layoff and new entrants into the labor force—probably about 1.5–2 million. In addition, some of the unemployed were out of work, during 1967, as a result of economic conditions in their industries, such as inadequate sales.

The large numbers of remaining unemployed—and the underemployed part-time workers, as well—were essentially disadvantaged and unskilled workers, with little if any education or regular work experience. The general economic advance had not yet reached the most disadvantaged workers among the unskilled, teenagers, and Negroes, particularly those in urban slum areas and depressed rural communities.

Yet there are those who claim that the economic advance has gone too far and clamor for unemployment—breeding restrictive policies.

In 1966, the Federal Reserve pursued a very restrictive monetary policy, which pushed interest rates to their highest levels in 40 years, threw residential constructioin into a deep recession along with related industries and contributed to the economic slowdown of the first half of 1967. There is danger that similar policies may be pursued in 1968, despite the fact that unemployment persists and industry is operating only about 85 percent of its productive capacity.

There are also those who clamor for a slashing of Federal expenditures for such essential measures as Federal aid for education, housing, urban affairs, health care, air and water pollution measures, antipoverty and welfare—those who claim that America's $800 billion economy cannot afford improved public facilities and services in the midst of the Vietnam war.

To adopt unemployment-breeding restrictive measures and to slash expenditures for programs to achieve domestic social progress would be unwise economic policy and dangerous social policy. America needs continued progress toward full employment and it needs improved and expanded public facilities and services to meet the needs of a rapidly growing, urban population.

Recent estimates by the staff of the Joint Economic Committee and the National Planning Association indicate that the real volume of total national production must increase about 4–4½ percent per year merely to prevent unemployment from rising. These estimates are based on the rapid growth of the labor force and increased pace of rising productivity.

A continued reduction of remaining unemployment and underemployment in the period ahead, therefore, will require a continuing rise

in the real volume of total national production that is somewhat greater than 4–4½ percent per year. It will also require adoption of a Federal program to create 1 million public service jobs for the hard-core unemployed and seriously underemployed.

On these issues, the AFL–CIO Executive Council declared on February 23, 1968:

> We reiterate our conviction that the American economy has the resources to extend and expand social advances at home, while meeting military requirements in Viet Nam. The cost of the war should not be absorbed by cutting back or freezing essential federal programs for domestic progress. The great productive ability of the American economy can provide the foundation for both continued social progress at home and an honorable settlement of the war in Viet Nam.
>
> The expected sharp rise in the government's administrative budget deficit in fiscal years 1968 and 1969, due to military expenditures, can be reduced, without mounting pressures on interest rates and the availability of money and credit. A temporary war surtax is needed to reduce the amount of money the government will have to borrow in the money market and to eliminate the threat to home-building and related industries from tight money and higher interest rates.
>
> The needed temporary surtax should be based on ability to pay, including taxation of personal and corporate income that escapes taxation through major loopholes in the tax structure. The surcharge on corporations should be at least twice as great as on personal income. The surcharge on personal income should be clearly set on the basis of ability to pay. Corporate and personal income, excluded from taxation by tax loopholes, should be subjected to at least the same tax rate as the surcharge.
>
> We insist that the top-priority objective of national economic policy should be to achieve and sustain full employment—jobs at decent wages, for all people who are able to work and desire employment. The demand for goods and services from consumers, government and business must expand sufficiently to provide enough new job opportunities for the unemployed, for the great numbers of entrants into the labor force and for those displaced by spreading automation. The federal government's tax, expenditure and monetary policies, in combination, should encourage the necessary expansion of demand to achieve and maintain full employment.
>
> Adoption of a program to create one million public service jobs for the unemployed and seriously under-employed is essential—along the lines of the bill introduced by Congressman O'Hara of Michigan. Such decisive measure to create jobs in socially useful work—to perform much needed services that would not otherwise be done in parks, playgrounds, hospitals and other public facilities—is urgently needed.
>
> Manpower training programs—including basic literacy education, personal guidance and health rehabilitation—are essential to aid the unemployed and under-employed to compete more effectively for available employment. Although such programs do not create jobs, they can be of great benefit to the national economy, as well as the workers themselves, by upgrading the skills of the unemployed and unskilled. The recent emphasis on government-financed business programs to train workers should not include wage subsidies or other payments to the employer, beyond the extra cost of providing special training and supportive services for the hard-core unemployed, that are in addition to his normal training costs. Even the best-planned training programs, however, can be of little avail, if they are not accompanied by government programs to create jobs and achieve full employment.

Unbalanced Distribution of Benefits of the Economic Advance

Most Americans have benefited from the economic advance of the 1960's—from increased employment and gains in income. But these benefits have not been shared equitably.

Business and upper income families have received a major share of these gains. Improvements in the wages and salaries of nonsupervisory workers have lagged.

Although some business and Government spokesmen attempt to blame rising unit labor costs for much of the increase in the price level in the 1960's, the record clearly shows that the price level has been rising, regardless of what happened to labor costs per unit of production. Between 1960 and 1965, for example, when unit labor costs of manufactured goods fell 1½ percent or more (the decline may have been about 3 percent, according to the Bureau of Labor Statistics), wholesale prices of manufactured products rose 1.7 percent, boosting profit margins and increasing the business share of the fruits of the economy's progress. And when workers sought to catch up with the gains of the economic advance and the more rapid rise of living costs in the past 2 years, business raised prices at a faster pace, in an attempt to maintain enlarged profit margins.

After a brief and slight decline in 1967, from the great heights, corporate profits are now booming again. As the Wall Street Journal of February 13, 1968, reports:

> Business appears to be back on the comfortable track it wandered off for a year beginning in late 1966—the track that leads straight from one quarterly profit record to another.

Between 1960 and 1967:

—Corporate profits, after payments of taxes, skyrocketed 77 percent.

—Dividend payments to stockholders soared 70 percent.

—Total wage and salary payments to all employees in the entire economy increased merely 56½ percent—reflecting increased employment of 8.6 million people, as well as the wage and salary advances of individual employees.

—Weekly aftertax take-home pay of nonsupervisory employees in private industry, with three dependents, increased only 25 percent—and in terms of buying power, less than 11 percent.

Moreover, in the 2 years between December 1965 and December 1967, the buying power of these workers' weekly take-home pay actually fell 1½ percent.

—Real compensation per hour of nonsupervisory employees in private, nonfarm industries increased only about 2½ percent a year in the 7 years, 1960–67. But the real volume of production per man-hour in the entire private economy rose at a yearly rate of 3.3 percent.

These disparate trends, which result from business policies and Government tax measures, are utterly ignored in the Economic Report, as if they never occurred. The failure of the Council of Economic Advisers to examine these lopsided trends represents poor economic analysis, a blindness to social issues and, perhaps, simple prejudice against nonsupervisory workers, the major economic group in the Nation.

The vast majority of wage and salary earners have not received a fair share of the fruits of the national economy's advance.

A disproportionately large share has gone to business, to executive and managerial personnel, to the self-employed such as doctors and similar groups, to capital gains from the sale of property, to those who receive a significant part of their income from interest payments.

This unfair distribution of the benefits of the economy's progress is clearly unjust to wage and salary earners, who are the vast majority

of the population and the backbone of American society. It undermines the strength of consumer markets, the base of our economic system.

This lopsided distribution of the gains of the economic advance helps to explain the slower-than-expected expansion of consumer sales in the past year, which seems to mystify so many business and Government commenators on economic trends. In addition, it widens the economic and social distance between various groups in the Nation—a trend that is socially dangerous.

In the Economic Report, the Council of Economic Advisers rarely, if ever, deals with workers' wages and salaries as income. The text of the Economic Report deals with them almost invariably as costs. This failure to recognize wages and salaries as income to workers, as well as costs to business, reflects a bias that runs through the report. This bias results in inadequate economic analysis—a failure to recognize that nonsupervisory wage and salary earners are the major demand factor in the economy and that the lopsided distribution of the benefits of the economic advance has economic consequences, such as the unbalanced relationship in 1965–67 between business investment and the expansion of productive capacity, on the one hand, and the effective demand for goods and services, on the other hand.

While the Economic Report stresses the cost impact of wages and salaries, it utterly fails to indicate, even in as little as one sentence, that the purchasing power of aftertax weekly earnings of nonsupervisory employees in 1967 was less than in both 1966 and 1965.

Nowhere in the Economic Report is there an analysis of the serious, continuing lag of increases in nonsupervisory employees' wages and salaries behind the incomes of business and wealthy families—behind profits, dividends, the nearly 100 percent rise of personal interest payments in 1960–67, the incomes of managerial personnel and self-employed professionals, capital gains from the sale of property.

In its statement on national economic issues, adopted on February 23, 1968, the AFL–CIO executive council states:

The lag of real wages and salaries must be ended. A substantial rise in the buying power of wages, salaries and fringe benefits is needed to provide wage and salary earners with a fair share of economic progress and to strengthen consumer markets that are the foundation of the American economy. Only through an improved balance in the economy—between wages, profits, dividends and other forms of income—can there be assurance of sustained economic growth to reach full employment and maintain it.

Rising business profits should be based on an expanding sales volume—rather than on swollen profit margins at the expense of workers and consumers.

We will continue to press for wage and salary increases to offset rising living costs and to advance buying power. We firmly believe that wage and salary earners deserve to share equitably in the gains of the economy's progress. The nation's rapidly rising productivity and great profitability of business makes possible such improvements in wages, salaries and fringe benefits, within the context of a relatively stable price level.

We repeat again, as we have in the past two years: If the President determines that there is a national emergency that warrants extraordinary stabilization measures—with even-handed restraints on all costs, prices, profits, dividends, rents, corporate executive compensation (salaries, bonuses and stock options), as well as employes' wage and salaries—he will have the support of the AFL–CIO. But rigid application of a single "magic number" based on one economic factor alone, cannot be a workable or fair means of wage determination in a country of continental size, with thousands of different markets, industries and occupations. We are prepared to sacrifice—as much as anyone else, for as long as anyone else—so long as there is equality of sacrifice.

A much-improved balance in the private economy is essential if America is to be able to reach and sustain full employment. The lopsided distribution of the gains of the economic advance makes it difficult to achieve full employment and, within the context of social and political realities, impossible to sustain it.

Failure to recognize the consequences of this lopsided distribution is one of the major failings of the "new economics," which naively believes that the Federal Government can quickly and simply offset any and all weaknesses in the private economy by pushbutton controls. Not only is America a vast and complex continental economy, with scores of different industries and markets, but, in addition, the Council of Economic Advisers is neither the Congress nor the Federal Reserve System nor the entire executive branch.

The forward advance of the American economy requires a sound foundation in a much-improved balance in the private economy.

Adjustments to Radical Social Changes

Radical changes in technology and race relations, accompanied by rapid urban growth, continue to strain the fabric of American society. America's urban crisis is rooted in these rapid and radical social changes, as well as in the long, tragic history of Negro slavery, segregation, and discrimination.

These problems festered during most of the 1960's—with a rising trend of unemployment, government subsidies for technolgical change and no adjustment programs, a sharp decline of low-rent public housing construction and general neglect of urban, public services.

Much of the long-delayed legislation of the 1960's to achieve piecemeal adjustments to the radical changes in American life were first steps, without previous experience, precedents, and trained personnel. Moreover, Federal appropriations for these purposes were kept down by public apathy. Yet these measures were greatly oversold and their adoption aroused expectations of overnight solutions that were impossible to achieve.

The growth of the American population has increased sharply—from several hundred thousand a year in the 1930's to an average yearly rise of 2.7 million since World War II. Moreover, the number of people in rural areas has been declining while metropolitan area growth has been booming. Each year, the population of America's metropolitan areas grows by over 3 milion, the size of a very large city.

The pace of technological change, too, has speeded up considerably in the years since World War II. One measure of that speed is the time elapsing between a new discovery and the point at which it is introduced commercially. A study prepared for the National Automation Commission found that the time required to cover that distance has been cut by almost two-thirds—from an average of 37 years for innovations developed around the turn of the century to 14 years for innovations developed in the post World War II period.

Another measure of the speed of technological change is the rate of productivity growth. Between 1909 and 1947, output per man-

hour in the total private economy rose at an annual rate of 2 percent; between 1947 and 1967 it rose 3.2 percent per year. This jump in the rate of productivity growth by more than 50 percent means that, on the average, production during each hour of work can double in 22 years instead of in 36 years.

This stepped-up pace of technological change has resulted in the displacement of large numbers of unskilled and semiskilled jobs, difficult problems in labor-management relations concerning in-plant changes of job requirements and classifications, shifts in industry location, the economic distress of many old mining and railroad center communities, the decline of several labor intensive industries and the growth of new industries that employ relatively few unskilled workers who have little education.

In 1967, for example, manufacturing production was more than 70 percent greater than in 1953. But the number of factory production and maintenance workers was only 1.4 percent greater.

Between 1953 and 1967, the number of people employed on class I railroads declined 600,000, a drop of 50 percent. Employment in mining fell 253,000, a decline of 29 percent.

The largest employment decline was in agriculture—a drop of 2.5 million or 40 percent. Hundreds of thousands of farmers, farmworkers and their families have been leaving the rural areas in search of jobs and homes in the cities. But the types of unskilled and semiskilled jobs, in the urban areas, that helped to adjust previous generations of foreign immigrants and rural American migrants into America's cities have not been expanding.

These trends of rapid technological change and migration out of rural agricultural and mining areas are continuing.

Many of those who seek their future in the cities are Negroes. Between 1940 and 1967, probably about 4 million Negroes moved from the South—primarily rural areas—to the cities of the North and West. In 1960, according to the Department of Labor, about 40 percent to nearly 50 percent of the Negro population of 10 major northern and western cities was born in the South.

The Department of Labor estimates that almost 1.5 million Negroes left the South in 1950–60, following a similar migration of 1.6 million Negroes in the wartime decade, 1940–50. This historic migration is continuing at about that rate in the 1960's.

For the country as a whole, the proportion of Negroes in city populations rose from less than 10 percent in 1940 to over 20 percent in 1965. In most of the large northern and western cities the rise was greater.

All of the new migrants to America's cities of the past quarter of a century—white and Negroes, Puerto Ricans and Mexican-Americans—have faced the difficulties of adjusting to a new and strange environment. But these difficulties have been especially harsh for Negroes.

The Negro migrants to the cities of the past quarter of a century have brought with them a history of slavery, segregation, lack of education and frequently poor health, as well as suspicion of government authorities. On coming to the cities of the North and West, the new migrants have faced the discriminatory practices of those areas, lack of adequate housing and the impact of automation on job opportunities for uneducated, unskilled workers.

In ghetto areas in the cities, about 10 to 15 percent of the adult men and about 40 to 50 percent of out-of-school teenagers (including an estimate of those usually not counted by the Labor Department) are unemployed. In addition, a Labor Department survey of slum areas in November 1966 found that nearly 7 percent of those with jobs were employed only part time although they wanted full-time work, and 20 percent of those working full time earned less than $60 a week. This same Labor Department survey found that nearly 40 percent of the families and unrelated individuals in big city slum areas earn less than $3,000 a year.

However, it costs about $9,200 at present prices, to maintain a modest standard of living, including some amenities and a few luxuries, for a family of four in America's metropolitan areas—more for a larger family and less for a smaller family. Elimination of the amenities and luxuries would result in a cost of about $5,000 to maintain a minimum decent standard of living for a family of four in our urban areas—scaled up and down for different family sizes.

Yet Government reports indicate that probably 20 percent of the families within city limits earn less than the amount necessary for a minimum decent standard of living. Within ghetto areas, perhaps 60 to 70 percent or more of the families are in that category. The result is badly overcrowded housing, inadequate diet, poor medical care, few books and magazines for about 20 percent of city families and about 60 to 70 percent of those who live in ghetto slums.

The hard-core slum areas continue to deteriorate. People with jobs, some skills and some regular incomes have been moving out. They are replaced with new migrants from the rural South—adding to the remaining lowest income families, the jobless, the aged and fatherless families.

A large proportion of these slum residents depend on welfare payments, often to mothers with dependent children and no father present. The Labor Department survey of November 1966 found that 30 percent of the population in East Harlem, 30 percent of the Watts population, 40 percent of the Bedford-Stuyvesant chilren and 25 percent of the adults receive welfare payments. Moreover, the lack of adequate child-care facilities in slum areas is a barrier to employment for women with children.

Trapped by a history of degradation and the recent impact of automation, these new migrants to the city are also trapped by the unavailability of low- and moderate-cost housing, as well as by discrimination against colored people.

The peak home construction year, before World War II, was 1925. From 1926 to 1945, a period of 20 years, homebuilding was in a slump.

It wasn't until 1946 that the 1925 level of housing starts was reached. Since 1945, the ups and downs of residential construction have followed conditions in the money market—interest rates and availability of money. Normal business operations and Government programs have provided housing for families in the middle-income range and above (at present, about $8,000 annual income and more).

The residential construction of the postwar period, however, has essentially ignored housing for the entire bottom half of our income distribution—for the lower middle-income group as well as the poor.

For lower middle-income families, with current incomes of about $5,000 to $8,000, the postwar years have seen only little new housing construction, with present rentals or carrying charges and taxes of about $85 to $135 per month. This is particularly true for large families, with three or more children, in this income range.

For the urban poor—families with current incomes of about $5,000 a year and less—there has been hardly any new housing construction during the 22 years since World War II and there was very little of such construction in the preceding 20 years from 1926 through 1945. Almost a half century of rapid change in our cities—including the great Negro migration—has passed, with hardly any housing construction for low-income families.

Realistic rentals for poor families would have to be concentrated around $40 to $70 a month. Since the private market cannot provide such housing, public housing and public rehabilitation are essential. But, in recent years, the total number of new public housing dwelling units has been only about 30,000 to 40,000 per year.

Moreover, the urban renewal program, which has bulldozed city slum areas has concentrated on the construction of commercial buildings and luxury high-rise apartments. Relocation of families, displaced from the slums, has been neglected or ignored and there has been hardly any replacement of low-rental housing.

In addition, during the 1950's and early 1960's, the traditional conservative opposition to low-cost publicly subsidized housing for the poor was joined by many so-called liberals—the same coalition that debunked the impact of automation on unskilled and semiskilled factory workers and on industrial location as a trade union myth. As a result, the New Deal's beginnings to provide low-cost public housing nearly perished between 1952 and 1966.

At the same time, middle- and upper-income families have been moving to the suburbs. This movement has opened up older housing in the cities. But, combined with the movement of industry to the suburbs and countryside, it has reduced the tax base of the cities, when the demands on their financial resources for housing, welfare, education, and public facilities are mounting. Moreover, the change of industrial location has compounded the problems of inadequate mass transportation facilities for low-income city dwellers to get to the new areas of employment growth. And most suburban communities have rather rigid color-bar restrictions, as well as an absence of low-cost housing.

America now faces a complex of social problems that are related to rapid and radical changes in technology, urban growth, and race relations, as well as the history of the American Negro in the past 350 years. No city or State or private group can solve these problems in isolation or by themselves. Workable solutions require nationwide social measures, with adequate Federal funds and standards.

Instant adjustments and overnight solutions to this complex of problems are impossible. Gimmicks and slogans can achieve headlines, but hardly any positive results. Yet rapid forward strides are essential to the preservation of a free and democratic society.

Immediate measures are needed to provide jobs, decent housing, and adequate community facilities. Planned programs over the next decade or two are required to revitalize the fabric of American society.

One million public service jobs for persons now unemployed or seriously underemployed are needed—such as in parks, playgrounds, day care centers, hospitals, schools, and libraries. To provide this necessary means of helping people lift themselves out of poverty and deprivation, Congress should immediately adopt a $4 billion program to fund Federal, State, and local government agencies and nonprofit organizations for the creation of such public service jobs at wages not less than the Federal minimum wage.

The Federal Government must become the employer of last resort.

Two and a half million new housing units each year including:

Public housing through new and rehabilitated low-rent homes for the 20 percent of city families whose incomes are below requirements for a minimum decent standard of living. New low-rent public housing construction, at a 30,000 to 40,000 annual level in 1960–66, should be immediately increased to 200,000 to 300,000 for each of the next 2 years and 500,000 a year thereafter. Such construction should be supplemented by a large-scale public rehabilitation program. Adequate appropriations for the rent supplement program are also a necessity.

The Federal Government must become the landlord of last resort, as well as the employer of last resort.

Housing for lower middle-income families, not eligible for public housing and unable to afford decent dwellings in the standard, privately financed housing market. Federally subsidized interest rate loans and a Federal subsidy for the partial abatement of local taxes on such properties are needed to increase construction of such housing by cooperatives, nonprofit and limited dividend corporations. In addition, Federal legislation should make it possible for such groups to acquire existing properties, with Government insurance of long-term and low-interest loans.

Moderate-income housing, already operating with Government-insured mortgages, stepped up through measures to encourage greater involvement of pension funds, college endowment funds, and private trusts.

Open housing, in suburbs and new towns as well as in cities, as an essential part of a meaningful effort to rebuild our metropolitan areas.

Urban renewal, no longer confined to commercial and expensive high-rise construction. The focus instead must be on homes in balanced neighborhoods, with families displaced by slum clearance given assistance in finding decent dwellings at rents they can afford.

Model cities program, with adequate appropriations.

Mass transit, improved and expanded, is an urgent need in all metropolitan areas.

Accelerated construction of public facilities, such as water supplies, sewage systems, mass transit, schools, hospitals, day-care centers, playgrounds, libraries, museums, clean air and water are essential to rebuild America's metropolitan areas. Congress should adopt at least a $2 billion a year grant-in-aid program to State and local governments, in addition to categorical grants-in-aid.

A substantially expanded Neighborhood Youth Corps program, to help youngsters remain in school and to provide work and training for those who have dropped out of school.

The opportunity for quality education for all, by closing the educational gap between the privileged and underprivileged schoolchildren

of our Nation through special incentives to teachers in the areas, Federal aid for more effective school types programs, full use of school buildings for job training, adult education, and community activities. In addition, expanded vocational training must be realistically geared to the modern job market.

Manpower training, linked with job placement and adequate training allowances, should aim at lifting the skills of the labor force, particularly the disadvantaged.

Public welfare assistance, restructured, with the program based on need alone, a Federal minimum standard of payments and adequate Federal funds should be provided; State work-incentive programs should enable welfare recipients to retain a substantial amount of the dollars they earn without penalty, to encourage people to find jobs and eventually get off the welfare rolls, and demeaning investigations of applicants should be eliminated.

Relief of rural poverty, concentrated in the Southern and Southwestern States primarily, by Federal legislation to provide farmworkers with unemployment compensation and according to them the same right other workers have under the National Labor Relations Act to organize unions and bargain collectively; by adequate Federal funds to assist low- and moderate-income rural families to buy or rehabilitate housing; continuation and strengthening of the Vocational Education Act of 1963 and the Education Act of 1965 in rural areas; Federal aid in establishment of adequate public facilities, such as highways, hospitals, schools, vocational and technical training institutions, in rural areas; application of the regional approach, used in the Government's Appalachia program, to other economically depressed regions of the country; extension of the Agriculture Department recreational and tourist activities in rural areas, and provisions of full and fair employment opportunities for Negroes, Mexican Americans, and other minorities to work in the industries of rural areas and in State and local governments.

Continued labor-management efforts, through collective bargaining, to provide improved job security to workers and to cushion the effects of technological change on the work force.

A Federal Government maintained national inventory of needs for housing, public facilities, and services, by specific categories, based on present unmet backlogs and estimates of future population growth. Each State and metropolitan area, with the technical assistance of the Federal Government, should develop and maintain a similar inventory of needs within its geographical jurisdiction.

The Joint Economic Committee has demonstrated the feasibility of developing such inventory by category. The Council of Economic Advisers, however, has failed to coordinate such national inventory, by category, program, and degree of annual progress in meeting the needs.

Such inventories of present and projected requirements should serve as the foundation for nationwide programs in each category. They should also be used as yardsticks for the measurement of progress toward meeting the objectives of adequate housing, public facilities, and services.

A planned national effort, under Federal leadership is needed to apply as much of the Nation's resources—manpower, materials, and

finances—as possible, to meet the requirements of a rapidly growing, urban population, while providing a sound foundation for the continued advance of the private economy.

Achievement of these objectives will require Federal funds, planning, and leadership. But it will depend, too, on the initiative and local implementation by the States and metropolitan area governments, as well as the cooperation of private groups in society.

Successful adjustments to rapid and radical social changes will not be achieved automatically. Positive and bold policies are needed—by local communities and State governments, as well as by the Federal Government. Resources for such adjustments are available in the ingenuity of the American people and in the vast productive power of the national economy. But the will to achieve such adjustments—and the necessary foundation of a rapidly growing full-employment economy—must be strongly asserted by the American people and implemented by their elected representatives and officials.

AMERICAN IRON AND STEEL INSTITUTE

The testimony on the domestic steel industry before the Joint Economic Committee on February 16, 1968, of Mr. Harry L. Graham, legislative representative of the National Grange, appears to have been based upon observations he made several months ago during a 2-week visit to Germany. He is critical of the industry on essentially four grounds: Archaic production methods, lower technological efficiency than foreign steel companies, interest in expanded profits, and lack of interest in plant modernization.

I. Production Methods

A. The charge that the American steel industry "by and large is still engaged in producing by the Bessemer process of the last century" is incorrect. During the last year for which Bessemer production was separately reported by steel producers to the American Iron & Steel Institute (1966), such production accounted for only two-tenths of 1 percent of the total production. Bessemer steel was 2.8 percent of total U.S. production during 1956 and 5 percent in 1946—thus of only minor significance in the United States even two decades ago.

B. Mr. Graham used the West German steel industry as an example of efficient production methods which the United States should adopt. West Germany, however, produced 27.7 percent of its steel in 1966 by "the Bessemer process of the last century" and 42.8 percent in 1956. Comparable figures for the total European Coal and Steel Community (ECSC) were 35.5 percent by the Bessemer process in 1966 and 52 percent in 1956.

C. Not only is there a sharp contrast between the United States and the ECSC (including West Germany) in the degree to which the oldest steelmaking method (the Bessemer process) has been utilized during recent years but there is also an equally sharp contrast in the rapidity at which production by the newest steelmaking method—the basic oxygen process (BOP)—has been substituted for open hearth production(still the major method of steelmaking in both areas). Specifically, during the decade from 1956 to 1966 (the latest year for which data are available for the ECSC and West Germany), BOP production went from less than a million tons in both the ECSC and the United States to 22 million tons in the community countries—but to 34 million tons in the United States. On the other hand, during this same period open hearth production was expanded in both the ECSC and in West Germany (by 3 million and 2 million tons, respectively), while production by this method was reduced by 18 million tons in the United States. (During 1967, open hearth production in the United States declined an additional 14 million tons.)

In passing, it should also be noted that Mr. Graham's claim that National Steel Corp., was the first to install a BOP furnace in this

country is also incorrect. McLouth Steel Corp., installed its first BOP furnace in 1954—8 years before National Steel; in fact, there were 19 other commercial-scale basic oxygen furnaces in operation in this country at the time National Steel's first furnace began operation in 1962.

D. Any realistic evaluation of rates of modernization which compares the speed at which new methods of production are adopted in various countries and which seeks to arrive at value judgments about differences in such rates must necessarily recognize and allow for differences between countries with respect to a wide variety of factors, such as the following: Economic conditions, alternative uses of available funds, purpose of investment (for example, expansion versus replacement), efficiency of existing equipment contemplated to be replaced, operating costs of new facilities as compared with the costs of continuing to operate existing facilities, efficiency of existing interrelated facilities, economical scales of production, costs and benefits associated with possible improvements to existing facilities, versatility of new facilities, likelihood of further significant technological improvements in the near future, and attractiveness of other alternative new processes.

Likewise, a decision by one company to utilize its funds for a particular type of investment gives little, if any, indication of whether a similar investment would be appropriate for another company faced with completely different circumstances.

II. Technological Efficiency

A. Mr. Graham asserts that German and Japanese steel companies "have been bringing into production new steel mills with the most advanced production techniques in the world" and that as a result they have been able to sell their steel cheaper in this country than American steel. He also asserts that quotas "would simply lock in our inefficiencies in the competitive steel business."

B. There is, of course, no completely accurate method of comparing steelmaking efficiencies among countries because of wide differences in methods of measurement, product mix, factor prices, and methods of industry organization. One measurement which has been used, however, is the number of man-hours required per ton of production; man-hour data, of course, reflect the combined effect of all the factors of production. In 1966, the latest year for which comparable data are available, American steel producers required an average of 12.8 man-hours per ton of shipments, versus 17.3 man-hours for Japan. With respect to the European Economic Community, a recent publication of the United Nations concluded that—

> While it is not possible to derive precise conclusions from the comparison, it can be stated that: (a) One country—the United States—had lower (in most cases substantially lower) labor requirements per unit than any of the other countries covered by the comparison and also showed one of the fastest reductions in unit labor requirements between 1960 and 1964; (b) All but one of the large and medium-sized European steel industries included in the comparison had unit labor requirements one and one-half to two and one-quarter times those of the United States with a bunching of countries (on a man-hour basis) near the upper end of this range * * *.

C. Technological knowledge about steelmaking and related subjects is quickly transmitted throughout the steelmaking world so that any company—if it can obtain the necessary capital—can have the latest technology in a relatively short period of time. Although steel is made in the United States with fewer man-hours per ton than abroad, our advantage in efficiency is insufficient to offset our much higher hourly employment costs—as is reflected in unit costs being about $25 per ton higher than in Europe and about $40 per ton higher than in Japan. This is one of the major reasons why foreign steel is sold in this country for less than domestically produced steel—not our lower productive efficiency, as Mr. Graham contends.

D. American steel producers not only shared their technical knowledge with foreign steelmakers after the war to help them get back onto their feet, but the American Government and international agencies such as the Export-Import Bank of Washington advanced over $2 billion to build, modernize, or expand foreign steel plants from 1947 through 1966. Much of the postwar gain in technology abroad has been the result of borrowing American technology. Japan, for example, started very late in steel research; in fact, most of the major steel laboratories in Japan have only been established during the last decade.

The role which American steel producers have played in the development of the Japanese steel industry was acknowledged by Mr. Yoshihiro Inayama, president of Yawata Iron & Steel Co., at the recent meeting of the International Iron & Steel Institute:

> In counting our achievements since the end of the World War II, the Japanese steel industry cannot but recall the whole-hearted assistance that the American and European steelmaking nations extended to us in respect to techniques, equipment, raw materials and funds. This assistance was vital to achieving today's prosperity in our industry. It is my firm conviction that, however hard we may have tried, such phenomenal development as Japan's steel industry enjoys today could never have been achieved without the invaluable assistance and cooperation extended to us. . . . In this sense we may say without exaggeration that you are the real magicians who accomplished our "economic miracle."

E. During much of the postwar period American corporations and individuals were being taxed for aid to steel industries and other industries abroad, while at the same time both the ability and the incentive of American steel companies to invest in new plant and equipment were being severely restricted by tax law provisions for depreciation which were far less adequate than those applicable abroad. In addition, American steel producers have expanded and improved their steel mill facilities without direct financial help of any kind from Government.

F. On the question of "inefficiencies" an American steel production, it is true that if the industry could start from scratch, the total production function would obviously be somewhat more efficient. The reason why all existing facilities are not immediately scrapped and replaced with others incorporating the latest technology is because an orderly, case-by-case evaluation of facility needs is financially much more prudent. But this approach to facility replacement is no different from that utilized by any other industry. (In agriculture, for example, a farmer might wish to scrap his existing tractor or milking machine, regardless of their efficiency, and buy an improved model every time one becomes available. However, he knows that such an approach would quickly lead to bankruptcy.)

III. Profits

A. Mr. Graham asserts that American steel companies "have been more interested in expanded profits than in modernization of their plants." Domestic steel companies are obviously interested in increasing their profits. That is one of the objectives of the very high levels of capital expenditures. Actually, however, just opposite of Mr. Graham's assertions has been occurring recently. Profits earned by 14 of the largest 15 domestic steel companies during 1967 were lower than those earned in 1966 and also lower than those earned in 1965.

B. Rather than being conflicting objectives, plant modernization and profits are closely related objectives. For example, facility improvements are made with the hope and expectation of earning a profit. Prospects of profits are necessary to attract either new debt capital or new equity capital. Other factors being equal, the greater the profits available for reinvestment in the business, the faster improvements can be made in productive efficiency.

C. During recent years, the domestic steel industry has ranked near the bottom of all industries in terms of rates of return on investment. This restricts domestic steel companies' ability to invest in more efficient facilities at a faster rate not only from internally generated funds but also from externally generated funds from investors obtained in competition with companies in all other industries.

IV. Plant Modernization

A. Mr. Graham cites the modernization undertaken during recent years by the German steel industry as an example which the domestic industry should follow. From this, one would conclude that the German industry has been investing money in new facilities at a rapidly increasing rate and that just the opposite is the case in the United States. Actually, exactly the reverse of this has been happening during recent years. As shown below, capital expenditures by U.S. steel companies increased by 120 percent during the 1963–67 period, whereas they have declined by 45 percent in West Germany and by 43 percent in to the total ECSC.

CAPITAL EXPENDITURES BY IRON AND STEEL INDUSTRIES

[Dollars in millions]

Year	United States	West Germany	E.C.S.C.
1963	$1,040.0	453.1	1,479.5
1964	1,600.0	379.3	1,315.3
1965	1,822.5	311.6	932.3
1966	1,953.0	292.0	837.5
1967	2,292.0	247.1	837.6
Percent change (1963–67)	+120	−45	−43

B. In light of the above, it is apparent that the American steel industry has been doing exactly what Mr. Graham and other critics of the industry advocate. However, as the recent Senate Finance Committee's staff study on "Steel Imports" pointed out, "Unless the new investment in fixed assets produces cost savings in excess of

higher costs per ton, and unless tonnage increases to absorb the increases in fixed costs, profit margins will actually fall." This, of course, would make further financing more difficult.

C. Despite the current level of capital expenditures by the American steel industry, such expenditures cannot be expected to lead to significant reductions in unit costs because existing technology, including that presently approaching adoption, does not point the way to massive reductions in unit material and labor requirements. Certainly, it will not reduce substantially the difference between the low unit labor costs of Japanese producers and the much higher unit labor costs of American producers. In fact, to equalize those costs without reducing hourly employment costs in this country, it would be necessary to cut immediately the man-hours required to produce 1 ton of steel from the present level of about 13 to a presently unattainable 4—a decrease of about 70 percent. Even if new technologies were developed which could quickly and profitably effect this substantial reduction, there would of course be no technical barrier to prevent their concurrent installation by foreign steelmakers.

AMERICAN LIFE CONVENTION and the LIFE INSURANCE ASSOCIATION OF AMERICA

This statement is submitted on behalf of the American Life Convention and the Life Insurance Association of America, two trade associations with a combined membership of 351 life insurance companies. These companies account for 92 percent of the legal reserve life insurance in force in the United States. The life insurance business today holds over $177 billion of assets, which represent the savings that millions of policyholders have entrusted to us. We have a deep concern in the proper functioning of the economy to protect these savings. Accordingly, we appreciate the opportunity to comment on the materials and recommendations contained in the Economic Report of the President together with the annual report of the Council of Economic Advisers and we hope that these comments will prove helpful to the Joint Economic Committee for the Congress.

PROSPECTS AND PROBLEMS FOR THE ECONOMY

The question of appropriate economic policies for 1968 must be analyzed against the background of the prospects for economic activity, and whether these prospects raise problems for the economic health of the Nation. The Council of Economic Advisers has offered the forecast that gross national product in 1968 will total $846 billion, representing a gain over 1967 of $61 billion. This forecast is based on the Council's estimate that our productive capacity will permit an increase in real output of somewhat over 4 percent, or about $32 or $33 billion in 1968. The remaining increase in estimated GNP would represent merely increased prices of goods and services which are expected to lift the dollar GNP by another $28 or $29 billion. The Economic Report forecast makes the assumption that overall price increases in 1968 will be "somewhat in excess of 3 percent."

In our view, unless remedial action is taken, there is a grave danger that price levels will advance significantly more than 3 percent in 1968, in the light of the recent price trends in the economy and the clear signs of excessive demands that are developing. The forces of inflation are gaining dangerous momentum which threatens price inflation at a rate above 4 percent with serious consequences for domestic economic stability and also for our critical balance-of-payments position.

Price increases have shown a rapid acceleration during recent months. As may be seen on page 105 of the Council's annual report, the GNP price deflator covering all goods and services rose at a 4-percent annual rate in the second half of 1967, following a 2.6 rate of advance in the preceding 9 months. Consumer price increases in

the second half of 1967 stepped up to a 3.8-percent annual rate after an earlier gain of only 2.2 percent. Wholesale industrial prices had been rising only 1 percent, but quickened their advance to a 2.7-percent rate in the latter half of 1967. These rates of price increases are rapid, and most alarming.

There is considerable evidence that these price trends are not merely temporary but will continue and strengthen if left unchecked. For example, the unemployment rate has been running well below 4 percent during the past 12 months and declined to 3.5 percent in January, revealing the pressures on our available labor force. Utilization of industrial capacity has risen in recent months close to the preferred operating rate for many industries. Recent wage negotiations have led to wage increases of 6 percent or more, well above productivity gains, setting an inflationary pattern for key labor contracts scheduled for bargaining in 1968. Minimum wage levels have advanced another notch, raising costs of production in many lines of business. In short, the stage is set for a wage-cost-price spiral during 1968 which could gain dangerous momentum if excessive demands are permitted to develop.

At the beginning of this year, the standard forecast developed by the majority of private economic analysts was that activity in the first half of the year would be quite strong, but that lesser gains in GNP were to be expected after midyear. The smaller gains foreseen for the second half were attributed primarily to the anticipation of a steel strike in August, a tapering off in the rise in defense spending, and assumptions that a continued high rate of personal saving would mean less-than-buoyant consumer spending. On these assumptions, many private forecasters predicted a GNP of about $845 billion in 1968, fairly close to the forecast of the Council of Economic Advisers.

It is our judgment that predictions of a second-half slowdown in GNP will prove to be in serious error and that the outlook clearly points to a continued strong advance and possibly an acceleration of GNP in the latter half of 1968. The temporary influence of a steel strike can easily be offset by other factors, as witnessed in similar periods in the past, with little effect on the rise in GNP. For example, the $1½ billion Government pay increase scheduled for the third quarter will provide a sizable boost in spending power. The accumulation of consumer savings during the past year provides a very large reservoir of potential spending, especially if consumers decide to speed up their buying in anticipation of substantial price increases on consumer products. Signs of serious inflation would stimulate further spending and add further to the pressures of demand.

Of perhaps greatest importance in the current outlook is the clear evidence that military spending will be much larger in the coming months than had been expected a few weeks ago. Recent developments in Vietnam and in North Korea are now expected to lift defense outlays by $4 to $5 billion more than had been estimated in the January budget figures. The second-half slowdown in GNP that had earlier been projected has been outmoded by these later developments.

It must be recognized that we are in a wartime economy, and our economic policies must be shaped to take account of the drain on our resources that the war requires. In contrast to goods produced for civilian use, military goods are not available to satisfy civilian de-

mands, with the result that military spending places greater pressure on domestic price levels. With national defense expenditures likely to reach $85 billion in fiscal 1969, instead of the $80 billion budgeted in January, our economy faces a heavy strain on resources.

The total impact of the Federal Government sector upon the economy and price pressures is shown most directly by the size of the Federal budgetary deficit. According to the January budget estimates, the deficit for fiscal year 1968 will reach $19.8 billion and will total $22.5 billion in the absence of increased taxation. For fiscal year 1969, the budget deficit would reach a range of $25 billion to $30 billion in view of the additional defense spending now in prospect. Coming on top of a resurgence of demand in the private sector and growing demands from our State and local governments, a Federal deficit of this dimension clearly is bound to create excessive demands and rapidly rising price levels.

Inflationary trends of recent months have been widely ascribed to "cost-push factors" in the economy, but the outlook for 1968 poses the additional danger of a "demand-pull" inflation based on excess demand for goods and services. If both types of inflation are allowed to exist simultaneously, reinforcing each other with successive price increases, a wage-price spiral of serious proportions is in prospect not only for 1968 but continuing into 1969 and beyond.

The threat of spiraling prices is a matter of great concern to everyone and especially to the life insurance business and its millions of policyholders. beneficiaries and pensioners whose benefit expectations, savings and living standards would be seriously eroded by price inflation. Because of its uneven impact upon different economic groups, and especially on those living on pensions or fixed incomes, inflation has been rightly described as the cruelest tax of all. Inflation poses a threat to the health of our entire economy and to our ability to sustain stable economic growth.

Effects of Inflation on Our Balance of Payments

The effects of inflation on our balance of payments are of great importance to our Nation. Our balance-of-payments position has sharply worsened within the past several months. dramatized by a drain on the U.S. gold stock of almost $1 billion during the fourth quarter of 1967 While the causes of these payments difficulties are many sided, a basic element is the degree of confidence in the value of the dollar in the eyes of our trading partners abroad. Foreign financial interests are watching carefully the ability of the United States to control inflation. Consequently, the stakes in the fight against inflation are enormous, involving our ability to control forces which could jeopardize the position of the dollar in international finnace.

If excessive demands are allowed to develop in 1968, one consequence would be to increase the volume of imports required by an economy under strain. Second, the inflation of domestic price levels that would result from an overheated economy would have a direct and contiuing effect upon our ability to compete in world markets during 1968 and for many years to come. Not only would there be greater price incentive to buy imported goods because of lower relative prices abroad, but the rise in domestic prices would compound the difficulties of selling American products in foreign markets.

A third element, of direct and immediate importance, relates to the willingness of foreign countries to hold dollars as an international reserve currency. This is perhaps the most vulnerable point in our balance-of-payments position in the immediate future. If it is believed that the United States will tolerate sharply rising price levels, foreign money centers will lack the confidence in the future stability of the dollar which is so vital to their willingness to hold dollars instead of gold in their international reserves. The result could be a flight from the dollar and disruptive shifts of short-term capital which would further damage our international payments position.

The Need for Restraints

The critical problems described above urgently demand immediate policy correctives. We are faced with total demands from the public and private sector which far exceed our productive capacity. In order to prevent a dangerous wage-cost-price spiral which would jeopardize our domestic stability and possibly cause irreparable damage to our international payments system, we must embark immediately on a program of fiscal and monetary restraint at home, combined with actions to control our precarious balance-of-payments position.

We believe that the problems we face offer a serious threat to the American economy. They are due in a large measure to the war in Vietnam and the need to improve living conditions in our cities. These extraordinary demands require that comprehensive measures be adopted to restrain inflation. We, therefore, urge the use of every available means to bring the situation under control.

1. Reductions in Federal Spending

We would urge the Congress to carefully review those areas of Federal spending which might be cut during the coming months. Expenditure reductions should center not just on the postponement of spending programs but also on the careful trimming of less-essential programs which are of lower priority under our present circumstances of rising defense needs and added strains upon our productive capacity.

The problem of controlling Federal spending is not merely one of immediate budgeted outlays. Over the years, a number of programs have been adopted which served useful and appropriate purposes at the time but which have been continued in spite of changing circumstances and have added to budgetary totals year after year. The result has been an unrelenting upward trend in governmental outlays and a mass of programs which prove to be relatively uncontrollable on short notice, even when other forms of spending become more essential.

For the long term, therefore, we urge favorable consideration of S. 2032 and H.R. 10520, identical bills which would establish a Government Program Evaluation Commission on a bipartisan basis to study existing Federal programs to determine the effectiveness of these programs and the priorities which should be assigned to them in the light of the fundamental needs of the Nation. We believe that this approach holds great promise for achieving the long-run objective of bringing budgetary outlays under closer control. By eliminating or

reducing programs with lower priority, greater flexibility would be provided, especially when military requirements arise to place more urgent demands upon budget resources.

We recognize that Federal programs must be responsive to urgent domestic problems that confront our Nation. For example, the Economic Report states: "We must deal more effectively with our urban problems. More and more of our people live in cities. Yet cities threaten to become less and less livable—unless we take decisive steps * * *." The life insurance business shares this concern and sense of urgency over the problems that beset our urban areas. Last September, we announced a program to invest $1 billion of life insurance investment funds to finance improved housing, increased job opportunities and needed services for low and moderate income families living in the blighted core areas of our cities. We believe that action to improve the quality of life in our cities should not be delayed and will require the efforts of private business as well as the government sector.

2. INCREASED TAXATION

Last August, the President proposed a program of increased Federal taxation to reduce the budgetary deficit. At that time, the life insurance business testified before the House Ways and Means Committee in support of the need for substantial spending cuts and a temporary uniform tax surcharge on both personal and cooperate income. We believe that enactment of a temporary tax surcharge is even more essential now and should be achieved at the earliest possible date.

Prompt passage of a tax increase could have an immediate impact on inflationary pressures by removing spending power from the private sector, with substantial effects on total demands on our economy. A tax increase would demonstrate to the world that we are willing to pay the rising costs of our defense outlays through taxation, rather than through inflationary borrowing. The urgency of our international payments problem also requires a prompt decision to increase taxes before the situation reaches a new crisis stage.

A tax increase can never be a popular measure. However, we believe that the public has not fully considered the alternative it faces—inflation arising from inordinate demands on our economy. We would urge passage of a temporary tax surcharge as an economic measure of the highest urgency, which is essential in the long-run interest of every citizen.

Without fiscal action to curb spending or increase taxes, the fiscal 1969 deficit could easily reach $25 or $30 billion, as described earlier. The tax measures proposed by the administration would reduce that figure by approximately $13 billion, leaving a deficit of $12 to $17 billion. If additional reductions in controllable budget programs can also be adopted, the deficit could be further reduced to a figure which would represent a more appropriate budgetary position in a period of rising private demands in a fully employed war economy. Moreover, a smaller deficit would lower Treasury borrowing requirements that would otherwise be extremely heavy, especially during the latter half of calendar year 1968.

3. MONETARY RESTRAINT

The question of Treasury borrowing needs are closely related to the credit posture of the Federal Reserve System. The view is sometimes expressed that fiscal restraint would lessen the needs for the Federal Reserve to embark upon a policy of credit restraint. Stated another way, failure to reduce the budget deficit would require the Federal Reserve to adopt a more restrictive monetary policy. However, this approach overlooks the market reality that the enormous financing requirements of the U.S. Treasury limit the freedom of the monetary authorities to restrain credit growth, since doing so could jeopardize the success of Treasury refundings or new cash borrowing operations.

During 1967, Federal Reserve policy remained in an easy position which permitted a growth in bank credit by an unprecedented dollar total of $35 billion. As pointed out in the Council's annual report, total bank credit expanded during the first 11 months of 1967 at an annual rate of 12 percent. This expansion in credit and in the money supply is related, we believe, to the accelerated rise in domestic price levels during the past several months. Continuation of credit expansion at the pace of 1967 would reinforce strong inflationary pressures through excessive additions to available spending power. However, the need to provide for the financing of Treasury securities through the commercial banks has left the Federal Reserves in the awkward position of maintaining relative ease in the face of an oversized Federal deficit. In brief, an unwillingness to adopt fiscal restraint to achieve a lower budget deficit would add to the difficulties of reducing the growth in bank credit. Stated another way, fiscal restraint and a lower deficit would permit the monetary authorities to follow appropriate policies to curb credit-financed demands in the private sector.

In our view, monetary policy should move in gradual steps toward less expansionary policies, to avoid making credit available in such large amounts that demand outruns our capacity to produce, with a resulting rise in price levels. It is well recognized that there is usually a considerable time lag before monetary policy begins to act upon basic economic forces. For this reason, if the Federal Reserve is to be effective in curbing excessive demands later this year, then steps should be taken as soon as possible toward a less expansionary credit policy.

Any discussion of a less easy credit policy usually brings fears of higher interest rates, credit shortages, and a shutting off of residential mortgage finance. But these consequences need not occur if a reduction of the Federal budget deficit lowers the borrowing requirements of the Treasury thus making room for the financing of residential construction, business capital outlays, and other private sector activities.

4. BALANCE-OF-PAYMENTS POLICIES

On January 1, the administration announced a broad program of correctives to improve our balance-of-payments position, including mandatory controls on direct investment abroad, a more stringent program of voluntary controls on financial flows to foreign countries, and proposed curbs on tourist travel outside the Western Hemisphere.

It is important that proposals to impose these direct controls should not divert attention from the urgent need to adopt reinforcing policies of fiscal and monetary restraint. In retrospect, adoption of such restraint some time ago might have helped greatly to avoid our present situation. For the future, policies of domestic restraint may prove even more important than direct controls in providing a fundamental solution to our international-payments problem.

Conclusion

We believe that the problems of excessive demand, spiraling inflation and foreign payments difficulties represent a greater threat in 1968 than in many years. Effective solutions to these problems demand immediate attention by the Congress, by the administration, and by the monetary authorities. It is not a question of choosing among available approaches but rather of using spending reduction, increased taxation, credit restraint, and balance-of-payments measures in a combined effort to restrain the excessive demands and resulting inflation that our economy now faces.

While these solutions are not easily accepted by many, they are preferable to the alternatives of spiraling inflation and a balance-of-payments crisis. Unless early action can be taken, the Government could later be forced to consider controls over wages, prices and credit in a desperate attempt to correct intolerable inflation.

CHAMBER OF COMMERCE OF THE UNITED STATES

By Dr. Carl H. Madden, Chief Economist

The Chamber of Commerce of the United States welcomes the opportunity to submit written comments on the Economic Report of the President and the annual report of the Council of Economic Advisers. Like their predecessors, these reports are highly useful and of excellent quality. Both the text and the appendix tables contain valuable economic information.

Traditionally, these documents provide a rationale connecting social and economic policy covering a wide range of issues. The chapter titles of the Council's report indicate the range and importance of these questions: sustaining prosperity, the strategy of stabilization policy, the problem of rising prices, economic development and individual opportunity, and the international economy.

But a careful reading of the reports brings all of these aspects of the economy into sharp focus on one overarching problem of national economic policy: because of past errors in national economic decisions, the chief policy aim, both at home and abroad, must be defense of the dollar.

It is no longer possible—if it ever was—to view domestic economic developments as though they occur in a "closed economy" insulated from the rest of the world. The pressures of our international commitments and recent balance-of-payments moves and raids on our stock of gold have awakened the country to the fact that domestic inflation, fed by a persistently large Federal budget deficit, "spills over" into internatioal trade and finance, threatening not only to worsen an already serious balance-of-payments problem, but even to upset the international monetary system.

THE EXTENT OF U.S. INFLATION

Although moderately prosperous by most standards, 1968 is expected to suffer from consumer price increases of 3 to 3½ percent. This further inflation follows rises to 2.8 percent last year and 2.9 percent in 1966. Nor are upward movements restricted to consumer prices: the average price of final goods and services produced (the "GNP deflator") rose even more—by 3 percent in both years. And the more sensitive wholesale price index, after remaining virtually unchanged from 1958 through 1964, rose 2 percent in 1965 and 3.3 percent in 1966 before leveling off during the minicession of last year. But in January of 1968 the wholesale index stood almost a full percentage point higher than in January of 1967; and in February rose further, so that its upward course has been resumed.

Not only is inflation continuing on a broad front this year, but its pace is accelerating. Moreover, inflation has changed in form. Unlike its 1965–66 demand-pull character, inflation last year turned into cost-push as a wage-price spiral was set in motion by leading labor contract settlements that established wage gains twice as great as productivity improvements.

Despite the tendency for inflation to be self-perpetuating, the argument is sometimes heard that our historical record justifies confidence in a reasonably stable price level. Those who argue this way point to the fact that 82 percentage points of the 130-percent rise in prices in the past three decades reflected wartime conditions during World War Two and the Korean war. But adherents to this viewpoint acknowledge that since World War Two the price level has neither leveled off nor declined. This is the "creeping inflation" phenomenon, some of which Arthur Ross, the U.S. Commissioner of Labor Statistics, has attributed to an upward bias in consumer price statistics as currently compiled. But this bias accounts for only about 1.3 percentage points of the average annual Consumer Price Index increases of 1.9 percent since 1961 and the current annual rate of 3 to 3½ percent. The difference remains to be explained.

WHICH PRICES ARE RISING?

A price index is an average; and averages can conceal as well as reveal what they are intended to measure. The Consumer Price Index, for example, is made up of several subindexes, including the cost of medical care, food, homeownership, apparel, and upkeep. Some of these costs have risen much more than others. For example, the fastest rising cost has been medical care, a labor-intensive item, which in December 1967 was almost 26 percent higher than in 1964—up almost 9 percent a year. On the same comparison, food prices rose 5 percent a year; homeownership 4 percent; and the item, "apparel and upkeep," rose 3½ percent. As previously indicated, all items combined rose about 3 percent per year. Individual items in the wholesale price index behaved in a similar fashion, with the prices of hides and machinery and equipment rising fastest.

Changes in prices of individual items reflect underlying shifts in demand and supply. Demand-supply analysis of the sharp rise in medical costs shows that the faster increase in demand for these services, partly due to medicare and medicaid, has exceeded the increase in the supply of skilled personnel and medical facilities. On the other hand, the fast rise in the price of hides has been attributed more to international supply than to demand conditions. But a general rise in prices, as measured by a broad index or average, reflects economy-wide changes and not simply forces affecting a few industries.

THE PROCESS OF INFLATION

There are two popular explanations of how inflation starts and is propagated. The first explanation, called demand-pull, stresses a faster increase in money spending than can be quickly translated into increased output. Such a rapid rise in overall money spending is brought

about by an excessively large increase in the money supply—7.2 percent in 1967, compared to the normal 4-percent growth figure. The second explanation, termed "cost-push," attributes rising prices to "administered" costs and prices set by powerful groups in the economy—the Government (through minimum wage laws, farm price supports, and the like), labor unions (negotiated wage increases greater than productivity gains), and some business firms ("administered pricing").

The stepped-up rate of price increase in late 1965 undoubtedly resulted from acceleration of Government spending for Vietnam in a fully employed economy without the slack to accommodate a comparable step-up in production. The result was that the Government bid away manpower and capital from the private sector and, in the process, boosted prices. This was the pull of demand at work. So rapid was the escalation of demand in the capital market—much of it speculative and anticipatory—that a "credit crunch" developed in mid-1966, especially in that part of the market devoted to mortgage financing.

This demand-pull inflation set the stage for a wage-price spiral that developed in 1966 as representatives of organized labor sought and obtained wage increases that built in the earlier price rise. These higher than productivity wage gains caused employer companies to raise product prices in an attempt to preserve the profit margins necessary to generate internal funds for investment in plants, machinery, and equipment. This investment is necessary not only to replace wornout and obsolete capacity, but also to expand that capacity. Profits are also necessary to provide investors with a return on their investment.

Once inflation gets underway it tends to be self-perpetuating. This is especially true of "cost-push" inflation typified by the current wage-price spiral, as is emphasized by the Council of Economic Advisers in chapter 3 of its report. Just so long as the greater than productivity annual increase in wage rates is "validated" by further injections of Federal deficit spending, the upward spiral of costs and prices will continue.

THE DANGERS OF INFLATION

But isn't a little inflation good for the economy—or at least not harmful? Why is a wage-price spiral so bad?

The answer to the first question is a flat "No." Inflation hurts the economy. It retards the real growth of output partly through a reduction in efficiency; it redistributes incomes away from the great majority who work for relatively fixed incomes in favor of the few who engage in speculative activities; it harms our international competitiveness; and if not checked it can bring on a recession if costs rise faster than prices. In fact, the whole international monetary system suffers because of inflation in this country, due to the dollar's role as the key international currency.

The cost-push pressures of the wage-price spiral accelerate and magnify inflationary pressures generated elsewhere. When we had high unemployment and a gradually rising level of total spending in the economy between 1961 and 1964 average union contract settlements were no higher than the productivity gain of 3 to 3½ percent. But

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the banking system can be an engine of inflation when it is speeded up through large and growing deficit borrowing by the Government in a fully employed economy. It is at this point that continuous deficit spending "engages the clutch" of the wage-price spiral.

CURBING INFLATION

It is far easier to permit inflation to develop than to curb it—not because the anti-inflationary weapons are lacking, but because of their political unpopularity. Excessively easy monetary and credit policies and Federal deficit spending in a high-employment economy are the direct causes of demand-pull inflation and the indirect causes of the cost-push variety. The cures are the reverse: tightening credit and shrinking the deficit. The 1951 tax increase helped stem the Korean war inflation. The Federal Reserve's tight credit policy in 1966 slowed the economy's price rise appreciably, despite a growing Federal deficit. But the inflation resumed after monetary policy once again turned expansionary in 1967 and the Federal deficit deepened. Even when the upward wage-price spiral is set in motion monetary and fiscal restraints can be effective.

Even when demand-pull pressures predominate, if fiscal policy does not support monetary policy, the Federal Reserve cannot do the necessary job alone. If the Treasury is running a deficit, the "Fed" is hampered by its commitment to "maintain an even keel" (not to tighten credit) during Treasury borrowing operations. Furthermore, if the "Fed" is forced to act alone to stem inflation by applying the monetary control brakes—as in 1966—it causes the economy to swerve, like a speeding automobile whose brakes work unevenly. In that instance the unduly severe impact of tight money on the construction industry brought a precipitate decline in homebuilding activity.

It is not sufficiently recognized that traditional monetary-fiscal policies can be effective in curbing cost-push inflation by dissipating the underlying demand-pull pressures. The Council of Economic Advisers' report (pp. 119-128) tacitly admits this fact in its discussion of price and wage policy; but there is no explicit treatment of this question which is of more than theoretical importance. The Council's apparent underestimation of this point affects the price-stabilization policy prescriptions in its report.

WAGE-PRICE CONTROLS

The seriousness of this oversight is apparent in the reiteration of the Council's wage-price guideposts which were abandoned in 1966 precisely because a wage-price spiral had set in. Wage-price controls either of a direct or indirect kind are undesirable—both because they are ineffective and, more importantly, because they distract attention from the need to follow the proper anti-inflationary policy—adequate monetary and fiscal restraints applied in unison. Pressure for such controls builds up because of the failure to use a proper monetary-fiscal policy "mix".

The nub of the question of price stability is the often cited "trade-off" between price increases and unemployment. Studies of this ques-

tion to date strongly suggest that once the overall unemployment rate drops below about 4 percent, price increases accelerate. If this is so, then any national economic policy is misguided that solely through excessive injections in spending depresses the unemployment rate below about 4 percent. Reductions in unemployment significantly below the 4-percent level should be accomplished by other than aggregative spending measures such as upgrading of worker skills, enhanced labor mobility, and improvements in job placement procedures.

The run on gold and the dollar since the British devaluation last November 18 and subsequent economic developments clearly indicate that if the United States does not by itself immediately take steps to control inflation and reduce its international payments deficit through proper monetary-fiscal policies, international pressures will force this action.

COMMITTEE FOR ECONOMIC DEVELOPMENT

By EMILIO G. COLLADO, CHAIRMAN, RESEARCH AND POLICY COMMITTEE

We appreciate the opportunity to present to the Joint Economic Committee the views of the Committee for Economic Development on the Economic Report of the President and the annual report of the Council of Economic Advisers. These reports provide a valuable description and analysis of many of the opportunities and problems facing the United States today and in the years ahead.

Our comments today are centered around four issues.

The first concerns fiscal policy, where we believe that fiscal restraint is necessary now. We support the President's tax proposals, which would represent the major element of restraint, but in addition believe that further expenditure reductions would be desirable. We shall attempt to state the case for a stabilizing budget policy as forcibly as we can.

The next issue concerns the evident failure to give adequate attention to a longer run program for Federal expenditures and taxes designed to meet both our existing and emerging needs. Each new fiscal problem brings forth a hastily introduced program designed to meet the problem of the day without any apparent relationship to a long-run program or strategy. We now have several forms of voluntary and direct controls over various forms of economic activity. We shall draw attention to these controls and suggest how an appropriate long-run fiscal strategy could avert their becoming permanent fixtures of Government policy.

The third question concerns the current inflationary pressures which, we believe, present a serious threat to economic stability and efficiency both at home and abroad. We agree with the Council's view that, while both cost-push and demand-pull elements are present in the current situation, prompt fiscal action would brake the rising spiral of wages and prices. We fear, however, that the administration still places far too much reliance on voluntary wage and price restraint as a means of dampening inflationary pressures.

Finally, there is the President's emergency program for dealing with the deterioration in the balance-of-payments position of the United States. The President's measures and proposals represent a continuation of the piecemeal approach to solving the balance-of-payments problem, an approach which has led the Government to rely principally on measures designed to reduce the flow of U.S. private capital abroad. These short-term expedients are clearly not in our long-run interests, nor is it clear that we are more prepared today than we have been for the past 5 years to embark on more basic, long-term solutions.

In what follows, our positions on these four issues will be more fully developed.

FLEXIBILITY AND POLICYMAKING IN 1968

The Council's report states that "the limitations of the economists' ability to predict the future argue for *prudence* in policy decisions, *flexibility* in the use of instruments, and continuing efforts to improve the reliability of forecasting techniques" (italic added). The efforts to improve the quality and quantity of economic information will no doubt bear fruit. But any benefits to be derived therefrom will appear with a long lag. For the present the courses of action open to us are only those of prudence and flexibility in stabilization policy.

As CED has said many times, a stabilizing budget policy is achieved when the Government sets its expenditure programs and tax rates so they would yield a surplus under conidtions of high employment and price stability. Since the Federal budget is now in deficit, the present budget policy of the Government falls short of the stabilizing budget rule. It is our view that a policy designed to provide a budget surplus best deals with the dangers of continued inflation without foreclosing our ability to handle a lapse from high employment. If the deficit at high employment is allowed to continue and if total public and private demand rises more than anticipated, we face the danger in the present overheated state of the economy of a still higher rate of inflation. If total demand should rise less than is now widely anticipated, the depressing effects of the surplus can be offset by prompt actions to reduce taxes, to move toward greater monetary ease, and to restore currently deferred but desirable public expenditures.

Several major uncertainties complicate economic policymaking in 1968 and argue for prudence and flexibility; these are the Vietnam situation and the strength of consumer demand. Almost all forecasts, including that of the Council, anticipate a continued acceleration of economic activity throughout the first and second quarters of 1968. There are a few signs, however, which lead some forecasters to anticipate that, even without a tax increase, private demand will moderate in the second half of 1968. Others see little reason to believe that with or without a tax increase economic activity will moderate at all in the last half of the year. This uncertainty about the future course of economic activity clearly is finding its reflection in the failure of Congress to come to grips with current fiscal and monetary requirements.

With the economy currently operating at or very near its potential, with wages and prices rapidly rising, with interest rates at historic highs, and with demand expanding more rapidly than our capacity to produce, the evidence strongly indicates the need for a program of fiscal restraint imposed in part by the proposed tax surcharge. If the surcharge is not enacted the country will suffer serious setbacks.

—Prices and wages will continue to rise at unacceptable rates. To paraphrase the Council, another ominous turn will have been given to the wage-price spiral, postponing still further into the future a return to price stability.

Our international competitive position will be weakened and the deterioration in our balance of trade will be accentuated. The effects of continued price inflation in the United States along with rapidly accelerating incomes will increase our demand for imports and reduce our ability to export.

—Monetary policy will once again be the only restraining influence with the result that interest rates will be under strong upward pressure. It is quite clear that if fiscal restraint is not exercised in the face of excessive demand and inflation, an expanded demand for loans in both public and private sectors will, unless deliberately accommodated by expanding reserves, produce a tighter monetary policy and rising interest rates.

—Our domestic capital markets, advanced as they may be, are not perfect and, as we were reminded in 1966, the pressures caused by restrictive monetary policy can cause confusion, disturb confidence generally, and lead to severe distortions in the pattern of economic activity. Small businesses, farmers, and prospective homeowners lose out to the Federal Government and other strong borrowers in the struggle for funds. Housing construction and local government projects can be substantially affected. In an economy with excessive total demand, some spending must be cut if price level increases are to be kept within bounds. To restrain housing substantially again in 1968 is to postpone a considerable amount of construction spending into some later period when finance is available. At that later time, rapid increases in construction will most likely lead to large price and wage increases in this sector of industry. Thus we will provide inadequate housing in 1968 and sectoral inflation in the housing industry whenever the level of demand in the economy moves back closer to its potential.

On the other hand, if we enact the tax surcharge and find that the strength of demand is not excessive several courses of action are open:

—Monetary policy could remain expansive or only moderately restrictive, thus assuring an acceleration of savings flows to savings institutions. This flow, given the high levels of income and low vacancy rates, could accommodate a substantial increase in the demand for housing. Moreover, under such a monetary policy, interest rates would moderate from their highs and credit would be made more available to those sectors unable to compete under current conditions.

—Certain of the more desirable Federal as well as State and local government expenditures which have been postponed could be undertaken or reprogramed.

—In the most unlikely event that private demands showed themselves to be so weak that a relaxation of monetary policy and an increase in government expenditures would not assure high employment at stable prices, the tax surcharge could always be revised or repealed.

Thus the course of prudence in policy decisions and flexibility in the use of stabilization instruments available to the Government argues strongly in favor of the proposed surcharge. The risks of excessive growth in demand and accelerated inflation are great, given the possibility of an acceleration of defense expenditures, significantly higher consumer spending, or an acceleration of inventory accumulation or plant and equipment expenditures. In the summer and fall of 1966 when monetary policy was the only instrument used to restrain the economy in the face of very strong demand, we experienced a very rapid rise in interest rates, severe distortions in credit markets, and

a pronounced depression in housing. Enactment of the tax surcharge substantially reduces the risks of a recurrence of these distortions and introduces considerable fiscal and monetary flexibility to deal with the uncertainties in the year ahead.

In our opinion the tax surcharge by itself will not achieve all of the fiscal restraint needed in the current situation. It is especially important that the Federal Government examine its own spending plans with great care. As the Nation's priorities change toward more concern about problems of cities, poverty, and education, new areas of spending become important. Therefore extra effort must be taken to assure both the necessary restraint in the total of expenditures and the needed reallocation of spending within the Federal budget. Among the areas where we would assign lower priorities, and hence seek expenditure reductions, would be, for example, in space exploration. Substantial cuts should be made in agricultural subsidies especially in light of the Council's statement that the bulk of farming now originates on large farm businesses rather than from poor farm families and thus the bulk of these subsidies do not meet their stated objectives. Reflecting the current shortage of resources for investment and the very high productivity of private investment, public investments in reclamation, harbors, rivers, and highways must be reduced, deferred, or stretched out and also be made to pass more rigid and competitive requirements.

Given the strength of private and public demands, the low level of unemployment and the evident strain in labor markets, and the rate of increase in prices, Congress must act now to provide a substantial amount of fiscal restraint. Prompt enactment of the tax increase and sufficient expenditures cuts to bring the high employment Federal Government budget on national income and product account into a modest surplus must be the objective of Government policy.

A BUDGET POLICY BEYOND 1968

Except for commenting on studies directed to the problems and opportunities presented by a deescalation of the war in Vietnam, the report contains few references to a fiscal program for the future. While much might be said about the effects of the changes in national priorities on the composition of future Federal expenditures, our comments here are concentrated on the problems of taxation. One major objective in this area relates to improving the flexibility of fiscal policy within the current tax structure. Another concerns changes in the tax structure designed to accelerate economic growth and improve the flexibility of the tax system as a stabilization tool.

The quickest and most effective method of affecting private spending, when change is needed, and with a minimum of carryover into a later period when change is not needed, is through a temporary change in tax rates. It is especially important that a generally accepted method of tax rate change, both up and down, be available for prompt use when recession or inflation threaten. Too often in the past we have been confronted with the alternatives of raising or lowering expenditures or relying solely on monetary policy.

To strengthen our ability to use temporary changes in tax rates as a way of stopping a recession and promoting recovery or holding back

excess demand and averting inflation requires that means be devised for putting the tax change quickly into effect and for assuring its termination at some point.

The essential condition for use of a temporary tax cut as an anti-recession instrument or a temporary tax increase as an anti-inflation instrument is that the Executive, the Congress, and the public at large should understand the functions that such a change would be intended to serve, the circumstances in which it would be appropriate, and the distinction between such a temporary change and basic, permanent revision of the tax structure.

However, basic revisions in the tax structure can also be timed to help solve current fiscal problems. For example, in April 1966 the CED advanced the concept of a value-added tax to add desirable fiscal restraint to the economy, to aid our balance-of-payments problems, and for the longer term to spur growth in the domestic economy by permitting a reduction in corporate income tax rates.

For almost 10 years, the United States has experienced a deficit in its balance of payments. Over that period of time it has become clear that the United States could improve its fiscal policy tools to assist in the solution of this problem. This lack of mechanisms with which to deal with the problem is in part responsible for the temporary interest equalization tax both at its original level and at its higher rates, for the voluntary capital constraints which have now become direct capital controls, the controls over foreign lending by financial institutions, the proposed taxes on travel, as well as the suggestion that we move to impose taxes on imports and rebates on U.S. exports.

In 1966 the CED suggested that discussions take place to establish the usefulness of a broadly based, low-rate tax on value added which is acceptable under GATT rules in stimulating both exports and domestic growth. If such an examination had taken place and such a tax were immediately available today it would contribute to our current objectives better than many of the alternatives now so hastily chosen. It could be used to restrain domestic demand and price inflation, and it would stimulate exports relative to imports and thereby lessen the need for the onerous direct controls on investment abroad as well as the proposed taxes on travel.

We do not propose the value-added tax now as a substitute for the income tax surcharge and expenditure restraint proposed above. These proposals should be adopted immediately, we do, however, once again call for a detailed examination of the role a value-added tax could play in the U.S. tax system.

Inflation and Voluntary Controls on Wages and Prices

We agree with the President and the Council in their belief that "inflation impairs economic efficiency, redistributes income capriciously, and weakens the Nation's competitiveness in world market." We also share their pronounced distrust for direct controls as a means of achieving price stability. However, we do not share their faith in the efficiency and effectiveness of voluntary controls over wages and prices. Wage and price guidelines are an attempt to make possible

a low rate of unemployment without inflation. We believe this is a desirable goal of public policy. But we do have severe reservations that the suggested procedures will achieve this end.

If one examines the history of the guideposts in the U.S. economy there are good reasons to believe that the stability of labor costs in the period 1961–65 in the United States was due more to slack in the economy than to exhortation about statesmanship in wage and price policy. The guidelines may have been innocuous, and in 1965 and 1966 when the economy reached high employment levels, insofar as the guidelines diverted attention from the basic need for fiscal restraint they may have been counterproductive. Now, with the economy producing at or above its potential for the third year in a row, with about 3.5 percent unemployment, and with very strong upward price and wage pressure, the need is for immediate and substantial fiscal restraint.

The report contains a proposal to establish a Cabinet Committee on Price Stability. One function of this Committee would be to confer with representatives of business, labor, and the public at large in an attempt to reach some consensus on appropriate general standards to guide private price and wage decisions. In most other contexts, such efforts to form a consensus on prices or wages would be considered inimical to a competitive market determination of prices and wages and therefore as undesirable and against the public interest. We seriously doubt that the findings of such a Committee, however correct, would result in the promotion of competition, efficiency, and price stability in the United States.

In addition to questioning the effectiveness of an incomes policy in achieving its stated objectives, there are other most important difficulties with these suggestions. As the CED said in its testimony on the President's Economic Report in 1964,

> At issue is the role of free, competitive markets as compared with the role of Government in the guidance of our economy. One aspect of the issue is whether there is a way of exercising Government influence over prices and wages through moral suasion and leadership that will be effective without in fact constituting Government control of a kind generally considered alien to American tradition and values. Other questions, on the assumption that such influence without control is possible, include how, by what legal processes, the Government will determine the standards of price and wage behavior to which the economy should conform. How can it be assured that the standards will bear equitably and without discrimination upon all the individuals, businesses and unions to whom they are expected to apply? If the guidepost policy is a response to a belief that competition in labor and product markets is inadequate, is it better to move in the direction of more Government influence rather than in the direction of strengthening competition?

In summary, the evidence seems to indicate that an incomes policy without fiscal and monetary restraint will not work and that with adequate fiscal and monetary policies an incomes policy is a poor substitute for improvements in labor mobility, a lessening of restrictive labor practices, and improvements in the competitiveness of product markets. We have already seen what were professed to be temporary and voluntary controls over foreign capital flows persist and actually become direct controls, because we were unwilling to adopt fiscal and monetary policies adequate to deal with our balance-of-payments difficulties. It would be most unfortunate indeed if we were to see the

same course of events unfold with respect to the wage and price controls which are advanced in the report because we continue to be unwilling to adopt the necessary fiscal restraint.

Toward International Equilibrium

For some years now the Government has invoked a variety of measures to reduce the U.S. balance-of-payments deficit and end the gold drain. Although the deficits recorded in 1965 and 1966 were smaller than in previous years, we were far from a satisfactory long-term solution to the balance-of-payments problem. Then, in 1967, the deficit increased sharply. It is clear that the balance-of-payments deficit can be eliminated either by increasing the surplus on private international transactions or by reducing the deficit of the Government's international transactions, or both. In recent years Government policies have been directed at both fronts.

To increase the surplus on private transactions the Government has tended to look for individual items which could be affected by specific actions rather than to seek more general adjustment through appropriate broad monetary and fiscal policies. The piecemeal approaches have often proved ineffective and this had led to their proliferation. The substantial increases in the payments deficit and severe gold loss last year have led to direct controls over a vital part of our economy. The emergency measures announced by the President on January 1, 1968, were designed to restore the waning confidence abroad in the Government's willingness and ability to deal with balance-of-payments problem.

The justification for introducing the various piecemeal balance-of-payments measures has been that they provide us with a "breathing spell" during which we could achieve basic improvements in our payments position. Yet, we do not find in the Council's report an adequate statement of how we are to move from the present emergency controls to a long-run solution which would make them unnecessary.

The United States continues to earn a surplus of exports over imports. However, continued inflationary pressures and repeated economic overheating over the last 3 years have damaged the U.S. competitive position and resulted in a declining export surplus. Moreover, continued inflation in the United States casts doubts on the stability of the dollar and thus undermines a principal reason why foreigners have found it attractive to hold dollars.

The most promising way to achieve a lasting improvement in the U.S. payments position is by restoring balance to our internal economy. More than a year ago, the Committee for Economic Development emphasized this in a policy statement entitled, "The Dollar and the World Monetary System." To use the words of this statement:

> Fortunately for the United States there is currently little conflict between the demands of an appropriate domestic fiscal and monetary policy and those of the external United States payments position. Under present conditions of inflationary full employment there is need for a program of further domestic restraint. Such a program could reduce the present balance-of-payments deficit substantially.

The consequences of continued inaction in the fiscal area are clearly evident in our deteriorating trade surplus. Moreover, the countries of

Europe view our continued fiscal inaction as highly irresponsible on our part and are likely, in the absence of early action, to circumscribe quite strictly the amount of cooperation we may expect from them in reducing the U.S. payments deficit further.

The CED is also concerned about the direction our policies have taken as a result of the most recent measures. We should not deceive ourselves into think that there is anything "better" about restricting international capital movements rather than restricting international trade or travel. Restrictions on either cause the world to forgo economic benefits which would result from voluntary decisions made in response to free market forces. Moreover, current and proposed restrictions on capital movements, trade, and travel will undo much of the progress that we have made in the last quarter century toward greater freedom for international trade and investment.

Summary

In summary, the CED believes that a prudent course of action at the moment is (1) a program of substantial fiscal restraint on the part of the Federal Government—the immediate enactment of the proposed surcharge and a reduction of expenditures to yield a modest surplus in the high-employment budget on national income and product account, (2) prompt consideration by the administration and Congress of the potential usefulness of the value-added tax along the lines suggested by the CED in 1966, and (3) preparations for a move in the direction of eliminating direct controls, specialized taxes, and direct Government influence in the functioning of business which have been imposed to offset the influences of inflation in the domestic economy and on the balance of payments.

COMMUNICATIONS WORKERS OF AMERICA

Last year the unemployment rate in the United States was 3.8 percent of the civilian labor force—the same rate as registered in 1966. In the early 1960's, when unemployment was at intolerably high levels of 5 percent or more, the Council of Economic Advisers set 4 percent as the "interim goal" on our road to the achievement of full employment. It is apparent from this year's annual report that the Council has now determined that the country will "settle" for an unemployment rate in the neighborhood of 4 percent in order to avoid facing the pressures of excess demand.

We find this evaluation of the potential of the U.S. economy rather conservative. In the first place, as the Council itself acknowledges, the (now) revised method of measuring unemployment undoubtedly understates the number of jobless, in comparison to what the figure would have been had the former criteria been used in assessing persons still actively in the labor force.

Secondly, we do not consider that an economy with 3 million jobless and with considerable idle plant capacity can be said by any means to be at full employment. A full-employment unemployment rate should be that rate at which most of the jobless, at any point in time, are classified as frictional unemployed (in transition between jobs). Yet the Council points out that the burden of unemployment last year fell most heavily on those disadvantaged groups who are being left behind in this period of general prosperity.

The utilization rate of manufacturing plant capacity was only 85 percent in 1967. This, coupled with substantial hard core unemployment, indicates to us that economic policy must be geared on a priority basis to increasing employment through measures designed (a) to match workers to jobs and (b) to create the new jobs necessary to move the unemployment rate to below 3 percent.

The Council of Economic Advisers does not believe that real gross national product can grow more than a little over 4 percent this year without severe excess demand. This rate of growth would leave the unemployment rate substantially unchanged from last year. We believe that there is enough slack in the economy to allow a higher growth rate without creating inflationary pressures beyond those already anticipated. Indeed, the most reliable "moderating" force, in terms of the threat of runaway inflation, lies in the degree to which we commit ourselves to an expanding (rather than a flat or "normal") rate of growth.

In addition to unemployment, there are a number of other domestic issues demanding immediate attention. Last summer's riots were a manifestation of despair among a substantial segment of our population, stemming from inadequate job opportunities, substandard housing, poor quality education, an antiquated welfare system, and a host of other conditions that are the antithesis of the Great Society. Yet

the Council, after acknowledging these problems and praising already existing programs, proposes few bold or imaginative solutions.

It is clear to us in CWA that what we are doing now is not enough. Massive programs and a commitment of genuine concern are urgently needed. The continuing unrest in our urban slums indicates that the disadvantaged are not willing to wait for the termination of the Vietnam war to enter the mainstream of American society.

We do not deny that the building of the Great Society is going to cost money. We recognize the pressures on the Federal budget resulting from our multibillion-dollar involvement in the Far East. We, therefore, call upon the 90th Congress—and specifically on the House Ways and Means Committee—to institute, on a priority basis, legislation to tap those sources in our economy which today carry no share of the tax load whatsoever, or ride at such reduced rates as to be virtually freeloaders.

In a recent article in the American Scholar, former Senator Paul Douglas—long a lone voice in the Congress on behalf of tax reform—noted that only about half the total personal income in the United States is subject to taxation—while the other half completely escapes a tax levy. The basic exemption in personal income tax of $600 per person accounts for only a fraction of this latter amount.

In a statement issued by CWA's executive board last August, we called on the Congress (a) to bring the half of long-term capital gains, which now totally escapes Federal taxation, under a progressive tax schedule geared to the level of such gains; (b) to tap the income from State and municipal bonds on a progressive basis, also geared to the level of income accruing to the individual taxpayer from such sources; and (c) to revise the depletion allowance schedule (beginning with the 27½ percent writeoff for oil and gas) to bring it in line with the level of taxation now levied on the corporate sector as a whole.

Provided that the Congress takes such action in closing tax loopholes, we would support a surcharge on personal and corporate income, tailored to an ability-to-pay principle which would assure that such additional tax payments enhance the progressive structure of our income tax schedules, rather than compounding their regressive characteristics.

We believe that sufficient revenue can be thus generated, not only to meet the cost of our foreign commitments and to ease the tight credit situation, but also to initiate the kinds of programs needed to achieve full employment and to tackle the most pressing of the other problems which continue to plague this society.

We are prepared to acknowledge that, as the Nation moves closer to full employment, there are likely to be inflationary biases; our resources are not perfectly mobile. Bottlenecks may occur in some industries while there is idle capacity in others; workers with certain skills may be in short supply while others cannot find jobs. Businesses have rather consistently taken advantage of strong demand to raise prices and to improve their profit margins. Lower unemployment rates may, in a word, incur the cost of rising prices.

Nevertheless, we are firmly convinced that the Nation can sustain the burden of a moderate rise in the price level far more readily than the grave consequences of letting our domestic problems fester for the duration of the war.

It may be that, in attempting to meet our commitments at home and to pursue a war abroad, it will become necessary at some date to institute direct economic controls in order to prevent a disastrous runaway inflation. Labor has long since indicated its willingness to face that eventuality—provided that all Americans are called upon to share the burden equally.

As part of its anti-inflation program, the CEA reiterates the controversial guidepost concept. The Council moved this year to an implicit absolute maximum of 5½ percent for "noninflationary" wage settlements. We in CWA continue to maintain that the guideposts are inequitable—that they call upon one part of the population to make a special sacrifice to correct a problem which that sector had no responsibility in creating.

During the period 1961–66—the guidepost years—corporate profits increased 77 percent, while employees' compensation rose only 43 percent. In an attempt to achieve higher and higher profits and returns on equity, business raised prices during the slowdown in late 1966 and early 1967 in order to maintain previous profit levels in the face of a decrease in demand. Wage earners watched impatiently as their incomes lagged behind other forms of income, including dividends, professional salaries and capital gains.

At the same time the purchasing power of workers' earnings was being eroded by rising food prices and the costs of essential services, especially medical care services. By late 1966 it was obvious to labor that a catchup to the mounting cost of living was necessary. Yet despite the negotiated settlements averaging 5½ percent last year—which the administration considers alarming—a recent Labor Department study showed that real wages were no higher last December than the two previous Decembers.

There is a growing imbalance in income distribution in this country; the guideposts penalize the very group whose incomes must be adjusted if the imbalance is to be corrected.

The movement back to one magic number that is to apply to all industries—the efficient and the inefficient—flies in the face of the economic realities by which resource allocations are made in a free economy. We cannot accept 3.2 percent or 5.5 percent or any other single figure as being the "right" wage increase for all workers in all situations.

We are somewhat puzzled over the role of the newly created Cabinet Committee on Price Stability. The President states that one of its functions will be to inform labor and business of the "consequences of irresponsible wage and price behavior," and "to seek ideas and initiatives to correct persistent structural problems that cause prices to rise." Yet he assures that the Committee will not become involved in specific current wage or price matters. We fear that the door has nonetheless been left open for this body eventually to grow into some kind of "final judgment" panel to give a "pass" or a "fail" to a negotiated settlement, on the basis of whether the Committee believes it to be inflationary.

On the other hand, there is much that we do not yet understand about our complex economy. If, through study and discussion, the Committee can add to this understanding, and can propose remedies

to correct existing misallocations and inefficient use of resources, CWA will be glad to cooperate to the fullest extent possible.

It might appear from our criticisms of the report that we are ignoring those areas in which we find ourselves in agreement with the administration and the Council. This is not the case. It is perhaps because we recognize the common bonds which we share with the President and with the Council that we dwell especially on those policies and programs which seem to us to fall short of our common objectives. We appreciate the enormity of the task of formulating viable economic policy for the United States in these difficult times.

Our underlying point, however, is that the annual report of the Council of Economic Advisers serves a unique purpose, in the dialog among our citizenry on "whither the economy". In our view, this report should serve, not only as a policy guide for the year ahead, but the report ought to make explicit a broader and longer range perspective on those targets which the American people have the capacity to achieve. The report might provide, as well, some of the guidance and the impetus needed to set us thinking and acting on the achievement of those targets.

It is in this vein that the Communications Workers of America addresses these comments on the 1968 Economic Report to the Joint Economic Committee of the Congress.

(Appended hereto is a supplementary and more detailed statement by the Communications Workers of America on the issue of wage and price guideposts.

We submit these observations as a contribution to the continuing public discussion of an issue vital to the health and stability of our economy, the resolution of which extends well beyond the immediate concerns of the 1968 Economic Report.)

THE WAGE-PRICE GUIDEPOST ISSUE

A COMMENTARY BY THE COMMUNICATIONS WORKERS OF AMERICA

The Council of Economic Advisers, reiterating the "guidepost" concept in its 1968 annual report, calls upon labor and management to act responsibly and with restraint to stem the inflationary trends of 1966–67. The principal burden is placed upon labor, however, via an implicit 5.5-percent ceiling on negotiated settlements, while there is no comparable guidepost stipulated for prices. To quote from the Council's report:

> This (price stability) can only be achieved if the average of new union settlements is appreciably lower than the 5½ percent average of 1967 and if business firms avoid any widening of their gross margins over direct costs and indeed absorb cost increases to the extent feasible.

We in CWA are deeply concerned, as are all citizens, that the steady march of rising prices has eroded the purchasing power of all workers' wages. It is our firm conviction, however, that wage guideposts are not the proper policy for achieving meaningful growth while maintaining relative price stability.

Although the record of the last 7 years has been marked by sustained growth, with only minor slowdowns, this prosperity has not been equally distributed among the various sectors of the economy. It is this

imbalance, plus the dislocations and pressures of the Vietnam conflict, which provided the initial impetus for spiraling prices—not reckless union demands.

Between 1962 and 1965 corporate after-tax profits increased 45 percent. The 1966 profit take was 9 percent above that of 1965. During the slowdown in late 1966 and the first half of 1967, when there was substantial idle plant capacity, business firms were still attempting to maintain the record-breaking profit levels of earlier years. To do so, faced with a lower level of total demand, the businessman sought to maintain his inflated "share" via a boost in the price structure in his particular bailiwick.

Prices did not decline during the "plateau period" in 1966—and profits are now rising again. A Dow Jones survey of 581 corporations indicated that profits in the fourth quarter of 1967 were 5.2 percent above the same period in 1966. The consensus of business forecasters is for a rosy and profitable 1968.

To compound the squeeze on the worker, interest rates for consumer credit have recently broken 40-year record highs. Food prices jumped 9 percent from January 1965 to December 1967. Even more dramatic has been the skyrocketing in the price of consumer services. In 1967, increases in the cost of consumer services accounted for almost half the total rise in the Consumer Price Index. The fantastic increase in the cost of medical care has been the primary contributing factor. Physicians' fees and hospital service costs rose 8.1 percent during 1966 and another 7.9 percent during 1967.

Meanwhile, wages have lagged. Average hourly earnings of nonfarm workers increased only 10.4 percent from 1962 to 1965, and 4 percent between 1965 and 1966—while productivity was increasing at a rate of 3.6 percent annually.

In short, wages have, in fact, stayed within the guidelines, but the rise in the price of essential goods and services has wiped out real wage gains—while corporate profits were taking a larger share of the economic pie. It is not surprising, then, that by late 1966 unions found the situation intolerable; it was imperative that union members catch up to the rise in the cost of living. And catch up is all that they did.

A recent Labor Department study found that, although average hourly earnings of nonfarm workers increased more sharply in 1967 than in any other year in the last decade, real earnings (earnings adjusted for price changes) were about the same in December of 1967 as in the previous two Decembers.

In our view, the proper method for maintaining a balanced growth in GNP without inflation is through the use of monetary and fiscal tools—not special "controls" directed at specific groups. CWA supports, in the area of fiscal policy, a wartime surtax, geared to the ability-to-pay principle and coupled with urgently needed reforms to close tax loopholes under which substantial amounts of income escape the kind of tax burden assessed on wages and salaries. This kind of tax policy can prevent a monetary crisis, and help keep at least one important price down—the cost of credit.

Orderly, noninflationary growth cannot be achieved so long as the purchasing power of wage earners does not keep up with the increase in profits and other forms of income.

The critical role of monetary and fiscal policy in stemming the price spiral was emphasized by two of the economists testifying on the guideposts issue before the Joint Economic Committee on January 31 of this year.

Prof. John Kendrick, of George Washington University, stated:

> The guideposts obviously cannot replace noninflationary monetary and fiscal policy.

Prof. George Perry, of the University of Minnesota, elaborated further:

> If present price prospects require a remedy * * * the main burden must fall on restraining total demand through conventional fiscal and monetary means * * * If, with all the benefit of hindsight, we could rewrite the history of the past 2½ years, applying fiscal restraint when the surge of demand first appeared in late 1965, I believe we could operate at today's output and employment levels with less inflationary risk than we actually face.

What are the operative results of wage guideposts, whether officially or unofficially enunciated as a decimal point ceiling?

Those sectors which have contributed most to the rise in consumer prices are food and services—both areas where guideposts pressure can seldom be brought to bear, due largely to the fragmented nature of price decisions in these industries.

In effect, the situations which receive the most concentrated attention from the Government's guidepost activities are the "visible" industries—those organized industries whose negotiations involve, at one time, all or a substantial portion of the workers in a particular industry.

Thus the wage guidepost stratagem seeks from organized labor a special sacrifice—in the form of hold the line—to cure a general economic problem of which labor is the victim, not the instigator.

In addition to a catchup in purchasing power, the labor movement will gear its bargaining in 1968 to assure to its members recognition of their contribution to rising productivity in the industry in which they work.

It is in this context that CWA approaches its negotiations this year with the communications industry. From 1959 to 1966, output per man-hour—productivity—grew more rapidly in communications than in any other industry, increasing 5.3 percent per year. The 1968 Council of Economic Advisers' report points out what CWA has been saying for a number of years:

> * * * public utilities (communications and electric, gas, and sanitary services) have not passed the full benefit of improved productivity on to their customers. Although their capital costs per unit of output have undoubtedly risen, their profits have increased at an exceptional rate.

The Bell System is an excellent example of just how exceptional the rate of profit in the public utilities industry has been. Between 1962 and 1967 A.T. & T.'s profits grew 47.6 percent, or better than 9½ percent per year. The Council's choice of the word "exceptional" is clearly not an attempt to understatement.

During the period 1959 to 1966, output per man-hour in the communications industry rose an average of 5.3 percent per year, while compensation per man-hour rose only 4.3 percent—and thus unit labor costs declined 1 percent per year. The correlation between declining unit labor costs and burgeoning profits in the communications industry is clear and direct.

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The guidepost concept attempts to tie the average increase in productivity for the economy as a whole to a sanctioned rate of increase for wages. From 1964 to 1966, 3.2 percent was the magic number to be applied to all contract negotiations, irrespective of conditions in each industry. The CEA has abandoned the explicit 3.2 percent in favor of an implicit 5.5 percent ceiling—although the Chairman of the Council acknowledged in testimony before the Joint Economic Committee that he thought a 3.2 percent figure would be "about" the right guidepost figure, if one had been published for 1968.

We reject any and all such "numbers games" by dint of which an attempted uniformity is to be imposed on a richly variegated economy. We in the Communications Workers of America are active and avowed supporters of that economy, of the economic freedom which is integral to it, and of free collective bargaining, a critical ingredient in assuring that the fruits of our economy return to those who have produced them.

CONFERENCE ON ECONOMIC PROGRESS

By Leon H. Keyserling,[1] President

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INTRODUCTION

The opportunity which the Joint Economic Committee has given me, year by year, to express my views with respect to the Economic Report of the President and the annual report of the Council of Economic Advisers is deeply appreciated.

My comments will deal mainly with the CEA report, for it develops the underlying analyses upon which the brief Economic Report of the President is based and, quite properly, there is virtual consistency between the two documents.

In terms of the history of the Employment Act and its legitimately ambitious purposes, the 22 years of cumulative experience with operations under that act, and the profound economic challenges imposed upon the U.S. economy by current and foreseeable international and domestic conditions, I regretfully regard the current CEA report as inadequate and disappointing. In my view, the performance goals which it sets are too low, the priorities which it establishes are not properly ordered, and the analysis which it undertakes is in important respects very deficient.

My comments upon the CEA's report will be set forth under the five chapter headings contained in that report.

CHAPTER 1: SUSTAINING PROSPERITY: RECORD AND PROSPECTS

CEA's excessive optimism about economic growth performance

The report is excessively impressed with the average annual U.S. economic growth rate in real terms of 4.6 percent during 1960–67. The real growth rate averaged 4.5 percent during 1922–29, 4.6 percent during 1947–50, and 5 percent during 1947–53. In none of these earlier periods did we possess the capabilities for economic growth which have been our during the more recent years, in terms of technology, industrial skills, and policy know-how. Nor in any of these earlier periods were we confronted by challenges as imperative as those now confronting us. Indeed, the recent years have been the first time within the 20th century that a war of substantial size, and tremendous domestic needs, have not prompted us toward a national economic policy which sought to call forth fully the great nonsecret weapon of America's optimum production capabilities. There is nothing in the report which gives even an intimation of the seriousness of this omission. The report focuses mainly upon the defensive purpose of restoring reasonable price stability (subsequently to be discussed), instead of upon the affirmative and dynamic purpose of obtaining the maximum objectives of the Employment Act of 1946.

The report exhibits extraordinary complacency in the face of a real economic growth rate of only 2½ percent 1966–67, which I equate with a GNP gap of about $70 billion measured in 1965 dollars, coming to about 8.7 percent of maximum production. It is noteworthy that the Council in this report has practically abandoned its previous concern about the GNP gap. To be sure, if the Council undertook to estimate the gap for 1967, it would undoubtedly come up with a much lower

estimate than mine, although a very significant one at that. But as I have shown previously, and will show subsequently in this statement, the Council has grossly and persistently underestimated the true growth potentials of the U.S. economy, especially in its interpretation of productivity trends. Additional perspective is shed upon the seriousness of the gap in 1967 alone by my estimate that, during 1953–67 as a whole, the production gap measured in 1965 dollars aggregated $781 billion, and was accompanied by 36.3 million man-years of lost employment opportunity (see my charts 1 and 2).

Even more serious is the apparent satisfaction which the Council takes in its forecast of a real economic growth rate of somewhat more than 4 percent during 1968, assuming enactment of the President's fiscal program. Even if we were now enjoying reasonably full resource use, an average annual economic growth rate in real terms of at least 5 percent would be the optimum or maximum in view of current capabilities and needs, and in view of the growth rate registered during much earlier periods of reasonably full resource use (when the growth rate was not artificially accelerated by starting from a base of very low resource use).

Moreover, assuming current and proposed policies, including the tax surcharge, I find the Council's forecast (p. 55) of a somewhat better than 4 percent real rate of economic growth during 1968 excessively optimistic. The Council itself estimates that Federal expenditures will rise about $15 billion in 1968, compared with $21 billion in 1967, and the estimated $6 billion slackening in this phase of expansion would not be counteracted fully by an estimated rise of $5 billion in transfer payments to persons. Thus, I cannot fully understand the Council's statement (p. 39) that "as 1968 opens, fiscal policy * * * is now overly expansionary, in an economy now growing at a rapid pace." Further, the proposed tax surcharge if enacted (which the Council incorporates in its forecast) would as estimated by the Council add $8 billion to the Federal revenue take in 1968. Coupling these factors with the Council's estimate that the recovery of business investment which commenced in the middle of 1967 will proceed in 1968 at only a moderate rate, and with the extraordinarily high rate of about 7 percent in personal saving, I cannot find justification for the Council's view that a 2½-percent rate of real economic growth during 1967 will be converted into a better than 4 percent rate of real economic growth in 1968 (see pp. 54–57). This seems especially the case, in that the Council (p. 43) says that "the strongly expansionary fiscal policy [during the first half of 1967, to be contrasted with a less expansionary fiscal policy in 1968] supported the growth of personal income and hence of consumption." I think that most other competent forecasters share my concern.

CEA's inadequate awareness of excessive unemployment

I am equally concerned about the Council's obvious equanimity in the face of a full-time unemployment rate of 3.8 percent during both 1966 and 1967, its expectancy of nothing better in 1968, and its apparent willingness, in the name of fighting inflation (subsequently to be discussed) to urge policies which might cause unemployment to rise appreciably or seriously above recent and current levels.

The tolerable level of unemployment depends upon the international and domestic circumstances confronting the Nation, the impact of a given level of total unemployment upon its distribution, the social response to unemployment and a more empirical appraisal of the relationship between levels of unemployment and inflationary trends than the Council has troubed itself to undertake. By none of these tests is a 3.8-percent level of full-time unemployment tolerable now. It is not tolerable in terms of the production challenge confronting us in view of a large war and our vast unmet domestic priorities; at the peak of World War II unemployment was reduced below 1 percent. It is not tolerable because an overall full-time unemployment rate of 3.8 percent means unemployment two to three times as high among vulnerable groups such as teenagers and Negroes, and 10 or more times as high in some critical urban areas. It is not tolerable because the fair expectancy of these vulnerables means social unrest and disorder in the event of so high level of unemployment. And it is not tolerable because a 3.8-percent rate of full-time unemployment means a true unemployment rate of about 5.6 percent, taking into account the full-time equivalent of part-time unemployment, and the concealed unemployment of those who are not participating in the civilian labor forces and not counted as unemployed because the scarcity of job opportunity discourages them from actively looking for work.

The Council's attempts to explain no rise in the rate of full-time unemployment during 1967, despite an economic growth rate in real terms of only 2½ percent, by noticing the decline in working hours and in the rate of productivity growth (p. 51). This correlation is indeed a said confession, for (as will be shown) the sharply declining rate of productivity growth, and to a degree the shortening of hours, in 1967 were attributable to the abysmally low rate of economic growth. Meanwhile, the declining rate of productivity growth (as will be shown) contributed to the inflationary pressures which may inhibit real economic growth. The shortening of hours contributed to a diminution of total labor input which is not revealed by measurement of full-time unemployment, and also contributed to the inadequate expansion of consumer buying power and consumption which in turn inhibited real economic growth in 1967 and will continue to do so in 1968.

In other words, while we can all be glad that full-time unemployment did not grow in 1967, it is running around in a circle to be complacent in the face of the interrelated factors of a low rate of economic growth, a shortening of hours, a sharply declining rate of productivity growth, and the mere stabilization of the unemployment rate (see again my chart 1).

CEA's neglect of problem of economic equilibrium

The shortcomings in the Council's approach to the problems of economic growth and unemployment are particularly disturbing, because in none of its report thus far has the Council undertaken a really penetrating analysis of why we have not been able to obtain economic equilibrium at maximum resource use, maximum employment, and maximum economic growth. This failure to maintain the

desired equilibrium has occurred because of a very serious and persistent distortion in the patterns of incomes and spendings. These distortions certainly lend no support to the Council's statement (p. 45) that "the years 1961–65 had been characterized by a remarkably balanced expansion among the various sectors * * * business fixed investment, though rising rapidly in 1964–65, was geared appropriately to the expansion of markets * * *"

This cheery statement cannot be reconciled with almost universal recognition, and recognition even in earlier CEA reports, that the investment boom in late 1964 and 1965 was inordinant and nonsustainable. It is not consistent with the call for the suspension of the investment tax credit in 1966. It is not consistent with the serious excess of personal savings over gross domestic investment which emerged by 1967, to which the Council calls attention (p. 48).

My own studies, presented to this committee and elsewhere, have for years been underscoring these serious disequilibriums, which have not been redressed. From 1961 to 1967, total national production, measured in uniform dollars, rose only 34.6 percent, private consumer spending only 33.3 percent, Government outlays for goods and services only 37.9 percent, and transfer payments only 45.5 percent, while private investment in plant and equipment rose 63.5 percent. Underlying these distortions, wages and salaries rose only 38.4 percent, labor income only 39.6 percent, and farm proprietors' net income only 5 percent, while corporate profits rose 43.7 percent, personal dividend income 51 percent, and personal interest income 70 percent.

The shrinkage of the economic growth rate to only 2.5 percent in real terms during 1967 was responsive to these disequilibriums, but did not cure them. Of course, in reaction to previous excesses, the growth rates in private investment in plant and equipment and in corporate profits were slightly negative in 1967. Even so, aggregate profits, and certainly per unit profits, were at least ample to generate whatever levels of business investment might be justified by trends in ultimate demand. As of now, plants in general are operating somewhere in the neighborhood of 85 percent of rated capacity, which is far too low.

Meanwhile, private consumer spending rose only 2.8 percent in real terms in 1967, which was egregiously below the requirements for equilibrium at maximum resource use. The savings rate above 7 percent during 1967 did not indicate a sufficiency of private consumer income in the aggregate; it merely indicated in part the reaction to the relatively excessive investment boom during previous years, and in part an unsatisfactory distribution of total consumer income, aggravated by recent fiscal and monetary policies and by the low economic growth rate itself (see my chart 3). (The inadequate trends in consumer spending and incomes, and the unsatisfactory income distribution, are illustrated more specifically in my charts 4, 5, and 6).

CEA's bias with respect to wage trends

The failure of the Council to develop an adequate equilibrium analysis is nowhere more manifest than in its treatment of the whole problem of wages during recent years, especially in connection with the price-wage guidelines. Faced with the rather chronic problem of inadequate expansion of wage rates and wage buying-power to play their

role in achieving maximum resource use, the Council has persistently forgotten all about wages as a factor in consumer buying-power, and has dealt with wages only as a factor in business costs. The concern has been only to avoid such wage rate increases as might result in cost-push inflation.

This CEA preoccupation has been misplaced, in terms of the realities of recent economic developments. Based upon my aggregate analysis, I estimate that, measured in 1965 dollars, the deficiency in wage and salaries ranged from $42.6 to $55.1 billion during every year from 1960 through 1967, and was $45.1 billion in 1967 (see my chart 7).

This aggregate analysis is fortified by comparative trends in wages and productivity. During 1960–1966, when the economic growth rate in real terms averaged annually 5 percent, productivity or output per man-hour in the private nonfarm economy grew at an avearge annual rate of 3.2 percent, while real wages and salaries per man-hour in the private nonfarm economy grew at an average annual rate of only 2.7 percent, representing a very serious lag in real wage-rate gains behind productivity gains.

During 1966–67, preliminary estimate indicate that productivity in the private nonfarm economy grew only 1 percent, while real wage and salaries per man-hour grew 2.8 percent. But it is entirely fallacious to regard this wage-rate gain as "too high" relative to the productivity gain. For the productivity gain of only 1 percent did not represent a break in the technological trend toward increasing rates of productivity gains, but rather reflected the response of actual productivity to the underutilization of the labor force resulting from the economic growth rate of only 2.5 percent in real terms. To have attempted to repress the rate of gain in wages and salaries to this artificially repressed productivity growth rate would have been institutionally difficult, if not impossible. And it would also have compounded the difficulties of inadequate expansion of demand, in terms of restoring an adequate economic growth rate.

Any attempt at thorough equilibrium analysis would have revealed to the Council that the low economic growth rate and the terribly low productivity growth rate in 1967 stemmed in large degree from the lag in consumer buying power and wages behind the productivity growth-rate during 1960–66. But ignoring all this, the 1968 report of the Council misappraises the real difficulty, and heightens its expression of concern about wage-rate gains exceeding productivity gains.

Beyond all this, when 1966–67 is included, the average annual increase in productivity or output per man-hour during 1960–67 in the private nonfarm economy was 2.9 percent, while the average annual increase in real wages and salaries per man-hour was only 2.7 percent.

The true nature of the disparities to be dealt with is demonstrated even more clearly by looking at total manufacturing. Here, during 1960–66, productivity grew at an average annual rate of 3.8 percent, while real wages and salary gains per man-hour lagged at 2 percent. During 1960–67, when the productivity gain dropped to 0.9 percent in consequence of the economic stagnation, real wages and salaries per man-hour grew 2.7 percent; these disparate trends should be inter-

preted the same as those in 1967 in the total private nonfarm economy (discussed above). But during the whole period 1960–67, productivity in total manufacturing grew at an average annual rate of 3.4 percent, while real wages and salary gains per man-hour lagged tremendously at 2.1 percent (see my chart 8).

Still further light upon the disequilibrium may be obtained by looking at relative trends in prices, profits, investment in plant and equipment, and wage rates. From 1960 to 1967 in total manufacturing, prices rose 5.5 percent, profits after taxes 83.6 percent, investment in plant and equipment 85.4 percent, and wage rates 25.2 percent. In motor vehicles and equipment, prices rise 0.9 percent, profits after taxes 30.8 percent, investment in plant and equipment 86.5 percent, and wage rates 26.3 percent. In four other key categories examined, the manifestations in general were similar (see my chart 9).

My foregoing analysis, in its entirety, reveals, in my view, the extent to which the analyses and emphasis of the Council in its reports over the years, and especially in 1968, have swung away from the realities of actual developments and needed adjustments.

CEA's low targets for the future

But what is past is only prelude. It is far more important to examine how the Council's over-exuberance and over-complacency about developments to date have been accompanied by understatement, or failure to state, our needed goals for the future—goals explicitly called for by the Employment Act of 1946. Beyond the shaky forecast of a somewhat better than 4 percent rate of real economic growth in 1968, the Council nowhere attempts in the current report to develop the long-range goals in quantified terms which are essential to rally our full economic power and to provide adequate indicia for specific economic policies. Nothing could be more essential than development of such comprehensive and integrated long-range quantified goals, in view of a growing international burden of unpredictable size and duration, plus the ominous intensity of our unmet needs across the whole domestic front.

A starting point for developing these long-range goals is a careful examination of long-range productivity trends and their genuine import. Over the decades, the average annual rate of productivity gains in the entire private economy has tended to *accelerate*, being 0.4 percent during 1910–20, 2.3 to 2.4 percent during 1920–40, 3.2 percent during 1940–55, and 3.7 percent during 1961–66 (4 percent during 1947–53). The decline to an average annual rate of productivity growth of only 2.4 percent during 1955–60, and apparently only 1.4 percent during 1966–67, was responsive (as indicated earlier in my discussion) to the underutilization resulting from an extraordinarily low rate of real economic growth. It follows that the Council, instead of predicating our economic growth potential in future upon the average annual productivity gains actually registered during a number of decades past—in the neighborhood of 3 percent—should take fuller account of the more pertinent recent developments and the trend toward accelerating productivity gains under the impact of a reasonably high real economic growth rate.

On this basis, it appears to me clear that a 3.5- to 4-percent-average-annual rate of productivity growth in the private economy in the years

ahead is not less than we should aim for and adopt policies accordingly. A 3.5-percent-average-annual rate is conservative indeed, and it is about this rate which I utilize for establishing economic growth goals of 5 percent annually after restoration of reasonably full resource use, and a somewhat higher rate until that restoration is accomplished through the taking up of slack resources (see my charts 10 and 11).

Accordingly, I estimate that, measured in fiscal year 1959 dollars (which appear to be utilized in the President's January 1968 budget message, and which roughly indicate current price levels), our total national production should rise from $820 billion in 1967 to $1,222 to $1,227 billion in 1975, a gain of $402 to $442 billion. This would mean, during the 8 years, 1968 to 1975 inclusive, a GNP averaging annually $227 to $246 billion higher than in 1967, and aggregating during the 8-year period $1,817 to $1,968 billion more than if GNP remained at the 1967 level during these 8 years. This should be the true measurement of what we can afford to do, internationally and domestically, and programs adjusted from year to year in terms of these potentials are indeed the steps by which we can achieve them (see my chart 12).

To illustrate the importance of an optimum growth rate, over approximately a 10-year period, each 1-percent difference in the economic growth rate means an average annual difference of about $50 billion in total output during the 10-year period. Thus, over a 10-year period, an average annual growth rate of 2½ percent as against 5 percent would cost us on the average about $125 billion of GNP a year, or about $1¼ trillion in the aggregate. The difference between the 4-percent-growth rate which the Council hopefully projects for 1968 and a 5-percent-growth rate would cost us about a half trillion dollars of GNP in the aggregate over a decade. The difference between a 3-percent-growth rate, which now seems to represent the dominant 1968 forecast, and a 5-percent-growth rate, would come to about a trillion dollars in the aggregate over a 10-year period.

The foregoing GNP goal for 1975 is consistent with the goal set forth in "A Freedom Budget for All Americans," a 1966 publication which I had a major role in preparing. But as indicated above, I have now converted the exercise from calendar 1965 dollars to fiscal 1969 dollars, and substituted as the base year calendar year 1967, instead of calendar 1965. To make a GNP goal meaningful in terms of analysis, and in terms of the policies needed to achieve it, the GNP goal must be broken down into major components representing an equilibrium model. My chart 13 depicts such a model, which I have developed, refined, and adjusted over the years in the light of evolving economic developments and pertinent considerations as to priority needs.

This equilibrium model does not contemplate drastic changes in the ratios of the main components of GNP to the total, and thus does not contemplate changes in our institutional attitudes, nor in relative reliance upon public and private sectors. To illustrate, in 1967 public outlays at all levels for goods and services came to 22.5 percent of GNP, and would be somewhere between 20 and 21 percent in 1975. Gross private investment (including net foreign) came to 16.6 percent of GNP in 1967, and would be about 17 percent in 1975. Private consumer outlays came to 62.6 percent in 1967, and would be about 63 percent in 1975 (see my chart 14).

As the Federal budget is the most important single instrument of national economic policy, and for the indication of our great national priorities, I have also developed a model Federal budget as part of my equilibrium model (see my chart 15).

The goal for national defense set forth in this model budget does not represent intensive work on my part, since I can claim to no expertness of this subject, but represents instead what might be called the composite judgment of informed experts, assuming continuation of the cold war and the engagement in Vietnam for a now indeterminable period of time. The value of this assumption is that it provides a foundation for estimating how much of our growing GNP would remain available for the great domestic priorities, even if we found it necessary to continue to bear international burdens rising very substantially above current levels.

The specific goals for the great domestic priorities set forth in this model budget are based upon extensive study of needs among the various priorities depicted, reconciled in terms of feasibility with my equilibrium model as a whole.

I have always felt that exercises of this type, regardless of the quantitative differences between my estimates and those which others might make, are at the very heart of the original intent and current potentials of the Employment Act of 1946. After 22 years of experience under that act, it has become increasingly lamentable that the Council of Economic Advisers has not yet substantially picked up this prime responsibility of economics in the public service.

II. The Strategy of Stabilization Policy

I do not feel impelled to comment extensively upon this chapter of the CEA report. The analysis contained therein is rather thin and sketchy, and the chapter in my view achieves neither its avowed intent at the outset, nor its revealed purpose as it proceeds.

Selfpraise may be slight recommendation

At the outset (p. 58), the intent is declared to deal "with some of the lessons of recent economic experience as they apply to the current and foreseeable problems facing the economy." One would expect, from this declaration of intent, a penetrating analysis of mistakes in policy from the viewpoint of equilibrium analysis. For there certainly must have been some serious mistakes in policy, in that a real annual rate of economic growth of above 5 percent during 1963–66 was more than cut in half to a real economic growth rate of only 2.5 percent during 1966–67.

But instead of moving ahead with the avowed intent of drawing important lessons from experience, the chapter discloses for the most part the revealed purpose of rendering a generally complacent and laudatory account of how sensibly and flexibly national economic policies were adjusted to meet problems as they arose.

Wrong diagnosis and wrong cure, 1966–67

The Council states (p. 68) that "as of mid-1965, there was every reason to believe that the record of orderly progress could be extended. The expansion was characterized by remarkable balance in all sectors and strong forward momentum."

I challenge most emphatically this appraisal. The economy at that time was suffering from an ominous inbalance between the rate of expansion of investment in plant and equipment toward enlargement of production capabilities, and the rate of expansion of ultimate demand in the form of consumer spending and public outlays combined. I had warned, at the time of massive tax reductions in 1964, that these imbalances would be aggravated by the distorted allocation of these reductions. I pointed out in mid-1965 that this danger was in process, and subsequent developments have borne this out. I feared in mid-1965 that these imbalances would result very shortly in a period of economic stagnation, if not recession. I still think that this was likely, but for the unanticipated increase in defense spending after mid-1965, which deferred for a time, but did not avert, the economic stagnation which set in during 1966–67, and which may well afflict us again during at least a part of 1968.

But the Council misses the point that this sharp increase in defense spending saved us for a short while from the consequences of failure to observe the evolving disequilibrium. Instead, the Council says (p. 68) that "the task of stabilization was immensely complicated by the sharp increase in defense spending after mid-1965."

Proceeding from that initial error, the Council thus goes on to say (p. 69) that "the need for restraint and policy was clearly recognized in the beginning of 1966." In this connection (pp. 69–70), it cites as effective and wise measures during 1966 the rise in payroll taxes for social insurance at an annual rate of $6 billion, the reversal of excise tax reductions, suspension of the tax investment credit, cutbacks in Federal spending, stringent limitations on net new issues by Federal agencies, and monetary restraints. It appears to me that, at this point in its analysis, the Council is proudly claiming credit for the utilization of national economic policy to help bring on a period of serious and very costly economic stagnation. The Council does not attempt to appraise how much worse the stagnation might have been, or whether it would have been converted into absolute recession, if the still-sought tax increases had been enacted by the Congress when first asked for.

Still wrong, 1967–68

Others have made similar mistakes before, but at times have learned from them. Not so the current CEA. Although hardly any recognized forecaster even now looks forward to the restoration of maximum resource use in the very near future, and although most of them expect that the second half of 1968 will be weaker than the first half of 1968 (which is no roaring boom), CEA is still plugging away for large tax increases.

Combined with this reiterated cry for higher taxes now, CEA argues once again that, if the tax increases are not granted promptly, there will be need for resort to a more restrictive monetary policy, which would evoke serious imbalances in the economy (p. 84).

Failure to resist wayward monetary policy

During the past year and even now, I have been led to suspect that CEA has recognized that large tax increases are not called for on economic or related grounds. Rather, it may be that CEA is fearful that, if the administration accepts a fiscal policy more con-

ducive to the needed acceleration of economic growth, the Federal Reserve System would negate that choice by its "independent" monetary policy, and that an unwise fiscal policy (i.e., tax increases now) might do less damage than an even more unwise monetary policy. If this be the case, I feel that CEA should vigorously challenge the prevalent monetary policy of the Federal Reserve Board during the past decade or longer, instead of yielding supinely to it, thus making the "independent" monetary authorities veritable arbiters of both fiscal and monetary policy.

But perhaps it may be too charitable to assume that CEA is still clamoring for tax increases only in order to avoid something even worse. It may be closer to the truth that CEA does not have that top-priority commitment to maximum resource use, optimum economic growth, and minimum unemployment which the times call for—and is instead erecting concern about inflation into a blinding obsession rather than treating it as only one facet of a well-rounded national economic policy. This comment brings me to the next chapter of the CEA report.

III. The Problem of Rising Prices

This long chapter in the CEA report, crammed with statistical trees which make it hard to see the forest, tends to corroborate the view that the Council's preoccupation with the one problem of rising prices prevents it from viewing in just proportions the problems of the economy at large. And ironically, this narrow preoccupation militates against correct diagnosis and cure of the inflationary *malaise* itself.

Price trends are not very meaningful per se

First of all, it is palpably erroneous to regard a stable price level, or even avoidance of inflationary trends in the magnitudes that we have recently experienced them, as objectives at all comparable with the objectives of optimum economic growth and maximum resource use. The real wealth of nations, and their ultimate capacity to prosper and advance and even to protect themselves against external dangers, reside in their ability to increase the output, and particularly the output *per capita*, of the goods and services which minister to practically all material requirements and aspirations.

The Council would undoubtedly admit, in purely logical discussion, that its concern about rising prices is prompted by its belief that these interfere with or threaten attainment of the more ultimate objective states above. But CEA's virtual assumption that rising prices necessarily have these unfortunate consequences are rooted more in theoretical preconceptions than in empirical observation of the American economic performance over the decades. This is clearly revealed by the nature of the Council's discussion (pp. 97–102) of why rising prices are bad.

For example, the argument is advanced that inflationary trends redistribute income regressively, and impose a "cruel tax" upon those who need help most. This would be an impregnible position, if price trends were unaccompanied by other trends. But the fact is that they are, and these other trends may outweigh the significance of price trends. Certainly, the millions currently unemployed are infinitely

worse off than if programs were adopted to provide them with jobs, even if (contrary to my thesis as set forth below) these programs caused prices to rise somewhat faster than they otherwise would. And economically speaking, the unemployed certainly need help most, especially in that excessive unemployment today and its side products are by far the largest explanation of poverty.

Indeed, in view of the certainty that income distribution in the United States has shifted most progressively during periods of full employment and maximum resource use, the Council's argument that such periods tend to accentuate inflation is in conflict with its argument that any accentuation of inflation redistributes income in ways which hurt most those who need help most. Insisting that rising prices are an unmitigated evil, without delving deeper, is itself a cruel tax imposed by those who should know better upon those who know less.

Price trends significant in their impact upon resource and income allocation

All empirical observation reveals that economic progress and social justice depend, not upon whether prices are stable (or rising or falling within moderate bounds), but rather upon what is happening to the allocation of economic resources and the distribution of income under any specific price trends. The greatest economic debacle we ever witnessed started almost four decades ago, after 7 years of a remarkably stable price level, except for falling farm prices. This debacle occurred primarily because of the failure of wage and farm income, under a stable price level, to keep up with our growing nationwide ability to produce. In other words, gross maldistribution of resources and income took place despite a stable price level.

Either a stable or a rising or falling price level within moderate bounds may be conducive to or destructive of that economic equilibrium at reasonably full resource use which benefits almost all. The Council, instead of pandering to misconceptions about rising prices *per se*, should turn its attention to the real task of resource and income analysis, and this calls for use of an equilibrium model which CEA is not yet revealing in its interpretation of economic developments nor in its development of policies for economic adjustment.

CEA exaggerates inflationary trends

The Council would enjoy much more freedom in moving toward the really core problems, if it did not so ardently fan the flames of exaggeration about recent or current price inflation.

During the 50-year period 1917–67, consumer prices in the United States advanced at an average annual rate of 1.9 percent. This period included the great depression era during 1929–39 at one extreme and, at the other extreme, the hyperinflation during some years of World War II and reconversion and 1 year during the Korean war.

During 1957–67, the most recent 10-year period, the average annual increase in consumer prices was 1.7 percent; and during 1962–67, the most recent 5-year period, the average annual increase in consumer prices was 2 percent. Thus, allowing for problems of statistical measurement and price-quality issues of immense difficulty, the movement toward rising consumer prices during the most recent 5 years has not been any greater than during the past 50 years. And during

these 50 years, we have made the greatest record of economic progress, and perhaps also the greatest strides toward social justice, which have ever occurred anywhere in human history. (See my chart 16.)

Price trends in an international perspective

Viewed in an international perspective, our price record is even better than the above data would indicate, and utterly inconsistent with the furor during recent years to the effect that we must achieve greater price stability to maintain our worldwide competitive position.

During the 10-year and 5-year periods ending with 1967, the average annual increases in consumer prices in the United States were 1.7 and 2 percent, respectively. Meanwhile, the respective trends in the United Kingdom were 2.9 and 3.3 percent; in France, 4.9 and 3.2 percent; in Germany, 2.4 percent and in Italy 3.5 and 4.7 percent; in Canada, 2 and 2.7 percent; and in Japan, 4.3 and 4.5 percent. The relative trends with respect to industrial prices have been closer, but even as to these, we have in general retained a considerable advantage, quite apart from issues of quality of product. (See my chart 16.)

A higher growth rate and less unemployment do not import more inflation

But even if I were wrong with respect to all of the foregoing—which I am sure I am not—the point remains that the Council has clung obstinately to the prevalent but untenable thesis that there is a strong and ineluctable positive correlation between the rate of real economic growth and the amount of price inflation, and that a lower rate of unemployment measured against the civilian labor force tends to induce more rapid price increases, especially when the rate of economic growth and the level of employment press close to reasonably full resource utilization. Verily, it is this thesis which propels the Council toward its adamant failure to espouse the more expansionary economic policy when we now so sorely need.

Since 1953 especially, I have been making continuous studies which challenge this prevalent thesis, and have recurrently brought them to the attention of this committee, top officials in the executive branch, economists throughout the Nation, and the public at large. I shall now attempt to do so again.

During 1955–58, when our average annual rate of real economic growth was only 0.2 percent and when the average unemployment rate was 5.1 percent, the average annual rate of increase was 3.1 percent in consumer prices, 2.2 percent in wholesale prices, and 1.5 percent in industrial prices.

In vivid contrast, during 1960–67, when the average annual rate of real economic growth was 4.6 percent and when the unemployment rate (although averaging 5.1 percent for the period as a whole) was brought down from 5.5 percent in 1960 to 3.8 percent in both 1966 and 1967, the average annual increase was only 1.7 percent in consumer prices, 0.7 percent in wholesale prices, and 0.7 in industrial prices.

Further, the relatively high rate of price inflation during 1960–67 came with the approach and advent of economic stagnation. During 1966–67, with the rate of real economic growth declining very severely to 2.5 percent and the unemployment rate no lower than in 1966, the annual increase in consumer prices was 2.8 percent, and in industrial prices 1.5 percent. (See my chart 17.)

It should be noted that even table 10 on page 97 of the CEA Report supports my thesis, at least to the extent of showing no discernable positive correlation between the unemployment rate and the amount of price inflation. For example, during January 1947 to January 1949, the average unemployment rate was 3.8 percent, while the average annual increase in consumer prices was 5.5 percent, and in wholesale prices 5.7 percent. But during September 1950 to November 1953, the average unemployment rate was much lower at 3.2 percent, while the average annual increase in consumer prices was much lower at 3.2 percent, and in wholesale prices much lower at 1.3 percent.

These trends during the past 15 years may not be entirely conclusive. But they are certainly sufficiently conclusive to torpedo the prevalent thesis, which sacrifices a higher rate of economic growth and further reductions in unemployment on the false altar of the insupportable presumption that these essential objectives, if vigorously pursued, would net more price inflation.

The trend indications that higher rates of economic growth and lower levels of unemployment are in fact anti-inflationary have not been fortuitous. There is a ready explanation for them. In an economy characterized in large measure by administered price decisions, there is a pronounced tendency to attempt to compensate for inadequate expansion of volume (i.e. low economic growth) by initiating price increases so as to increase per unit returns. This tendency is accentuated by the profit-maintenance or profit-advance targets which have now become common practice among most key enterprises of very large size. My conclusions in this direction have been strengthened, not only by general economic observation, but by more particularistic examination of relative volume-expansion and price-increase trends in many key industries during the past 15 years.

Some of the other price increases which have been most conspicuous in recent years, such as in medical care and housing costs, have no appreciable relationship to the rate of economic growth or the rate of unemployment. The usually rapid price increase in these areas have been due to deficiencies in aggregate supply and its distribution, which in turn has been due to those very deficiencies in public outlays which have been inflicted in a futile effort to stop inflation thereby.

Another reason why inadequate economic growth exerts upward pressure upon prices is this:

The most recent manifestations of rising prices, according to the Council's analysis, have been mainly of the cost-push rather than the demand-pull type. In this connection, the Council (pp. 111–116) appears almost to exonerate most of the rising industrial prices during 1967, on the ground that rising costs have resulted from the very sharp decline in productivity gains accompanied by maintenance or enlargement of customary wage-rate gains.

But why did the rate of productivity gain fall so dismally in 1967? There was no diminution in technological advance, nor in labor and managerial skills. The rate of productivity gain fell so dismally because of underutilization of employed labor, in consequence of the decline of the real economic growth rate from more than 5 percent to only 2.5 percent.

It follows, quite contrary to the thesis of the Council and entirely in accord with my thesis, that the cost-push aspects of inflationary pressures would be overcome most effectively by restoring the actual rate of productivity gains to levels consonant with the potential productivity gains representing technological trends, in which event real wage-rate increases tends to lag behind, rather than to exceed, productivity gains (see again my chart 8). And the surest, in fact the only, road toward this achievement would be to lift the economic growth rate to 5 percent or better.

Other flaws in CEA cost-push thesis

The line of reasoning which I have just advanced should not be misinterpreted to imply acceptance on my part of the CEA implication that recent price increases in the main have been caused, or even justified, by cost push. Even rising labor costs do not justify price increases, when both profit margins and aggregate profits are as high in general as they still remain. And the Council is woefully derelict, and even biased against labor, when it does not accompany its cost-push analysis with any real examination of relevant profit levels.

Further, as I demonstrated earlier in my analysis, over any period of recent years long enough to be highly meaningful, real-wage rate gains have lagged seriously behind productivity gains, which disposes entirely of the legitimacy of the cost-push argument in general (see again my chart 8).

Of course, the Council in table 18 on page 123, and in its reassertion of the "productivity principle" on page 126, reaffirms its position that productivity trends would need to be related to changes in current (money) wage rates rather than to changes in real wage rates, if cost-push inflation is to be reasonably restrained.

This position is indefensible, not only on institutional and social grounds, but also on narrower economic grounds. Viewed as a factor in maintenance of adequately expanding consumer purchasing power, real wage buying power should rise pro tanto with productivity gains which represent a physical concept of growth in output per hour per worker. Indeed, this is at least half of the whole rationale of linking productivity gains and wage-rate gains. Even from the viewpoint of business costs, which is the other half of the rationale adjusting wage-rate gains to price increases which have already occurred (in addition to allowance for productivity gains), can hardly be regarded as exercising large legitimate cost-push pressures. For all experience indicates that, to the extent that the price level has already risen, industrial concerns in general have already attained their fair share, or more than their fair share, of the increases in dollar incomes resulting from these upward price movements. They are therefore not unjustly hurt, when asked to make cost-of-living adjustments.

Comment on new Cabinet Committee on Price Stability

It is too bad, in a way, that a Council which has been so deficient in its entire analysis of the inflationary problem should now come forward (pp. 127–128) in support of a new Cabinet-level committee to deal with this problem. There may be nothing wrong per se in establishing still another committee. But committees cannot take the place of analysis, and they cannot forge viable policies without analysis. I maintain that it is essentially CEA's job, within its own confines, to

set its own thinkhouse in better order, instead of asking others to help support its misconceptions.

It is especially discouraging to note that this new Committee is charged in effect with promoting policies to avoid so-called cost-push inflation, but is not charged with responsibility to consider the role of wages in maintenance of adequate expansion of consumer purchasing power. Nor, in the Council's summary of the functions of this new Committee, is there any mention of the fact that (as so abundantly demonstrated by the failure of the price-wage guidelines) any attempt to deal with prices and wages, without getting into the inseparate problems of profit and investment levels and needs, is entirely inequitable on its face and a dangerously astigmatic approach to the whole problem of needed economic adjustments.

Directing the attention of such a group, without sufficiently broad economic perspectives, to segmental problems such as wage and prices, tends toward futility, and toward mere reiteration of the established positions of labor and management.

Coordinating public and private economic policies

I have long recommended, and now recommend again, an entirely different kind of voluntary labor-management-Government instrumentality. The starting point, however, should be development, by CEA itself, of a long-range and short-range budget of our economic resources and the economic and social ends which they should serve, quantified in nature, and integrated with the development of policies attuned to the achievement of the revealed goals. This is what I have at times called an American economic performance budget, and this is no less than the Employment Act of 1946 really calls for.

With this starting point, labor and management and other groups could be brought into consultation with the CEA on a regular basis. This would confer upon these private and voluntary groups (without delegating to them the public responsibilities of CEA) a sense of real participation in the development of the analysis and policies ultimately embodied in the Economic Reports of the President and the annual reports of the Council of Economic Advisers.

Such a process would improve the formulation of public policies, and promote understanding and support of such public policies by private economic groups. It would also help these private groups to achieve a larger consensus in their own voluntary development of policies and programs geared more closely to the public interest, more consistent with concurrent public policies, and more in line with the great purposes of the Employment Act.

This, I suggest, is the kind of creative relationship between public and private efforts which can steer between excessive centralization in the Federal Government and excessive reliance upon uncoordinated private adjustments.

IV. Economic Development and Individual Opportunity

This chapter of the CEA report discusses a wide range of very important problems, such as trends in the distribution of population and their significance, the demography of poverty, and problems of housing, education, and health.

Interplay of economic and social problems

From the time when I became a member of the Council of Economic Advisers in 1946, I made manifest my view that those problems, sometimes looked upon as "social" or "noneconomic," are just as much economic problems (though social also), and just as much within the purview of the Employment Act of 1946, as problems of business investment, tax policy, or price levels.

In fact, all programs which involve use of substantial goods and services, and are very substantially affected by economic and financial decisions, are clearly within the purview of the Employment Act. Such programs, therefore, should be made part of something equivalent to an American economic performance budget or a freedom budget. This equivalent, as I have long insisted, should be at the core of the Economic Reports of the President and the annual reports of the Council of Economic Advisers. For these reasons, I am in accord with the inclusion of some discussion of these programs within the current CEA report, as well as in its previous reports.

Ineffectual CEA treatment of economic-social issues

But I feel compelled to criticize most vigorously the scope and quality of the treatment of these problems in the current CEA report. This treatment does not rise to the mandate and challenge of the Employment Act of 1946. A comparable treatment (aside from such matters as the details figures on the demography of poverty, which are available in other Government publications), could be prepared in the main by assembling a paste-up of recent articles on these subjects in well-known or semipopular magazines and journals.

Admittedly, the Council exhibits modesty in these matters. Its report says (p. 139):

> There does not appear to be available at the present time an adequate amount of information to answer [these important questions], nor even a satisfactory analytical framework within which these answers can be approached in a tolerably scientific fashion.

My view is that these matters are quite as susceptible to treatment in depth as others of far lesser importance which CEA does attempt to deal with in depth, and that their superficial treatment by CEA is without justification.

For example, the Council attempts to set forth (pp. 140–142) some general clarification of problems of migration and redistribution of population within the United States. These stated general principles are that migration helps as well as hurts; that local problems are outcroppings of our more basic national problems; that the most explosive issues in urban areas relate to racial antipathies and prejudices; that we suffer from artificial and obsolete political boundaries; that there should be more study of the per capita cost of service relative to population density; that there should be more study of alternative local distribution of private production and consumption; and that trends in technology can alter the course of some of the foregoing developments. It seems to me that any competent graduate student could include this highly generalized statement of principles in a master's

thesis; the CEA adds little if anything to its exercise of responsibilities by listing them.

The issue of what the Federal Government can afford

While there are many vitally important issues in connection with serving more adequately our great domestic priorities, the outstanding single issue today is how much the Federal Government through the Federal Budget can and should contribute toward these great priorities, in view of the high and rising international burden. This towering problem should be dealt with in depth in any mature CEA report at this time, on both a short-range and a long-range basis. It is a problem incomparably more important than the balance-of-payments problem, to which the CEA report turns with such meticulous diligence.

The issue of urban-rural balance

It is true that there is a lot that we do not yet know about the optimum-distribution pattern of population within the United States, and there is a lot that we will never know about it. But we do know that, since World War II, the Federal Government has adopted changes in the national farm program which have contributed to the brutal deflation of a farm income, in the thought that by thus driving millions of people off the land we would cure the "overproduction" of farm commodities and thus bring per capita farm income toward reasonably parity with that of others. We do know now that this policy has failed miserably. We do know also that the assumption among most economists and others that the farmers driven off the land would find employment and improved living standards in urban areas has been proved to be a tragic illusion; major portions of them have found unemployment and despair in the cities, and have aggravated almost every one of the critical problems in our urban areas.

The intensity of these profound maladjustments would never have come to pass, if the CEA during the past 15 or 20 years had recognized that the so-called farm problem was and still is one of our greatest overall economic problems and if, correspondingly, the CEA had recognized that farm policy should have had and still should have quite as important a place in the work and reports under the Employment Act as price-wage policy or fiscal policy.

The issue of the war against poverty

Another salient example of CEA default is that the treatment of poverty in the current CEA report adds little or nothing to what can be found in other current sources. Yet, broadly conceived, what to do about poverty is the most pressing and stupendous problem involved in the management of our economic resources, and especially with respect to the role of the Federal Government in the deployment of these resources.

For the past 10 years at least, the work under the Employment Act should have focused very largely upon policies directed toward the liquidation of poverty. And during the several years since the official declaration of the war against poverty, taking into account the disillusions and dangers which have arisen in the course of that war, the

CEA above all others should be now offering to the Nation an expert economic analysis of what, as experience indicates, the central elements in a more effective war against poverty should be.

Tragically, this task of evaluation is being left far too largely to sociologists and psychiatrists, artists and amateurs, in the popular magazines, instead of being taken up by the one agency which, in terms of its potentials and responsibilities, should be moving most actively and fruitfully on this whole front.

The issue of housing and urban renewal

Treatment of this subject in the current CEA report adds nothing much to what can be obtained from the reports of other agencies, nor very much to what those reasonably informed about the subject already know.

It has long been my view that, in view of technological and other trends, almost half of the whole problem of achieving and then maintaining maximum employment and reasonably full resource use during the decade ahead converges on what we do about the housing problem and the entire range of related problems, mainly in our urban areas. These same problems are intimately connected with the whole poverty problem.

This being the case, I submit that CEA should long since have commenced to do effectively what can hardly be done anywhere else in the full perspective of the whole economy that is, develop a long-range budget relating to the amount of investment required for urban renewal during the decade ahead, accompanied by analysis of the respective roles of the Federal Government and others in the supply of these needed levels of investment. Lacking this, we are even now moving ahead with "new" types of approaches to housing and urban renewal. Some of these are sufficiently far from the realities of what can be accomplished, through the identified means, that we face the prospect of some of difficulties which have arisen from our excessively optimistic—or rather excessively careless in terms of the means employed—initiation of the war against poverty.

Minimum ambits of CEA responsibility

Even if the Council, for one reason or another, feels that it cannot yet attempt the kind of Performance Budget which I think it should, there is something else that the Council can and should do at once. It should select one or two of the specialized but vast problems which I have identified above, and aim within a year to make a really significant contribution toward that problem in its next report. This would be of immense service to the President, the Congress, and the country. That essential service is rendered in pretense only by the yearly reiteration of discussions at the level of those contained in Chapter IV of the current CEA report.

V. The International Economy

This chapter of the CEA report contains a competent and through treatment of the problems of our international balance of payments, in terms of the viewpoint toward this problem which the Council has

maintained for a number of years. My criticism is not of how the members of the Council deal with this problem as they see it; instead, I offer a fundamental challenge to their way of looking at this problem.

Balance-of-payments problem grossly exaggerated

I submit that a grossly exaggerated importance has been attached to our unfavorable balance of payments. This, in turn, has been responsible in substantial measure for many shortcomings in policies related to the domestic economy. In the name of dealing with the balance-of-payments problem, the Council itself has admitted on occasion that it was inhibited from recommending domestic policies which otherwise would have been desirable to expedite the rate of economic growth, and reduce further the level of unemployment. In the name of dealing with the balance-of-payments problem, interest rates have been elevated unconscionably, to the great detriment of economic progress and distributional justice.

An unfavorable balance of payments, running recently at an annual rate in the neighborhood of $4 billion, comes to only about one-half of 1 percent of our $800 billion GNP. During recent years, our unfavorable balance of payments, averaging annually somewhere in the neighborhood of $2 billion, has been somewhere within the range of one-third of 1 percent of GNP during these years. I venture the prophesy that, within a decade, most economists will look back upon the fear and trembling which has been generated by an unfavorable balance of payments in these magnitudes in somewhat the manner that most economists today look back to 35 years ago, when a national debt about one-twelfth the size it is now was regarded with fear and trembling by so many.

We should run a much larger unfavorable balance of payments

I believe that it would be in our own national interest to average, during the decade ahead, an unfavorable balance of payments several times as large in ratio to our GNP as the ratio today. Upon observation of its internal structure, it appears that our unfavorable balance of payments results substantially from the fact that our business system is a large net investor in other parts of the world. It seems to me that this is good for the U.S. economy; and it is only natural that our dominant world position, in terms of wealth, production, and capital accumulation, should result in our being a very large net investor in other parts of the world. Moreover in this connection, I believe that restraint upon the free flow of this type of investment is tantamount in many respects to the placement of tariffs and other prohibitions upon the international exchange of goods, a policy which we have not favored in general over the decades, and declared further against in the trade act several years ago.

Our currently avowed intent to reduce or even erase our unfavorable balance of payments is sorely neglectful of the economic circumstances and needs of other countries. It is inconsistent with the scores of billions of dollars which we have spent since World War II, to help these other countries avoid economic retrogression and make economic progress. For by definition, to the extent that we reduce our

unfavorable balance of payments by x billion dollars, some of other countries somewhere in the world must simultaneously have their balance-of-payments positions made less "favorable" by the same x billion dollars. And when we look around the world, it is abundantly clear that these other countries would be far more hurt by this change than we would benefit by it, even if we take the position (which I maintain to be wrong) that we would benefit by it at all.

To take some obvious examples, a reduction of $1 billion in our unfavorable balance of payments would do us only a bagatelle of good, compared with the damage that would be done to an economy like that of England if its balance-of-payments position were unfavorably affected in this same amount. If we were to reduce our unfavorable balance of payments by cutting back on our investments or aid to a country like India, the damage done to that country would be incomparably greater than any benefit accruing to us. This is quite apart from the equally valid point that our international economic and political policies are correctly based upon the proposition that it is in our own vital interest to speed the economic and social progress of the most highly populated democracy in the world.

I therefore think that the CEA, instead of participating in the fears and warnings about our unfavorable balance of payments, should embark upon a sophisticated analysis of the productive role of U.S. investment in other parts of the world, if wisely guided, looking a decade ahead. What part of our GNP should flow in these direction? Where should it be encouraged to go? Insofar as this might have some unfavorable side effects, how can countermeasure be developed which do not throw out the baby with a bath?

Our international goods and services account

The comments which I have made above are particularly pertinent to these portions of our international accounts which relate to the exchange of goods and services. On these, we have run in most years a very large surplus, perhaps too large in that we should always remember that commerce and goods and services between nations must run along a two-way street. These considerations make it particularly undesirable that we should seek to improve our overall balance-of-payments position by such restrictive measures as those under consideration, such as application to American travel overseas. Even if this were not true on purely economic grounds—which I believe it is—placing restrictions upon opportunities for our people to make contacts with other peoples in their own lands is fundamentally inimical to the advancement of friendship and peace among nations.

It seems to me also that, just as it is natural for us to be large net investors in other parts of the world, it is also natural for the Nation with by far the highest per capita income in the world to expect that its own people will enjoy a much higher standard of living, in terms of worldwide travel, than is enjoyed by others. While we should en-

courage others to come visit the United States, it seems to me utterly unrealistic and undesirable for us to anticipate that there will be as many others economically able to enjoy vacations in the United States as there are citizens of the United States economically able to enjoy vacations elsewhere. We should regard our "unfavorable balance" in this aspect of it as a national asset, not a national liability.

Methods of accounting need recasting

Our unfavorable balance of payments, as recorded, is due in part to failure to distinguish adequately between short-range and long-range aspects, such as investments which are minus items in the short run, but which will yield plus items later on in the form of interest and amortization. The unfavorable balance is also due in part to commingling items, without differentiating among those which are liabilites and others which are assets in a true economic sense. Our huge investments in military operations overseas, even while essential to our national security, are a burden upon the U.S. economy, because almost all military outlays are nonproductive or even wasteful in a purely economic sense. But our investments in economic enterprises overseas, or our repayable loans to others, are of an entirely different color. Yet both, under current methods, are treated as minus or unfavorable elements in our balance-of-payments accounts.

The unworkability of settlement in gold

The real problem confronting us resides, not in our unfavorable balance of payments, but in the use of gold as a method of settlement. This is an unworkable anachronism. As the gold supply of the world is increasing at the rate of only about 1 percent a year, its use is not suitable in connection with the need for an expansion of international transactions in the range of 4 to 5 percent a year on the average. The use of gold simply means that some nations will not have enough of it to meet their essential obligations; and it is foolish and shortsighted for us to think that we would be in the clear if could change things around so that we had enough gold, or more than enough, while others were caught seriously short. For any nation which is caught dangerously short will need to resort to other measures of a restrictive or retaliatory nature (as we, to a degree, are doing now). These measures inflict far more damage than they are worth.

In concert with others, we should move as rapidly as possible, and with great vigor, toward improved international machinery for the adequate and flexible financing of international transactions. Resorting, for these purposes, to realistic currencies backed by the real wealth and integrity of nations, we should stop being impaled on a cross of gold.

The current CEA report intimates correctly that we should do this, but still clings excessively to traditional approaches to the entire balance-of-payments program--approaches no longer relevant nor creative.

Comments on Economic Report of the President

I shall not comment extensively upon the Economic Report of the President, because to do so would be redundant of what I have said in detail about the annual report of the Council of Economic Advisers. After all, the two documents are consistent.

The aspect of the President's Economic Report which seems most significant to me, and which I attribute basically to the Council of Economic Advisers for reasons subsequently to be stated, is that the points of emphasis in the President's report are so wide of our most imperative current problems under the Employment Act of 1946.

On the day that I am transmitting this statement to the Joint Economic Committee—March 1, 1968—there appeared in the press of the Nation the magnificant and compelling report of the President's National Advisory Commission on Civil Disorders.

This report on civil disorders states most emphatically that the causes and manifestations of these disorders tower above and affect all of our other domestic problems, and indeed threaten the destruction of basic democratic values if not dealt with promptly and fully. The report states further that by far the most imperative task of all is to wipe out the excessive unemployment among vulnerable groups. This is clearly tantamount to a finding that the total rate of unemployment in the United States is now dangerously high—a point which I have made all along. For it is manifest that unemployment among vulnerable groups cannot be cut by more than a million—preferably by close to 2 million—without corresponding reduction in the nationwide rate of unemployment, unless the vulnerables are to take jobs away from others.

This brings to the forefront a truly amazing situation. The reduction of unemployment is fundamentally the task of economic policy, i.e., the use of economic resources, although it is fraught also with social and human implications, as are all of our important economic policies. The prime responsibility of the Council of Economic Advisers is to focus upon maintenance of "maximum" employment. Yet the Economic Report of the President makes only casual reference to the towering problem of reducing unemployment further, and does not even list this task specifically and pointedly in the ordered priorities of action which he sets forth on page 8 of the Economic Report.

This omission is clearly due to the fact that the Council of Economic Advisers, both last year and this year, has written reports based upon the thesis that we are enjoying maximum employment now, or at least that policies designed to drive unemployment substantially lower would cost more than they would be worth because of alleged inflationary consequences. Thus, there is an absolute dichotomy between the view of the civil disorders report that unemployment is our top economic problem, and CEA's view that curbing inflation is our top economic problem, reflected in the President's second-ordered priority that "we must slow down the wage-price spiral."

The only way to employ more people, whatever may be the reasons for their unemployment, is to spend money to employ them. And spending money to employ the unemployed increases pro tanto the volume of production and the GNP. Thus, the finding of the civil disorders report that we must drive unemployment sharply downward is equivalent to the finding that we must substantially accelerate the rate of economic growth, far beyond the level forecast and espoused by the Council of Economic Advisers. But, responsive to the advice of the Council, the five priorities of action cited by the President do not even mention the task of accelerating economic growth.

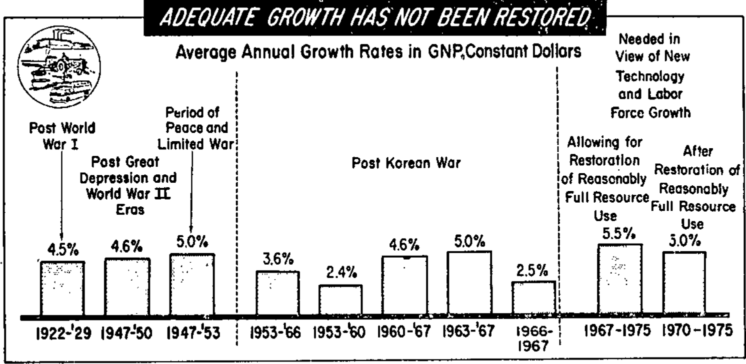
The first-ordered priority of the President is that "first and foremost, we must take the necessary steps to put our fiscal affairs in order." There is nothing wrong with our fiscal affairs, except as an indication of the state of our economic affairs. If the Federal budget deficit has become too large, this is mainly in consequence of the drastic economic slowdown during 1966–67, with slight prospect of complete economic restoration in 1968. And the only way to reduce that budget deficit, without damaging the economy, is through a vigorous speedup of the rate of economic growth. Thus, the focus of the President's report upon reducing the budget deficit per se, rather than upon reducing the deficit of excessive idleness of plant and manpower in the American economy, reflects abandonment by the Council itself of what used to be regarded as the hallmark of the "new economics."

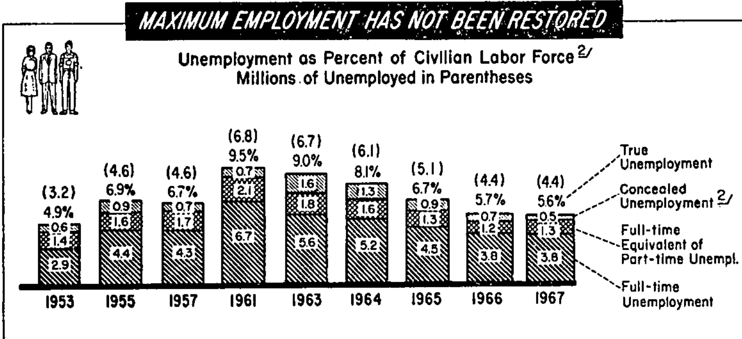
The third-ordered priority of the President's report is that "we must push forward vigorously to restore equilibrium in our international acounts." For reasons which I have stated fully in the body of my analysis, this, on all economic and social scores, should be a low priority indeed, compared with the problem of economic growth and employment. Here again, the upsidedown priorities of the Council have unfortunately led the President into serious error.

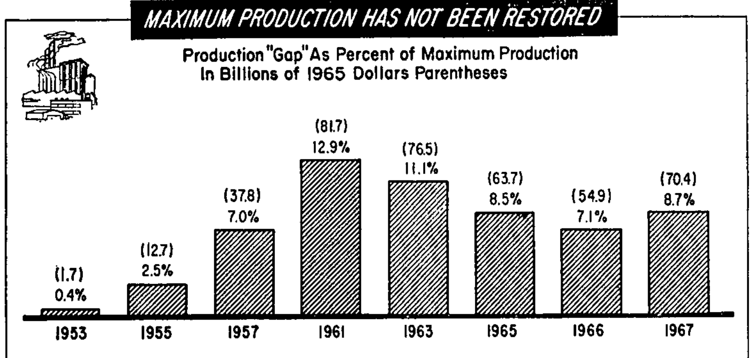
The fourth- and fifth-ordered priorities of the President's report are to "deal more effectively with our urban problems," and to "continue the struggle to expand the opportunities available to every citizen." These are assuredly top-priority objectives. But they are not sufficiently implemented either by the analysis or the programs offered, and indeed cannot be adequately implemented without prime reliance upon maximum employment and optimum economic growth.

It is always an interesting question whether the Council is restrained by the independently arrived at views of the President, or whether the President is restrained by the advice he received from the Council. Based upon my experience and observation, I believe the latter dominantly to be the case now. I believe that the Council this year has fallen down on its job, and thus has done a disservice to the President, all of whose impulses and instincts and motivations would move him in the right direction if the Council, in economic terms, helped more to point the way.

BASIC U.S. ECONOMIC TRENDS, 1953-1967





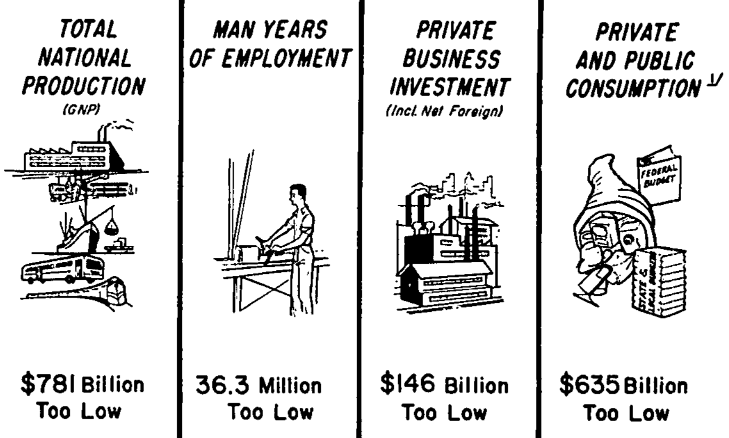


1/ Seasonally adjusted annual rate.

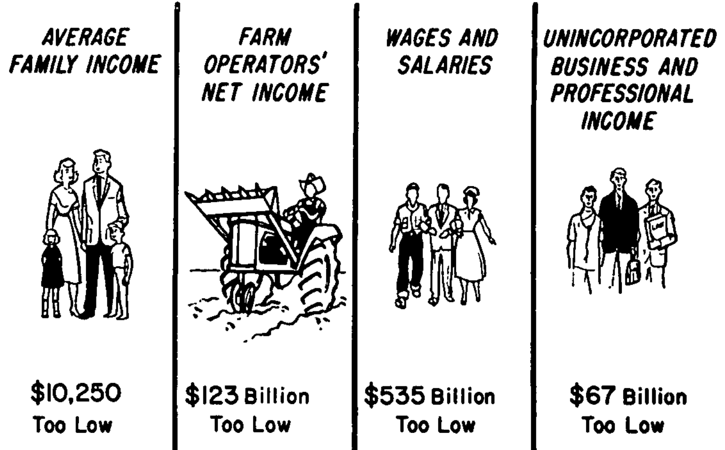
2/ In deriving these percentages, the Civilian Labor Force is estimated as the officially reported Civilian Labor Force plus concealed unemployment. Full-time unemployment of 2.9% and true unemployment of 4.1 % would be consistent with maximum employment.

LARGE NATIONAL ECONOMIC DEFICITS DURING PERIOD 1953-1967

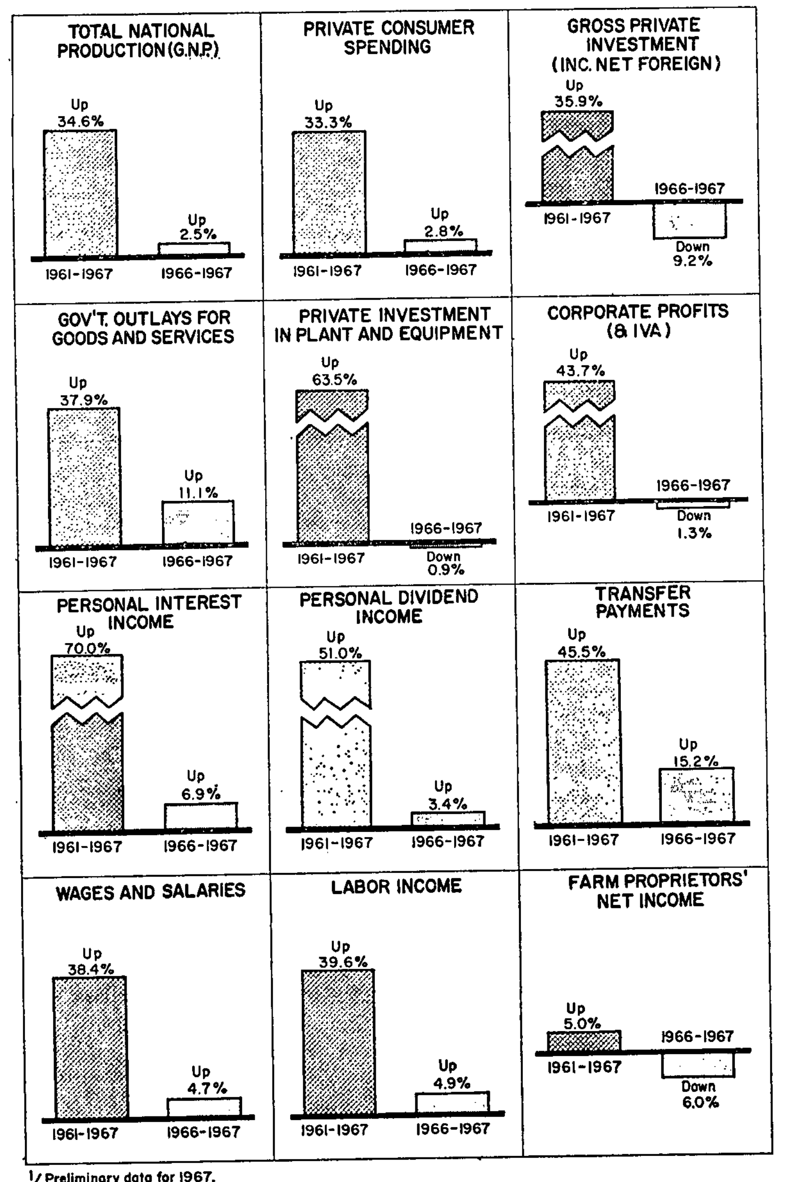
Dollar Items in 1965 Dollars



. . . THESE HAVE LED TO LARGE LOSSES TO ALL ECONOMIC GROUPS



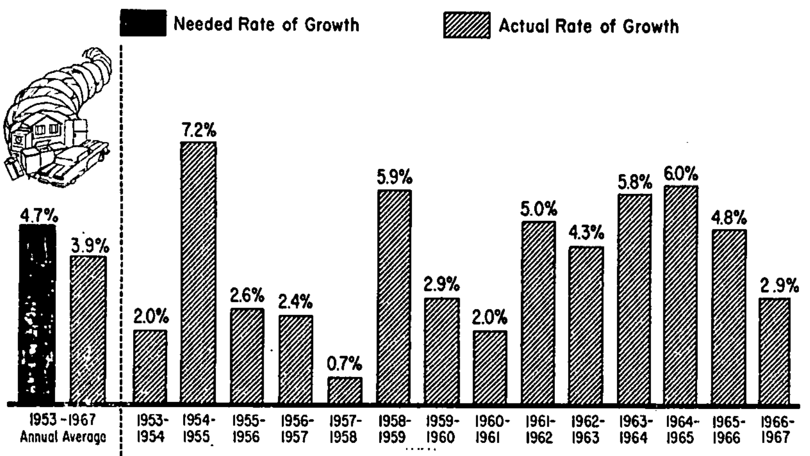
1/ Includes personal consumption expenditures plus government (Federal and, State and local expenditures $582 and $53 billion, respectively).



1/ Preliminary data for 1967.
Source: Dept. of Commerce, Office of Business Economics and CEP.

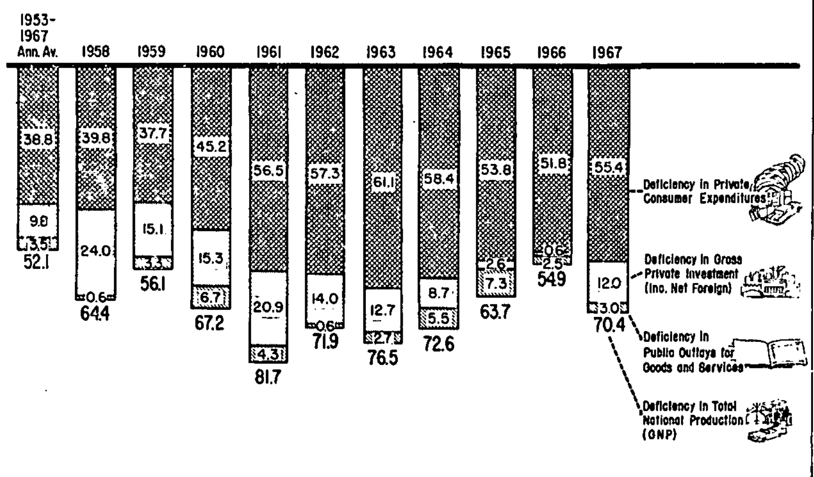
THE GROWTH IN CONSUMER SPENDING HAS BEEN MUCH TOO SLOW, 1953-1967

Rates of Change in 1965 Dollars

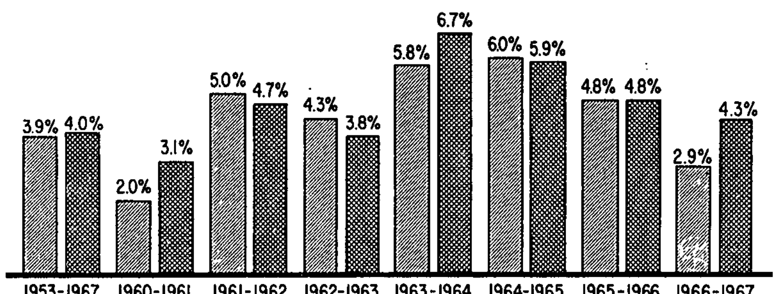


AND THE LAG IN CONSUMER SPENDING DOMINATES THE TOTAL GAP IN GNP

Billions of 1965 Dollars

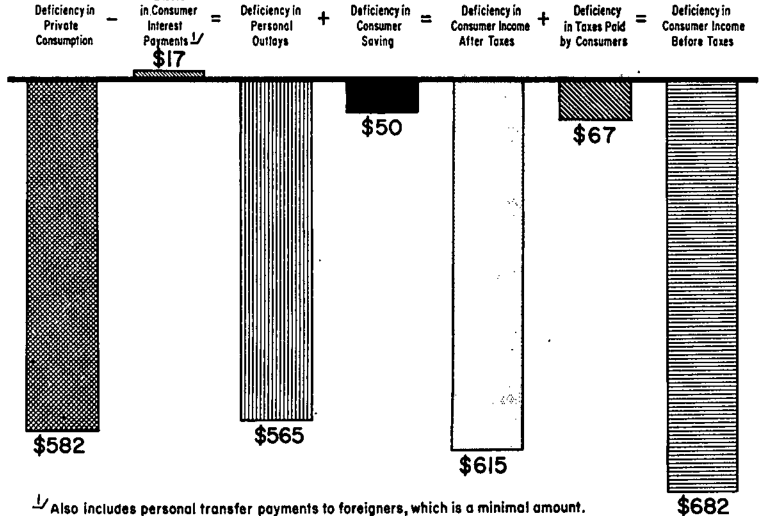


INADEQUATE CONSUMPTION GROWTH STEMS FROM INADEQUATE INCOME GROWTH



THE PRIVATE CONSUMPTION DEFICIENCY OF $565 BILLION, 1953-1967 REFLECTED A $682 BILLION INCOME DEFICIENCY

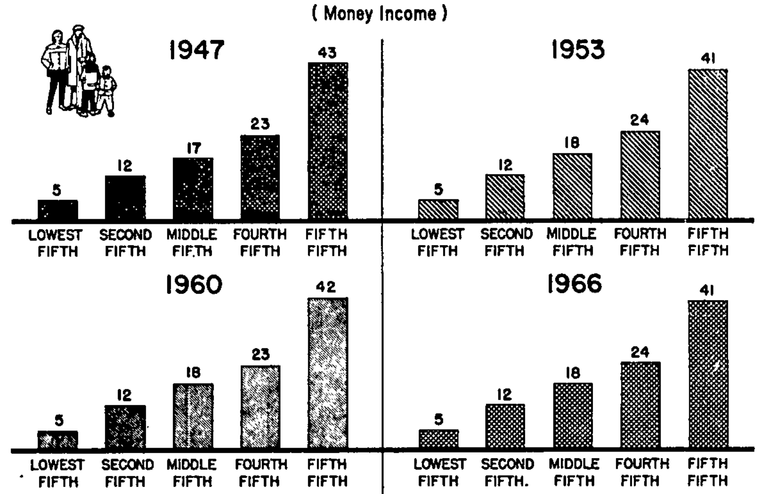
Billions of 1965 Dollars



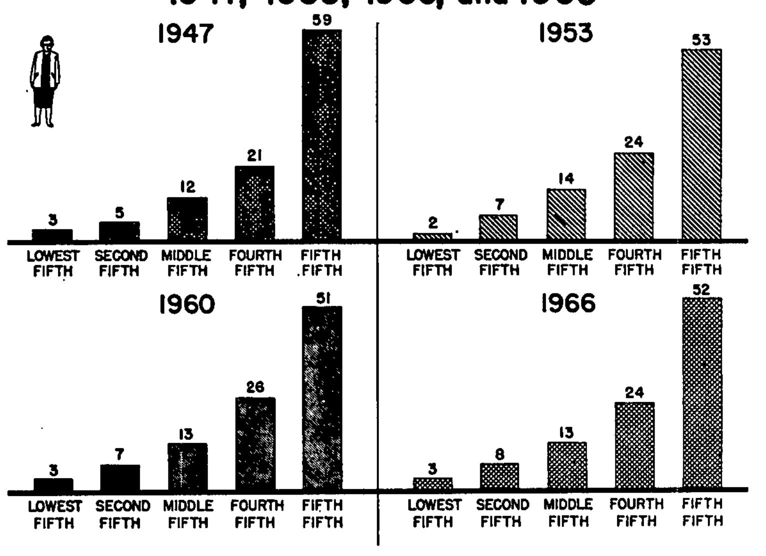
1/ Also includes personal transfer payments to foreigners, which is a minimal amount.

SHARE OF FAMILIES IN TOTAL FAMILY INCOME BY QUINTILES, 1947, 1953, 1960, and 1966

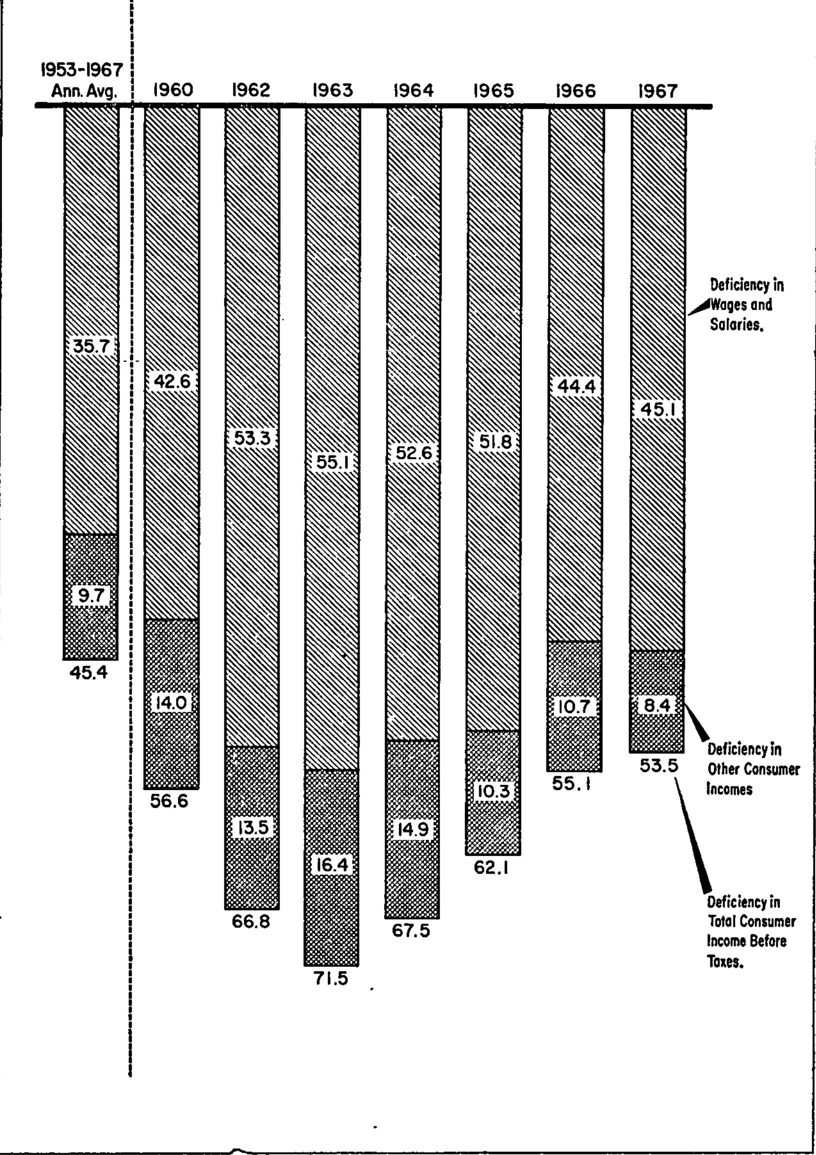
(Money Income)



SHARE OF UNATTACHED INDIVIDUALS IN TOTAL INCOME OF UNATTACHED INDIV., BY QUINTILES, 1947, 1953, 1960, and 1966

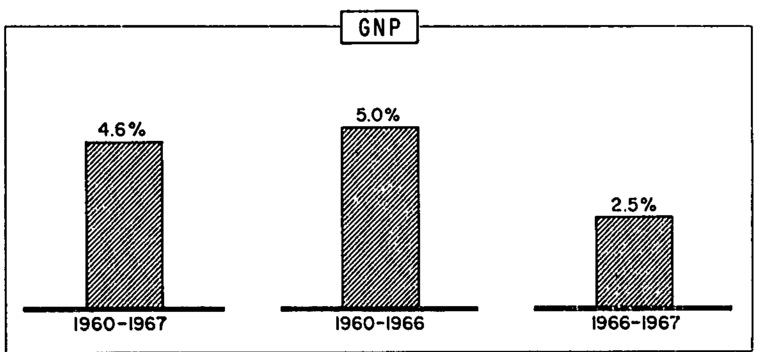


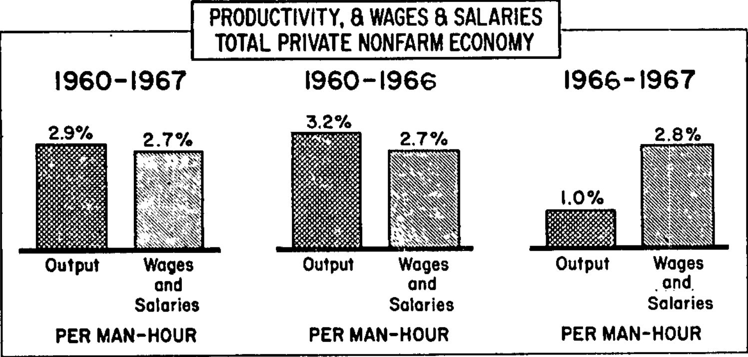
Data: Bureau of the Census.

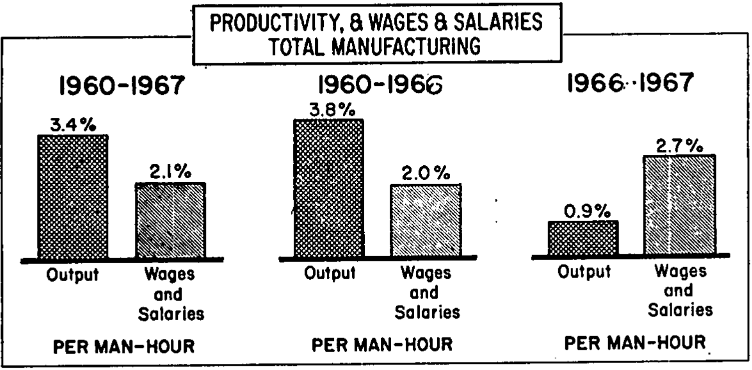

DEFICIENCIES IN WAGES AND SALARIES ARE LARGE SHARE OF DEFICIENCIES IN TOTAL CONSUMER INCOMES BEFORE TAXES
Billions of 1965 Dollars
1953-1967 Ann. Avg.
1960
1962
1963
1964
1965
1966
1967
35.7
42.6
53.3
55.1
52.6
51.8
44.4
45.1
9.7
45.4
14.0
56.6
13.5
66.8
16.4
71.5
14.9
67.5
10.3
62.1
10.7
55.1
8.4
53.5
Deficiency in Wages and Salaries.
Deficiency in Other Consumer Incomes
Deficiency in Total Consumer Income Before Taxes.

RATES OF CHANGE IN GNP, PRODUCTIVITY, & WAGES & SALARIES, 1960-1967[1]

GNP, and Wages and Salaries in Uniform Dollars







[1] Preliminary 1967 data.

PRICE, PROFIT, INVESTMENT, AND WAGE TRENDS DURING 1960-1967

Percentage Change, 1960-1967

Prices[1/] | Profits after Taxes[2/] | Investment in Plant and Equipment[3/] | Wage Rates[4/]

Industry	Prices	Profits after Taxes	Investment in Plant and Equipment	Wage Rates
TOTAL MANUFACTURING	UP 5.5%	UP 83.6%[5/]	UP 85.4%	UP 25.2%
PETROLEUM and COAL PRODUCTS	UP 6.0%	UP 86.3%[6/]	UP 75.8%	UP 23.8%
CHEMICALS and ALLIED PRODUCTS	DOWN 1.8%	UP 49.6%[6/]	UP 85.0%	UP 24.0%
ELECTRICAL MACHINERY	UP 0.5%	UP 112.0%[6/]	UP 89.7%	UP 21.4%
IRON and STEEL	UP 2.8%	UP 15.6%[6/]	UP 42.5%	UP 23.2%
MOTOR VEHICLES and EQUIPMENT	UP 0.9%	UP 30.8%[6/]	UP 86.5%	UP 26.3%

1/ Data: U.S. Dept. of Labor, wholesale commodity price indexes.

2/ Data: Federal Trade Commission-Securities and Exchange Commission.

3/ Data: U.S. Dept. of Commerce and Securities and Exchange Commission.

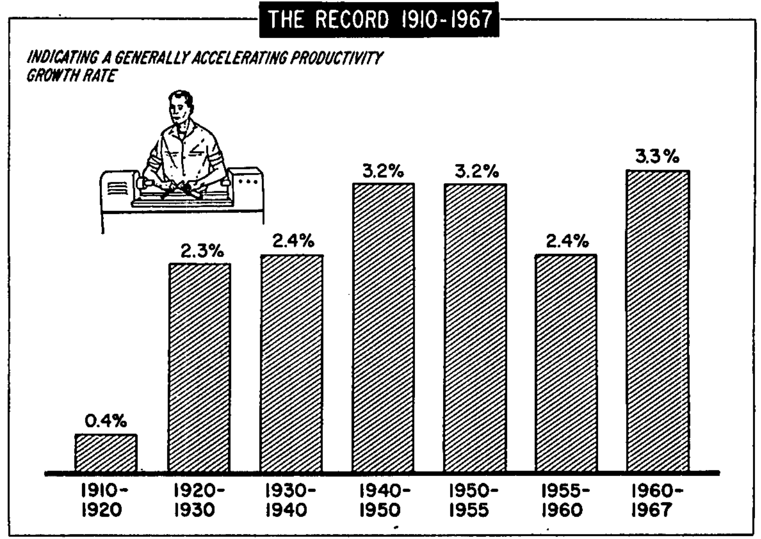
4/ Data: U.S. Dept. of Labor, Bureau of Labor Statistics; Average hourly earnings of production workers.

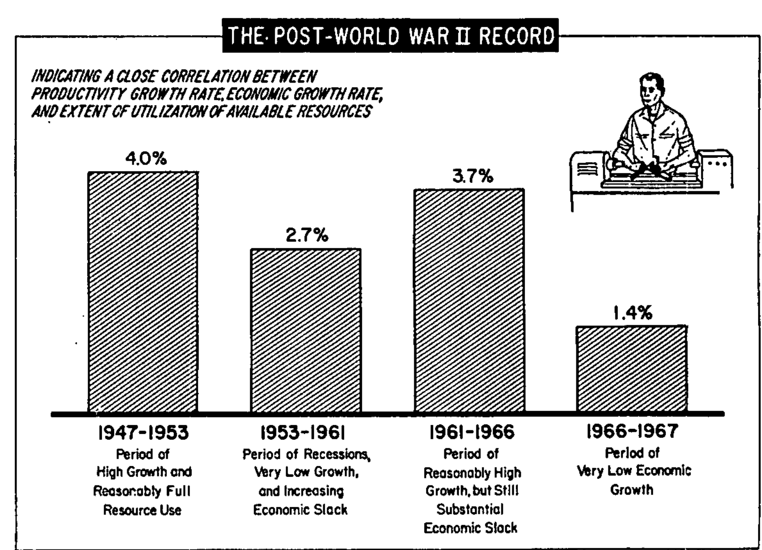
5/ Estimated for 1967.

6/ Data for 1967 are for first three quarters at annual rate, not seasonally adjusted.

TRENDS IN PRODUCTIVITY FOR THE ENTIRE PRIVATE ECONOMY, 1910-1967[1]

Average Annual Rate of Growth in Output per Man-hour for the Entire Private Economy





[1] Preliminary 1967 data.
Source: Dept. of Labor estimates relating to man-hours worked (Establishment basis).

U.S. ECONOMIC GROWTH RATES, 1922-1967,[1] AND NEEDED RATES, 1967-1975 FOR REASONABLY FULL RESOURCE USE

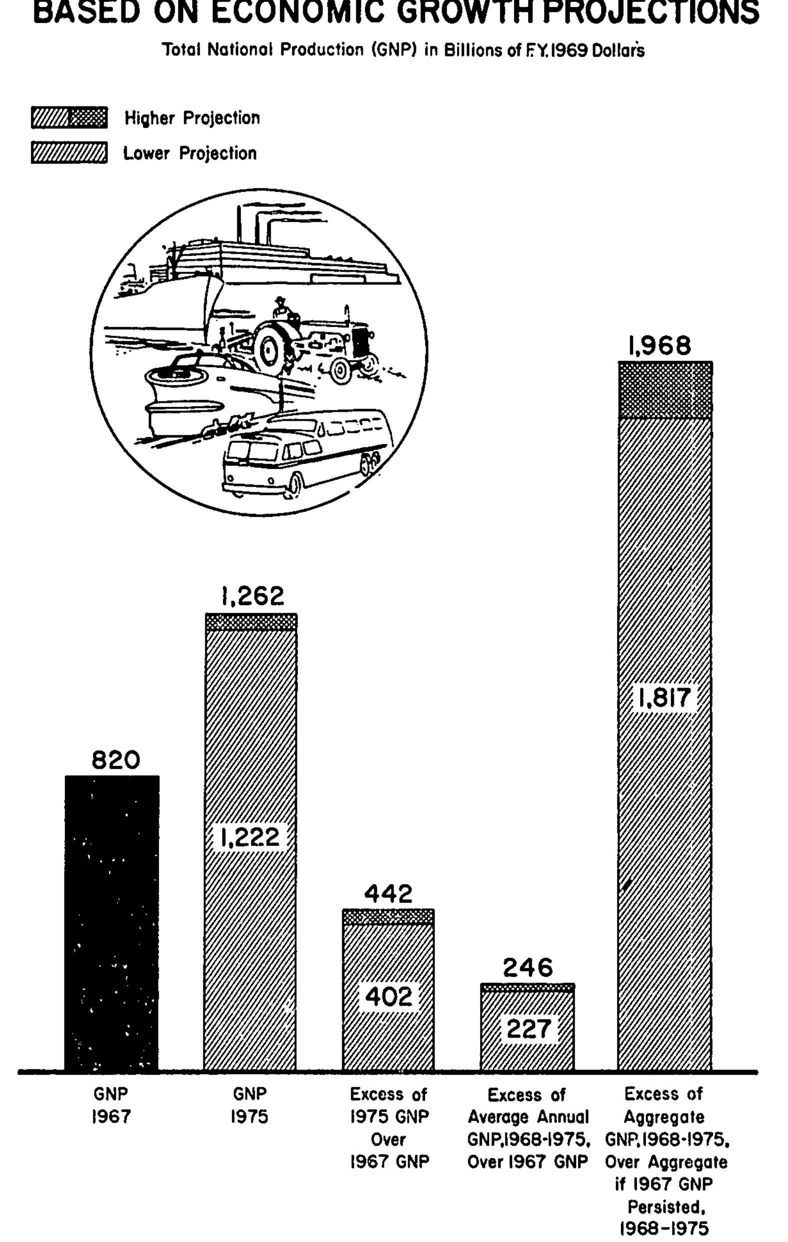
Average Annual Growth Rates in GNP, Constant Dollars

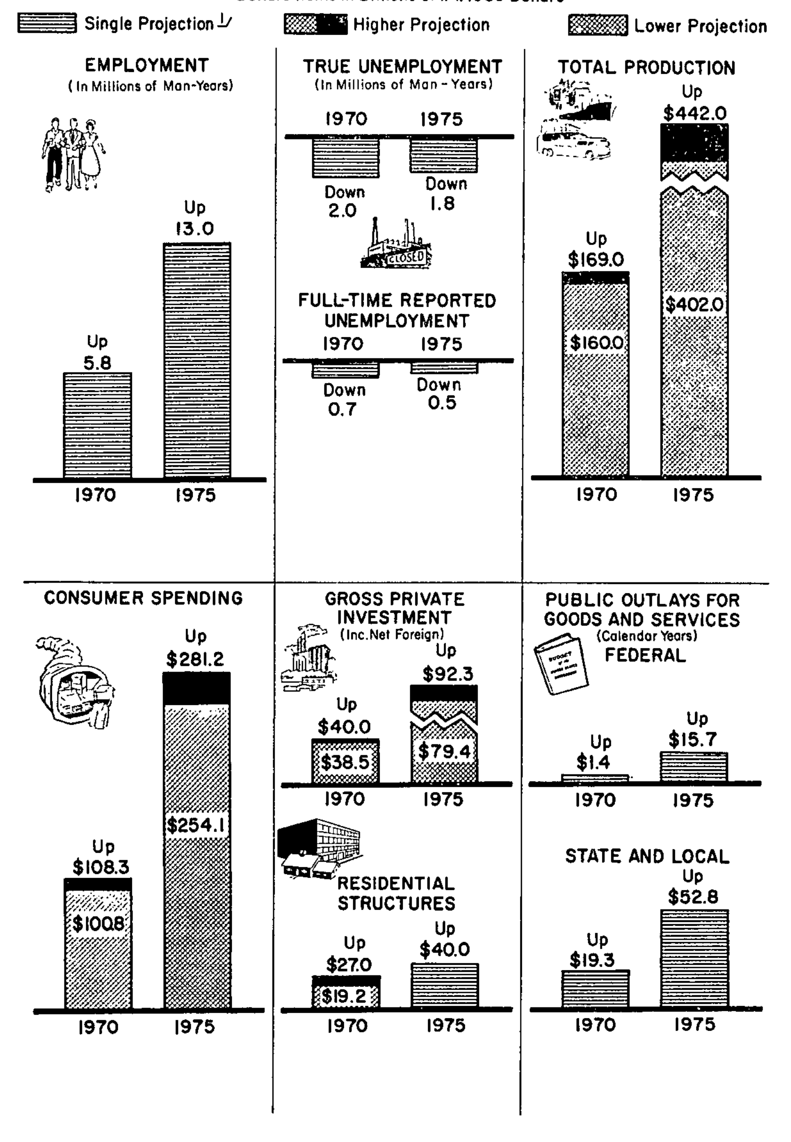
Post World War I Growth Period	Post World War II Growth Period	Period of Limited War Growth Period	Stagnation Period	Renewed Growth Period
4.7%	4.7%	5.1%	2.4%	4.6%
1922-1929	1947-1950	1950-1953	1953-1960	1960-1967

NEEDED IN VIEW OF NEW TECHNOLOGY AND LABOR FORCE GROWTH

Most Recent Four Years	Most Recent Year	Allowing for Restoration of Reasonably Full Resource Use	After Restoration of Reasonably Full Resource Use
5.0%	2.5%	5.5%	5.0%
1963-1967	1966-1967	1967-1975	1970-1975

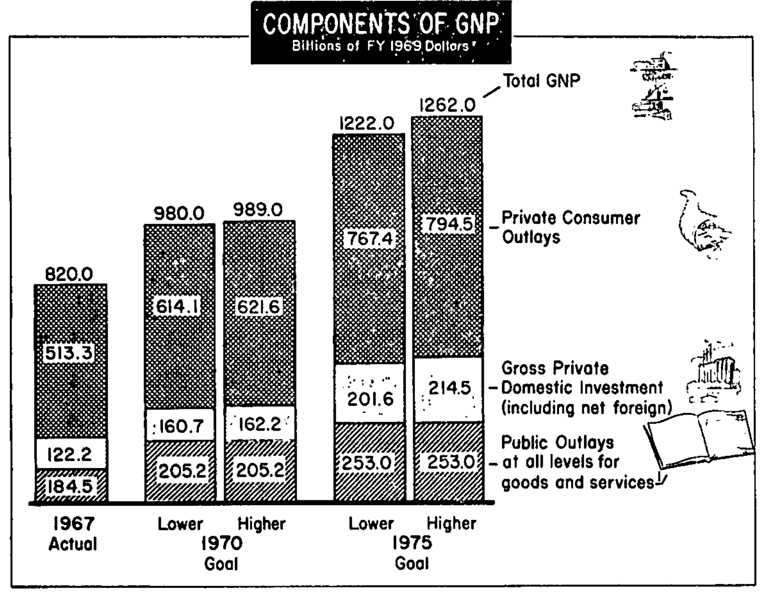
[1] 1967 estimate is preliminary.
Source: Basic Data from the Office of Business Economics.

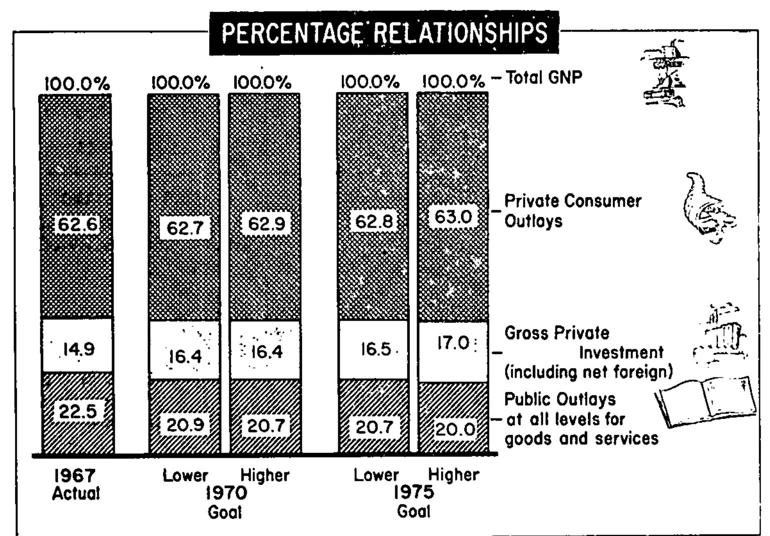

HOW MUCH WE HAVE TO WORK WITH, 1967-1975
BASED ON ECONOMIC GROWTH PROJECTIONS
Total National Production (GNP) in Billions of F.Y. 1969 Dollars
Higher Projection
Lower Projection
820
1,262
1,222
442
402
246
227
1,968
1,817
GNP 1967
GNP 1975
Excess of 1975 GNP Over 1967 GNP
Excess of Average Annual GNP, 1968-1975, Over 1967 GNP
Excess of Aggregate GNP, 1968-1975, Over Aggregate if 1967 GNP Persisted, 1968-1975



1/ The single projections relate to goals of such high priority that they should not be reduced even if only the lower goals for GNP are attained. In that event, lower priority objectives should be modified accordingly.

THE "FREEDOM BUDGET" MAINTAINS BALANCE OF PUBLIC AND PRIVATE RESPONSIBILITIES





1/ Public outlays are of such high priority that they are projected identically for the lower and higher GNP goals, with modifications of other goals accordingly.

GOALS FOR A FEDERAL BUDGET GEARED TO ECONOMIC GROWTH AND PUBLIC NEEDS

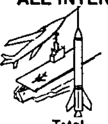
1969, fiscal year; goals for 1970 and 1975, calendar years

All figures in fiscal 1969 dollars [1]

ALL FEDERAL OUTLAYS

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	186.062	915.66	21.39
1970	200.000	964.79	20.22
1975	250.000	1,117.07	19.81

NATIONAL DEFENSE, SPACE TECHNOLOGY, & ALL INTERNATIONAL



Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	89.515	440.53	10.29
1970	93.000	448.65	9.40
1975	100.000	446.83	7.92

ALL DOMESTIC PROGRAMS

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	96.547	475.13	11.10
1970	107.000	516.16	10.82
1975	150.000	670.24	11.89

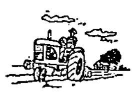
ECONOMIC OPPORTUNITY PROGRAM

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	1.997	9.83	0.23
1970	3.500	16.88	0.35
1975	4.800	21.45	0.38

HOUSING AND COMMUNITY DEVELOPMENT

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	2.784	13.70	0.32
1970	5.500	26.53	0.56
1975	7.000	31.28	0.55

AGRICULTURE; AND NATURAL RESOURCES



Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	8.099	39.86	0.93
1970	12.000	57.89	1.21
1975	13.750	61.44	1.09

EDUCATION

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	4.699	23.12	0.54
1970	9.800	47.27	0.99
1975	12.000	53.62	0.95

HEALTH SERVICES AND RESEARCH [3]

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	4.895	24.09	0.56
1970	5.500	26.53	0.56
1975	8.500	37.98	0.67

PUBLIC ASSISTANCE; LABOR, MANPOWER, AND OTHER WELFARE SERVICES

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 [2]	6.276	30.89	0.72
1970	9.200	44.38	0.93
1975	12.250	54.74	0.97

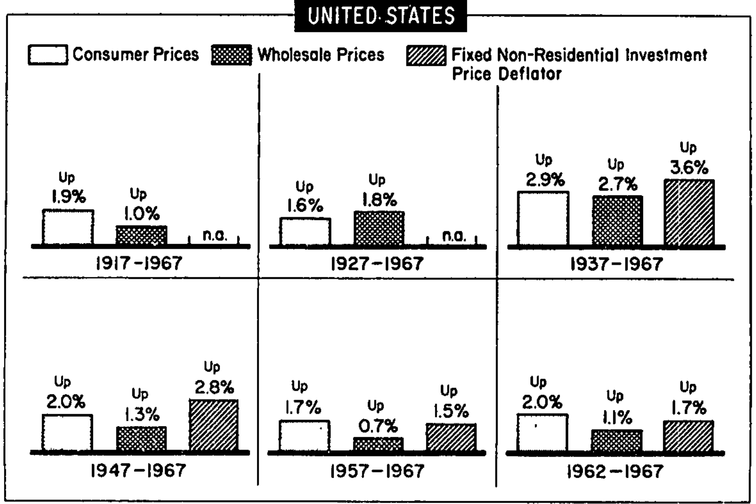
1/ Dollars of purchasing power apparently assumed in President's fiscal 1969 Budget.

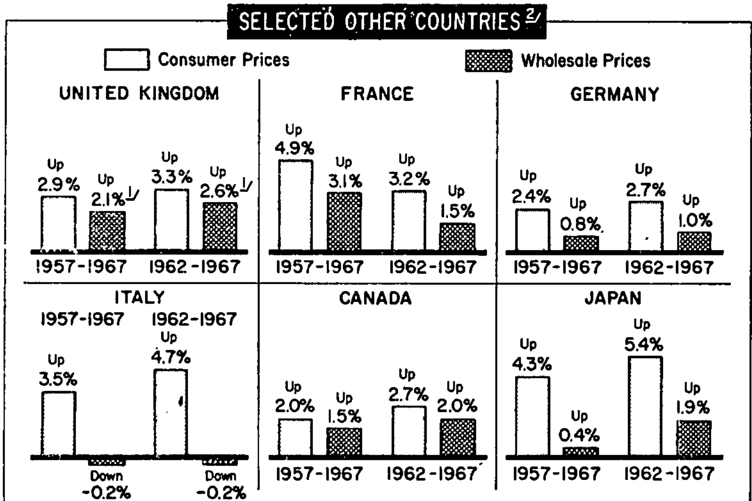
2/ Administration's Proposed Budget as of Jan. 29, 1968. Beginning with fiscal 1969, the Budget includes the immense trust funds, net lending, and other relatively minor new items.

3/ Exclusive of the Medicare trust funds, which are included in all domestic programs, but including Medicaid.

SELECTED PRICE TRENDS, 1917-1967
U.S. AND SELECTED OTHER COUNTRIES

AVERAGE ANNUAL RATES OF CHANGE



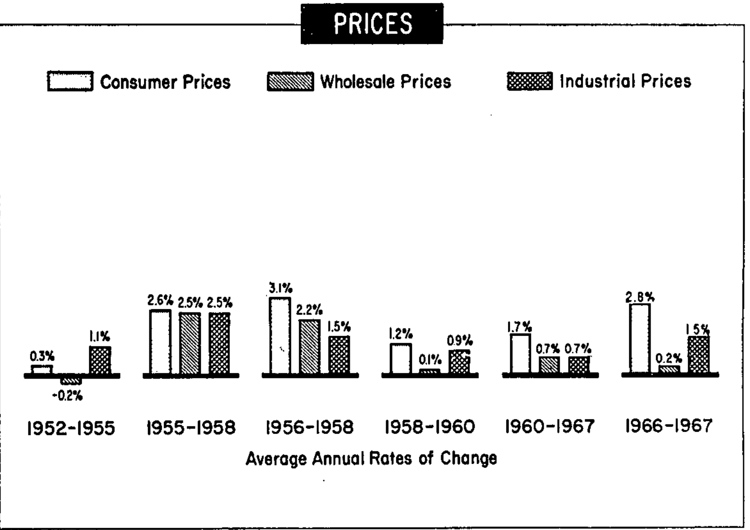


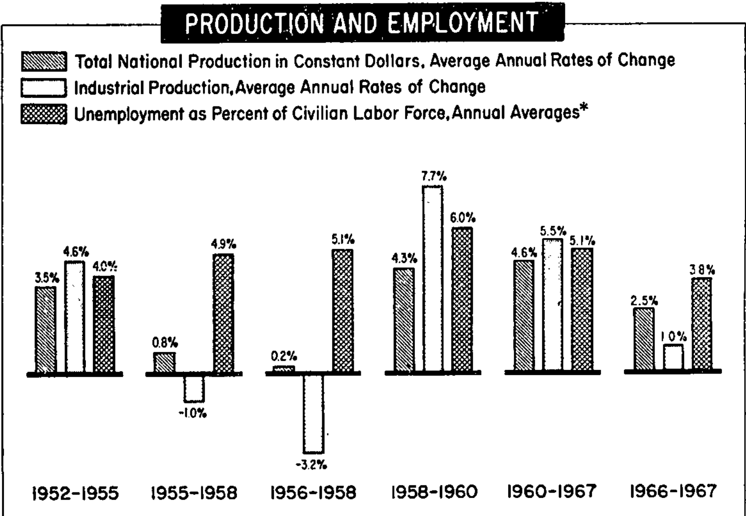
1/ Wholesale prices of finished goods (wholesale prices of basic materials increased 0.1 percent a year during 1957-'67 and 1.6 percent a year during 1962-'67.)

2/ 1967 data are preliminary estimates based upon first nine to eleven months.

Source: Bureau of Labor Statistics; Office of Business Economics; and the United Nations; Department of Labor; and Organization for Economic Cooperation and Development.

RELATIVE TRENDS IN ECONOMIC GROWTH UNEMPLOYMENT, & PRICES, 1952-1967 1/





1/ Preliminary 1967 data.

*These annual averages (as differentiated from the annual rates of change) are based on full-time officially reported unemployment measured against the officially reported Civilian Labor Force.

Source: Dept. of Labor, Dept. of Commerce, & Federal Reserve System.

CUNA INTERNATIONAL, INC.

By J. Orrin Shipe, Managing Director

As our economy nears the end of the first quarter of 1968, with many of the same inflationary factors in force as in the last half of 1967, the primary concern of our Nation's credit union movement is inflation. By slowly eating away at the value of their small savings and by increasing the cost of practically everything they buy or want to buy, inflation robs credit union members of every extra penny they have earned through their daily practice of thrift.

Inflation encourages families to act directly opposite to credit union teachings. Why save, if the dollars you save immediately begin to lose their full value? Why bother to shop wisely, if the dollars you save by shopping wisely are lost to inflation during the time it takes you to do your shopping? Why exercise restraint in buying on credit, if, by buying now and paying later, you can pay off your debts in dollars of lesser value?

Attempts to curtail inflation solely through monetary policies also hurt credit union members by seriously affecting their credit union's operations. Tight money causes higher interest rates. Higher interest rates increase credit union operating costs. Increased operating costs must be passed on to the credit union's members, through higher interest charges on their loans and/or lowered dividend rates on their savings. Higher interest rates also force credit unions to operate in a tight cost-price squeeze. By law, the maximum income a credit union can earn on a loan is 1 percent per month on the unpaid balance, or a true annual interest rate of 12 percent. Higher interest rates force credit unions to pay higher dividends to their members in order to compete with the interest rates being offered by other institutions, and to pay higher costs for borrowed money. Either one pushes credit unions into a tight squeeze between the maximum income they can earn on their loans and the interest rate they must pay to continue to attract savings or to borrow. Because credit unions are dependent almost entirely on member savings for their operating capital, they are severely affected by the tight money-high interest rate effects of anti-inflationary monetary policies.

The credit union movement supports all efforts to hold inflation within reasonable bounds. Rather than relying solely on monetary practices, however, it supports the full utilization of all methods, including necessary fiscal measures. In addition, we would urge continued research into monetary polices so as to bring about a greater refinement in their implementation in such areas as timing and coordination of action.

Proper steps in this direction will, we believe, do much to help this Nation put into practice the same wise management of its resources as we expect of our credit union members. As a matter of fact, the Pres-

ident might very well have been talking about our Nation as a credit union officer would talk about his credit union members when he said in his Economic Report: "Our achievements demonstrate that we can manage our economic affairs wisely—that we can make sound choices." We hope the Congress will assist in making those sound choices.

While our primary concern lies in the area of domestic policies to fight inflation, we recognize fully the interdependence between our domestic and international economic affairs. They are—and should be—permanently and inextricably intertwined. Stabilization of the delicate equilibrium in our international affairs is as important to credit union members, as citizens of the United States, as is the achievement of the best domestic balance possible to assure economic growth without inflation. Any imbalance in any part of our economic programs and policies adversely affects some segment of our credit union membership.

Credit unions are deeply involved in our Government's foreign assistance program on the international level and in the war on poverty on the national level. We seek increased participation in both of these programs, because we feel that the credit union idea provides people—both those living in underdeveloped countries and those living in poverty pockets—with a lever through which they can lift themselves to a more bountiful standard of living. The credit union movement has invested heavily in its own programs in these areas, and it welcomes financial assistance from the Federal Government to speed up these programs. It also strongly supports the Government's goal of obtaining greater economic assistance for underdeveloped countries from the wealthier nations. And it supports the Government's efforts to get State governments and the private sector of the economy to help finance and fight the war on poverty.

As consumer-oriented membership organizations, credit unions would be delighted to see this Congress "go down in history as the consumer-conscious Congress." Because we have supported a strong truth-in-lending proposal ever since the first bill was introduced in Congress several years ago, we would, of course, delight in seeing Congress complete its action on this legislation early this year. We hope the bill will be passed in the strongest form possible, covering all kinds of consumer credit transactions.

In conclusion, we would like to point out that we have purposely avoided taking a selfish-interest position on the President's Economic Report. Like our Nation as a whole, the credit union movement embraces people and institutions in all walks of life. Our purposes like that of the Federal Government is to serve all these people. For that reason, we hope and trust that "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."

FEDERAL STATISTICS USERS' CONFERENCE

This statement is submitted on behalf of the Federal Statistics Users' Conference whose membership is composed of organizations from all sectors of the economy. Our members have a common interest in the development of adequate, reliable, and timely statistics from Federal sources.

The conference appreciates the opportunity to express its views regarding certain statistical materials which provide much of the information upon which the President's Economic Report and the report of his Council of Economic Advisers is based. This vast storehouse of information is used by private as well as public planners and policy-makers in making important decisions that affect the course of the economy. It is important for all of us that our actions and policy decisions are based upon the best measures of the economy that it is possible to obtain.

We consider these two documents and the Federal budget of such importance to our members, and others, that for the third straight year we recently sponsored a 1-day conference at which these documents were discussed by James S. Duesenberry, member of the Council of Economic Advisers and Charles J. Zwick, Director of the Bureau of the Budget. Our purpose is to help raise the level of understanding of the public policy issues involved in these documents and to assist users of them in making more effective use of the information they contain.

The United States is fortunate in having available a vast quantity of demographic, economic and social statistical data. The appendix to the Economic Report of the President contains 90 statistical tables relating to income, employment, and production. Those concerned with policy decisions and the carrying out of Government programs take our wide data base for granted and freely utilize the data in analyzing problems and as a guide to determining positions or actions. However, little attention or concern is given by the majority of these data users to certain inadequacies or weaknesses in some of our statistical data and the need for improving them.

We were pleased to note that President Johnson, in identifying five "longstanding goals" in his recent budget message, included the following: "Providing improved statistics to aid business, labor and government in sustaining economic growth." In his Economic Report, the President said:

> Accurate, comprehensive, and timely statistics are essential to the development of sound economic policies by government, business, and labor. Our economic statistics are the best and most comprehensive in the world, but they can be and need to be further improved. The costs will be exceedingly small relative to the benefits.

More specifically, the Economic Report, on pages 91 and 92, outlines its program for improvements in economic statistics. We respect-

fully urge that the Joint Economic Committee give careful consideration to these recommendations and specifically support them in its report.

We believe the Economic Report has properly and carefully spelled out the need for these improvements which is stated as follows:

> That need is accentuated by the current state of the economy and the current aims of policy. Sustaining expansion close to the economy's potential growth path is a more difficult task than that of merely attempting to moderate wide swings in output. In a slack economy, it was often sufficient for the indicators merely to point in the right direction. Now more accurate information about the speed of the movement and the distance from full employment is called for. The need for early and careful diagnosis of the extent and location of inflationary dangers also requires comprehensive information about the price, cost, and productivity performance of various sectors of the economy. Capital markets and especially the mortgage market have taken on a key role, calling for more comprehensive data and indicators. The current importance of our international trade position places added emphasis on the need for better information about export and import prices.

We agree with and recognize the need for economy and establishment of priorities in connection with Federal programs. The 10 items proposed for improvement in the area of economic statistics are indeed priority items and the Federal Statistics Users' Conference has, in the past, urged and supported the majority of these items. We further agree with the Economic Report in its statement that each improvement has been recommended because it meets these tests: "that it assist current policy formulation, that the proposal be capable of rapid implementation and that its costs be moderate, given the present budgetary stringency." The total program of improvements will involve an annual budget cost of about $2.5 million which is approximately 2 percent of the total 1969 budget estimate for current statistical programs.

The fiscal 1968 budget included appropriation requests for certain statistical programs that would meet the needs of some of the priority items included in the 1968 Economic Report. Unfortunately, the Congress failed to approve these requests. The range in costs of these denied programs was from $120,000 to $200,000. We agree with Congressman Curtis who has said that the budget treatment of our statistical agencies is "one of the best examples I know of being penny wise and pound foolish." We further agree with the Economic Report that the small investment of $2.5 million for its recommended improvements "could make a critical difference in guiding decisions involving billions of dollars."

We wish to emphasize that expenditures for the total statistical programs of the principal statistical agencies is small in comparison with the total governmental administrative budget expenditures or the administrative budget expenditures exclusive of military expenditures. In 1967, statistical expenditures were about one-tenth of 1 percent of the former and about one-quarter of 1 percent of the latter. The proportion has never been higher than this.

We earnestly urge the committee to support the following 10 key items in the President's program for improvements in economic statistics:

(1) *Nonmanufacturing industries*—additional information on employment, wages, investments, sales, and other indicators for trade, services, and finance that will bring the data closer to the coverage and quality of the data now available for manufacturing industries.

(2) *Construction*—an enlarged effort to collect more accurate and more timely information on the value of construction activity.

(3) *Business investment*—extension of coverage of the plant and equipment survey to all nonfarm industries, and collection of separate quarterly data on business investment in plant, as distinguished from equipment.

(4) *International price competitiveness*—a better comparison of price trends of internationally traded goods.

(5) *Improved price indexes*—covering individual industries systematically, emphasizing actual transactions rather than quoted prices, and developing methods to make more adequate allowance for quality changes in our measurement of prices.

(6) *Quarterly data on national product by industry*—a new economic tableau that will ultimately provide comprehensive information on output, labor input, prices, and productivity by major sectors on a quarterly basis.

(7) *Manufacturing inventories*—expanded coverage and increased detail.

(8) *Mortgage flows and commitments*—a comprehensive system of quarterly and ultimately monthly statistics.

(9) *Bank deposits*—more adequate information on ownership and turnover to be collected by the Federal Reserve; and

(10) *Securities markets*—new information on purchases and sales by institutional investors, and more comprehensive and accurate data on new issues and retirements.

The Joint Economic Report of last year pointed out some of our deficiencies and needs in the statistical area. It emphasized that high priority should be accorded to research in the area of prices and price indices and also that Government agencies should push rapidly ahead with the development and regular publication of industry data on output, productivity, prices, capital, labor, and incomes. The minority views also stressed the need for greater effort to improve existing economic statistics. We hope that the Joint Economic Report for 1968 will place particular emphasis on the need for improvements in our statistical data and specifically spell out major priority areas for improvements which might even go beyond those outlined in the President's program.

In its recent report on the "Coordination and Integration of Government Statistical Programs," the Subcommittee on Economic Statistics of the Joint Economic Committee pointed out that the most significant increases in statistical programs in recent years have been for labor and demographic statistics, and particularly in the social area such as health, welfare, education, and poverty. Recognizing that this is appropriate, the subcommittee emphasized, and we agree, that at the same time, *major advances in economic statistics must not be neglected.* The problem, as the subcommittee pointed out, is that "Too often it is difficult to engender support for general statistical programs,

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since they do not appear to have a specific and immediate impact on particular individuals or groups."

In this connection, we think particular attention should be given to the budget, programs and value of the work of the Office of Business Economics. This agency that prepares the national income estimates, the balance-of-payments accounts and other vital economic statistics, has operated on a budget ranging from $2 million in 1963 to an estimated $2.9 million in 1968. Four modest improvement programs proposed for 1968, totaling $372,000, were denied by the Congress. The four programs denied called for: (1) beginning the preparation of real GNP by industry on a quarterly basis, (2) strengthening the analysis of determinants of business investment, (3) personal income by States on a quarterly basis, and (4) initiating work on estimates of the total tangible capital stock of the United States. These certainly are priority items for improving the national income and business financial accounts.

The Joint Economic Committee has made some invaluable contributions leading to improvements in the Federal Statistical System. In its 1967 Economic Report, is directed the Subcommittee on Economic Statistics "to look into the possibilities of a truly integrated system providing genuinely comparable statistics consistent with and meshed into an overall system of economic statistics, including the Federal, State, and local governments." The Report of the Subcommittee on Economic Statistics on the Coordination and Integration of Government Statistical Programs stated "Investigations by this subcommittee and by others have indicated that further significant improvements in our statistical services depends upon a higher degree of integration and coordination of our statistical programs. Indeed, *there are strong indications that this is the aspect of the statistical system where progress is needed most.*" (Emphasis supplied.)

In view of the above, we strongly urge that this committee, in its report, recommend that additional resources be provided the Office of Statistical Standards of the Bureau of the Budget to enable it to be more effective in carrying out its responsibilities for the coordination and improvement of our statistical system. Total budget for that office was $649,000 in 1967 which was 1.7 times greater than in 1948. On the other hand, total obligations for current statistical programs in 1967 was five times greater than it was in 1948. The OSS budget in 1968 declined to $632,000 and the 1969 budget request calls for $693,000. This budget increase does not include the addition of any new employees.

The Office of Statistical Standards also is responsible for minimizing reporting costs to the Government and the public under the Federal Reports Act of 1942. It is averaging about 2,600 actions annually on report forms submitted for approval. Despite its broad and important responsibilities, this office is operating with a staff of 35 persons—23 professional and 12 clerical employees. In 1942 it had 42 employees and in 1959 it had 37 employees. We would certainly question whether the current staffing of the OSS of the Bureau of the Budget is sufficient to enable it to exercise the maximum potential for the Government and the public.

THE MACHINERY AND ALLIED PRODUCTS INSTITUTE

By CHARLES W. STEWART, PRESIDENT

THE NEW GOVERNMENT PROGRAM TO IMPROVE THE U.S. BALANCE-OF-PAYMENTS POSITION: A CRITIQUE

SUMMARY

1. Essentially, the administration's program for improvement of our international balance of payments consists of controls—controls on foreign travel, foreign investment, and bank loans. Moreover, a central fallacy in the new program is its failure to recognize that all elements of foreign trade, including direct investment abroad, are parts of an integrated whole and the same is true of the various elements of the balance of payments. The institute regards any program grounded wholly in the "controlist" philosophy as unsound in principle. Such a program would:

a. Lack incentive and rely on compulsion.
b. Ignore long-range effects.
c. Impose intolerable burdens on individuals and businesses.
d. Provoke foreign reprisals.
e. Gravely erode personal freedoms.
f. Probably be unworkable.

2. The institute opposes travel restrictions proposed by the administration because they would:

a. Fall with unequal effect on citizens of varying means.
b. Fragment tax treatment of passenger transportation.
c. Establish a method of taxation that is poorly conceived, highly arbitrary, and nearly impossible to comply with.
d. Represent an unjustifiable intrusion on a fundamental right.
e. Call forth foreign countermeasures.
f. Probably, in the net, fall short of the fiscal goal which they seek to attain.

3. Similarly, we are opposed to the principal feature of the administration's balance-of-payments program—the system of mandatory controls on foreign direct investment. In our judgment, these controls focus on the wrong target, are likely to become permanent in effect, substantially reduce business' ability to compete in international trade, represent an invitation to protectionism, tend to obscure long-standing domestic fiscal disorder which substantially affects our balance-of-payments difficulty, and constitute an extraordinary assertion of Executive authority without congressional approval. The system of mandatory investment controls is so structured as to:

a. Adversely affect U.S. exports.
b. Produce widespread inequity by reason of the base periods chosen.

c. Harm most those U.S. direct investors who responded most effectively to the Government's entreaties under the voluntary balance of payments program.

d. Provide no incentives for individual efforts to improve the balance of payments.

e. Raise the near certainty of foreign reprisals.

f. Impose a crushing burden of administration on government and business alike.

4. In the light of conclusions summarized above, the institute recommends that:

a. Congress not approve administration proposals for restrictions on travel.

b. Congress call upon the administration to either:

(1) Abandon promptly the mandatory system of controls on foreign direct investment and return to the pre-existing voluntary balance-of-payments program, or

(2) Rethink and restructure the mandatory system so as to make it equitable in principle and workable in practice.

c. Congress insist upon further substantial reductions in nonessential Government spending, not only as a precondition to action on the surtax proposal, but as a means of correcting our balance-of-payments program over the longer term by improving our international competitive position.

d. Congress call for immediate consideration and prompt implementation of measures to expand U.S. exports.

e. Congress inquire into tax aspects of the direct investment program and other tax actions which might be taken to assist the balance of payments. Such an inquiry should consider affirmative measures designed to overcome the adverse effects of enforced repatriation of earnings, to induce the repatriation of foreign earnings not subject to the controls program and to encourage the increase of U.S. exports.

Introduction

It is a privilege for the Machinery and Allied Products Institute and its affiliate, the Council for Technological Advancement, to present their views on the administration's balance-of-payments program in connection with hearings on the 1968 Economic Report. These organizations are national in character and represent the capital goods and allied product industries. Their stake in foreign trade is extraordinary. Machinery exports are the largest single category of manufactured exports from the United States; in 1966 capital goods exports reached a level of $8.83 billion. Moreover, these industries have a very substantial interest in private investment abroad, in licensing, subcontracting, and other arrangements necessary to maintain a strong position in world trade.

Based on the experience of these industries and in reference to certain of the issues which will be discussed in our presentation, we should like to emphasize at this point that no private organization and no governmental program, whether the latter is drawn in the form of a control or an incentive, can afford to ignore one central fact about

foreign trade. To achieve, sustain, and improve a company's or an industry's position in international trade, the approach must be on a wholly integrated basis, integrated in terms of exports, private investment, licensing, subcontracting, etc., and also integrated in terms of the world, whether the countries are developed, or at some intermediate stage in industrial development. No industrial organization or governmental program in the face of this irrefutable fact of life can attempt to segment or splinter the total foreign trade effort. As we shall develop, this is precisely the central blunder of conception implicit in the administration's approach to balance-of-payments correction particularly as reflected in the foreign investment controls announced on January 1, 1968.

Perverse effect on exports.—Subject to later, more detailed, treatment, let me emphasize at this point the seriousness of the perverse or counterproductive character of the foreign investment controls and to some degree the proposed restrictions on travel. In brief the problem breaks down as follows:

1. There will be an immediate adverse effect on exports from the United States flowing from the direct investment controls. This effect will enlarge at the intermediate stage and grow very seriously in the longer run. It is documented by Government studies that there is a very direct relationship between private investment abroad and exports, it being estimated that approximately 25 to 30 percent of exports from the United States are tied to foreign affiliates of U.S. companies. Also when you affect the growth, viability, and flexibility of those foreign affiliate operations there will be an immediate adverse effect on exports from the United States, and as just indicated that adverse effect will grow in intensity.

2. Certain elements of the *structure* of the control program also will affect exports adversely, particularly rules governing open account transactions covering merchandise transfers.

3. As to all foreign countries affected by the controls program, it seems probable that reduction in inflows of capital from the United States, limitations on the growth of U.S. affiliates abroad, and restrictions on the flexibility of their management will in turn affect the economic growth of the host countries and in turn their importing capability. It is our judgment that this impact will be present to some degree in all foreign countries affected by the program but of course will be intensified in certain countries experiencing economic difficulties such as England and Canada.

4. The controls on foreign investment will disrupt in a general way the effective integration of individual companies' programs involving foreign trade. The energy, the time, and the money which will have to be expended to adjust or react to these controls, the adverse effects that they will have on the interacting elements of a company's foreign trade program—all of these things—undoubtedly will cut into the export performance of U.S. companies, their earnings, their job-creating potential in the United States, and their international competitive strength.

5. We have been discussing the boomerang effects of the controls program largely in terms of investment controls. To some

> degree at least, perhaps to a significant degree, there will be boomerang effects created by the controls on tourist expenditures. There can be no question but that these restrictions, if they work, will have an effect on the economies of foreign countries. There can be no question that these restrictions, if they work, will affect the capability of those countries to buy U.S. exports even if they are in a trade surplus position.

In general, the policymakers, with reference to the direct investment controls and to some degree at least also as to the controls on tourist expenditures, have not thought through on the counterproductive effects which will flow from these controls. They apparently live and think in a dream world that involves artificial separation of trade from capital flows into direct investment abroad. The two are inextricably related.

PHILOSOPHY AND CHARACTERISTICS OF THE ADMINISTRATION'S APPROACH

Let us first turn to the philosophy governing the administration's approach to the balance-of-payments difficulty which has worsened in recent months and examine the characteristics of that approach. Essentially the administration has taken a "controlist" and negative approach to the problem. For all practical purposes, the "new" program consists only of *controls*, principally in the area of foreign direct investment abroad and also in respect to tourist travel and expenditures.

Focus on controls—absence of incentives.—Although the President in his message on January 1 attempted to describe a more rounded program including certain incentives to exports and certain incentives that might be offered to induce repatriation of accumulated earnings, and although the special representative to the President for trade policy, Ambassador Roth, in hearings before the Ways and Means Committee referred to some negotiations with foreign Governments on nontariff barriers and tax rebates on exports, there is no current implementation of these noncontrol aspects. As developed in more detail later, the export assistance planks referred to by the President have been pending for years. The President's program now before the Congress consists solely of tourism controls; moreover, when and if the negotiations with foreign countries on nontariff barriers will produce anything in the way of substantial results is purely conjectural. This is hardly an approach involving a proper balance between punishing controls and incentives. Thus it is fair to say that the private sector, principally the business community, and the individual citizen who wishes to travel abroad are being asked to carry the principal burden of the program. We shall develop that this is paradoxical, at least as far as the business community is concerned, because the private sector has been the substantial plus factor in our balance-of-payments situation.

Absence of long-range view.—In addition to this fundamental aspect of the administration's approach toward the balance-of-payments difficulty, the action program that has been outlined is essentially short range in its objectives although lipservice is paid to the long range. The administration itself concedes the very salutary effects

on balance of payments which flow from foreign direct investment, but it is perfectly willing to restrict that foreign direct investment for what it considers to be a necessary short-term advantage. In our view, no substantial long-range program is outlined. And the administration is not even realistic about the disadvantages and boomerang potential for the short term of many aspects of the control program.

Burden.—Any system of controls involves heavy bureaucracy, painful paperwork, and serious disruption of normal activity. We can look for nothing better than the traditional incidents of control programs from the direct foreign investment and travel restrictions. Moreover, inequities will abound. In respect to burden, both in industry and Government, I suggest that the committee examine, or possible admit for the record, base period form FDI-101 with six supplements and instructions which has just come off the press and is due on a mandatory basis by March 22.

Effect on freedom.—Controls always involve serious restrictions on freedom. In any system of democracy, even in its purest form, it is impossible to practice complete freedom. But it has always been an essential part of the U.S. approach to government, to its institutions, and to all types of activity, human and institutional, to attempt to achieve maximum freedom consistent with the public interest. Any program which curtails freedoms must be undertaken only after the most careful examination of need, an appraisal of the probability of accomplishment of goals, and a determination to limit restrictions on freedom to the bare minimum. In our judgment, the control programs which have been launched by the administration, including the one in effect and the one now proposed to the Congress, meet none of these tests; indeed, they fail miserably. They were hastily conceived, weakly structured, and poorly rationalized. They are offered without any apparent appreciation of their perverse effects both in general and in respect to the policy objective of improving our balance of payments. They are offered without any real and credible assurances as to termination and without a definitive program for their supersession by longer range and more permanent solutions to a problem that has plagued this country for many, many years; namely, the balance-of-payments situation. It should be added that due consideration has not been given to the effect of these travel controls on foreign countries including their ability to import U.S. goods. We therefore consider it not only appropriate but we feel an obligation to contribute to the record of the joint committee and express our disapproval in principle and in substance with respect to these ill-conceived programs.

Do mandatory controls work?—In the annual report of the Council of Economic Advisers transmitted to President Johnson on January 25, 1968, under the heading "Price and Wage Policy," at page 119, the following statement appears:

Direct controls

The most obvious—and least desirable—way of attempting to stabilize prices is to impose mandatory controls on prices and wages. While such controls may be necessary under conditions of an allout war, it would be folly to consider them as a solution to the inflationary pressures that accompany high employment under any other circumstance. They distort resource allocation; they require reliance either on necessarily clumsy and arbitrary rules or the inevitably imperfect decisions of Government officials; they offer countless temptations to evasion or

violation; they require a vast administrative apparatus. All these reasons make them repugnant. Although such controls may be unfortunately popular when they are not in effect, the appeal quickly disappears once people live under them.

One need ask only the simple question: Is there any reason why mandatory controls as to foreign direct investment are more likely to work in a pragmatic sense or less likely to be repugnant to our system? It is our firm conviction that direct controls under the foreign direct investment program are certain to fail not only for some of the same reasons cited by the President's Council but because, as we have pointed out separately, they are addressed to an international scene involving the most complex elements one can imagine and having an impact on foreign governments and foreign entities as well as the interrelated factors of international commerce.

Reasons for commenting on travel restrictions.—Obviously from the standpoint of business spokesmanship, we believe that we can bring more experience, more knowledge and background to the committee on the subject of the foreign direct investment controls than is true in the case of the administration's proposals to restrict foreign travel by Americans. Moreover, there would be an understandable temptation for an organization such as MAPI to treat the tourism proposals of the Administration as more of a nuisance than anything else and therefore address ourselves only to other aspects of the administration's program. But we reject this temptation because it is our firm conviction that the philosophy which pervades the foreign direct investment control program is also present in the travel proposals which are directly before the Congress. And we do not believe that it is proper for the Institute cavalierly to say that the international travel controls can be lived with and all that needs to be done is to tinker with these proposals. We, therefore, submit criticisms and recommendations regarding restrictions on travel and travel expenditures.

Proposed Travel Tax and Tightening of Customs Treatment of Tourist Exemptions

Before proceeding to a more detailed consideration of the proposals before the Congress regarding travel and travel expenditures, let us state briefly our broad conclusions as to these recommendations.

As indicated in the introductory section of this statement, we feel that both the program of direct private investment controls and the foreign travel provisions reflect a preoccupation with a controls approach to an effort to improve the balance-of-payments program. The announced goal of the administration in respect to the statutory travel restrictions is a saving of $400 million in the balance-of-payments account. Although $400 million is by no means a small sum, in absolute terms it is a relatively modest goal in respect to the dimensions of our long-standing and continuing balance-of-payments problem. Moreover, it is our judgment that the actual saving will not approach the $400 million goal. Any technical or gross saving must be offset by the cost of administration to Government which we expect to be large, by the burden on the private citizen which will be substantial, and by the

cost to American business. One is tempted to conclude that the only persons who will be deterred from travel as a result of these restrictions will be the low-income groups. The businessman who must travel will travel. The persons of reasonable to affluent means will undoubtedly decide to pay the cost.

Even allowing for the stress of the administration on the objective of curtailed spending rather than trip cancellation, we think the goal will not be approached. In the net, therefore, we have a program conceived in a fundamental philosophy of controlism which will not even achieve its relatively modest goal and which will trigger a burdensome and complex system of procedures. These procedures not only will be annoying but they will be an encumbrance on the right of the American people to move freely on a domestic and international level except where the national interest absolutely makes it necessary to place restrictions on such movements. Beyond this, as usual, in terms of Government's approach to the solution of the balance-of-payments problem as we see it, not enough attention is being given on an action basis to affirmative means by which we may improve our net balance-of-payments position with regard to travel, taking into consideration both U.S. trips abroad and foreign trips to this country. Although there are practical limitations, we have done far from a good job in attracting tourists to the United States. One might conclude that it is a case of too many studies, too many "pronouncements" and not enough action. Let us hope that a really affirmative program will develop and be aggressively implemented in connection with the report of the White House Task Force headed by Ambassador McKinney. It should also be indicated that through the foreign direct investment control program, as we have pointed out above, businessmen will be put on a forced-draft schedule of foreign travel in order to try to compensate for the mischief which the Government is creating through its investment controls. In a word, the foreign travel restrictions aren't worth the price which will have to be paid for creating them, administering them, and living with their restrictive burden. There must be some more imaginative, some more affirmative, some more sensible approach to balance-of-payments improvement than is reflected in this proposal.

Broadening of the transportation tax.—The administration has proposed that the current 5-percent transportation tax on domestic air travel be extended to foreign air travel as well, and that it also be applied in the case of transportation by water. We can see some validity to taxing transportation by air and water to and from a foreign destination on the same basis as that applied to purely domestic air travel at the present time. So long as the tax is levied on fares paid in the United States, the collection problem would appear to be relatively simple. However, we have distinct reservations about attempting to deal with the problem of transportation taxes as part of a short-run program to cope with deficits in our balance of payments. We think it would be far better for Congress to consider taxes on air and water transportation in connection with

examining the current tax treatment of other types of passenger transportation. At that time, basic relevant features relating to equity, relative competitive positions, financial strength, etc., can be given adequate consideration within the framework of transportation facilities and needs as a whole. For this primary reason, we suggest that the Congress defer action on this proposal at the present time.

Tax on foreign travel expenditures.—Under the administration proposals, a tax would be imposed on the daily average expenditures for living, entertainment, and gifts, incurred by an American while traveling outside the Western Hemisphere. If this daily average expenditure figure exceeds $7, a tax of 15 percent would be imposed, while any excess over $15 would be taxable at a 30-percent rate. The tax would purport to be temporary with a scheduled expiration date of September 30, 1969, and it would not cover foreign travel of a student or businessman on a trip for more than 120 days.

The traveler would be required to make a declaration of the funds in his possession on leaving the United States. He would also have to pay an estimated foreign expenditure tax to the Internal Revenue Service at that time. On arrival back in the United States, the traveler would again report on his cash balance as he is processed through customs. Within 60 days he would be required to file a final return with the IRS, and the tax would be applied to the difference between the "departing" cash balance and the "returning" cash balance plus credit card charges and all other expenses attributable to the trip. A penalty of $200 would be imposed for failure to make a declaration of estimated tax and a statement as to cash balance. In addition, a penalty of 10 percent of the underpayment of estimated tax would be imposed for underestimation. Any difference between the original estimated tax and 80 percent of the actual tax shown subsequently on the return would be considered an "underpayment" for this purpose.

In general, we think that the proposed foreign expenditure tax should be rejected on the grounds that it is poorly conceived, highly arbitrary, difficult to comply with, and burdensome in the extreme for persons who have legitimate reasons to travel abroad. American industry, of course, would be forced to absorb the significant part of the burden of these proposals that would result from the application of the tax to American businessmen traveling abroad in the interest of their employers for periods of less than 4 months. The implications of this fact, of course, are significant in a number of ways: it penalizes the American businessman and his corporate employer at a time when he will be compelled by the foreign direct investment control program to travel more rather than less in order to attempt to make arrangements for borrowing and deal with administrative problems which will flow from the direct investment controls program; it runs up the costs of corporate American employers whose executives will be traveling; and adds to the inflationary impact both domestically and in terms of the company's ability to compete internationally.

What these proposals would evoke in the way of foreign countermeasures is a matter of conjecture, but we believe that the foreign

reaction would likely be swift and significant. Basically, we think that the tax would be an unjustified intrusion on the fundamental right of Americans to travel abroad, and we think for this reason alone the tax should be rejected.

Apart from matters of principle, we think it is clear that the techniques of requiring travelers to report cash balances on leaving and returning to the United States are going to cause tremendous administrative problems for the Internal Revenue Service and the Customs Service, and just as certainly there are going to be very difficult problems for travelers in attempting to distinguish between those expenditures which are subject to the tax and those which are not. Further, we request that the requirement for the final tax return to be filed within 60 days after the traveler's return to the United States is wholly unrealistic in terms of whether he can be expected as a practical matter to make a final accounting of his expenditures so soon after completing the trip. Clearly the $7 and $15 tax brackets as applied to daily average expenditures are wholly unrealistic in terms of what it costs Americans to travel abroad with any decent accommodations. Obviously it would be helpful to increase these dollar brackets considerably as well as to modify other aspects of the proposed procedures including the "60 day" final filing requirement, but frankly we think that the proposed tax is so bad fundamentally that we are reluctant to offer any palliatives which might make it endurable.

Tightening of customs exemptions.—Finally, the administration proposes to reduce the duty-free exemption on property brought into the United States by travelers returning from abroad from $100 to $10. A companion proposal would lower the duty-free exemption on gifts mailed from overseas from $10 to $1. These measures would not affect the interests of the companies we represent to any significant degrees. However, we think that they should be rejected on the ground that they are an integral, though an auxiliary, part of the overall package including the foreign expenditure tax and the broadened transportation tax.

We urge that the entire set of proposals now under consideration be rejected and that Congress express its desire that the administration come up with a broadened, imaginative, and "action" program of attracting foreign travel to the United States.

The Basic Policy Decision on Investment Controls

We have grave reservation about the basic policy decision to adopt a system of mandatory foreign direct investment controls and we also object to the structure of the control program implementing the basic policy decision. We deal first with the basic decision. Reasons for our opposition are sketched below and a more detailed analysis is set forth in the supplement to this statement.

A. *The wrong target.*—In the net, foreign direct investment is a favorable factor in our balance-of-payments situation when the

outflow of capital is measured against the return to the United States of subsidiary earnings, licensing fees and royalities. In addition there is the increase in exports attributable to foreign direct investment. This favorable position is true both presently and historically. The income returns on direct private investments abroad, on a cumulative basis for the last 13 years, exceed total outflow by $16 billion.

B. *Controls breed controls.*—Controls beget controls and once having established a control mechanism with respect to foreign direct investment abroad there is a grave danger that these controls will be tightened further, continued for an indefinite period of time, and lead to controls over other aspects of foreign trade. Our concern in this area is reinforced by the fact that there has been a trend toward control of private decision-making with respect to private investment abroad for a number of years. This trend [1] has been evidenced, for example, by the Interest Equalization Tax Act, the Revenue Act of 1962, the voluntary investment controls program, banking controls, etc. Moreover, it is impossible to accept with any credibility the "assurances" that are being offered currently that this is a temporary program. The country has had experience with "temporary" programs previously adopted that are now firmly embedded in our system.

C. *Protectionism in reverse.*—The control system that has been inaugurated represents protectionism in reverse. It is an attack on the ability of American industry to maintain and improve its position in international trade. It is a give-away to the competition. As for Europe, it is almost tantamount to a forced retrenchment of American industry's position in Europe.

In carrying on world trade in the broadest sense, American business confronts foreign competition abroad and at home. Nationalism and restrictionism abroad have created a wide variety of trade barriers. Regional trading blocs are growing in significance. U.S. private investment abroad has been a critical tool in our business effort to counter these obstacles. Now U.S. business' freedom to use that tool is being seriously disabled. The schedule of import-export ratios for certain capital goods products, shown on the next page, underscore a trend which should make it unthinkable for Government to support a mandatory investment controls program. There is a limit to what business can sustain.

D. *Invitation to protectionism.*—These controls represent an open invitation for the Congress to proceed toward protectionist measures with respect to imports, and a similarly open invitation to industries concerned with import problems to press for quotas and tariff increases. The administration cannot have it both ways. It cannot expect to adopt a restrictionist approach to foreign investment and hold the line with regard to the theory of free trade in other respects.

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[1] See the MAPI statement to the Joint Economic Committee, February 28, 1967.

IMPORT-EXPORT RATIO FOR MAJOR CAPITAL EQUIPMENT CATEGORIES

[Imports and exports in millions of dollars; ratios in percent]

	1960	1961	1962	1963	1964	1965	1966
Engines and parts:							
Imports	24	35	28	49	136	195	331
Exports	490	565	694	661	676	841	975
Ratio	4.9	6.2	4.0	7.4	20.1	23.2	33.9
Agricultural machines and tractors:							
Imports	135	115	152	172	195	249	327
Exports	565	541	558	645	825	865	860
Ratio	23.9	21.3	27.2	26.7	23.6	28.8	38.0
Office machines:							
Imports	68	75	85	98	104	136	191
Exports	208	310	324	362	434	471	557
Ratio	32.7	24.2	26.2	27.1	24.0	28.9	34.3
Metalworking machinery:							
Imports	37	34	41	48	40	63	135
Exports	293	391	435	347	408	332	338
Ratio	12.6	8.7	9.4	13.8	9.8	19.0	39.9
Textile and leather machinery:							
Imports	70	82	94	93	127	157	221
Exports	180	210	200	190	228	207	227
Ratio	38.9	39.0	47.0	48.9	55.7	75.8	97.4
Other nonelectrical machines:							
Imports	104	114	140	174	269	360	472
Exports	1,650	1,725	1,876	2,004	2,289	2,458	2,822
Ratio	6.3	6.6	7.5	8.7	11.8	14.1	16.7
Power machinery and switchgear:							
Imports	23	28	25	22	41	67	105
Exports	250	255	264	326	356	472	488
Ratio	9.2	11.0	9.5	6.7	11.5	14.2	21.5
Telecommunications apparatus:							
Imports	127	160	216	220	225	314	486
Exports	228	274	367	390	404	345	381
Ratio	55.7	58.4	58.9	56.4	55.7	91.0	127.6
Other electrical apparatus:							
Imports	136	146	174	177	177	259	425
Exports	612	696	730	777	905	844	1,030
Ratio	22.2	21.0	23.8	22.8	19.6	30.7	41.3
Machinery, nonelectrical, total:							
Imports	438	455	540	635	871	1,160	1,166
Exports	3,386	3,743	4,087	4,229	4,860	5,274	5,779
Ratio	12.9	12.2	13.2	15.1	17.9	22.0	29,0
Electrical apparatus, total:							
Imports	286	334	415	419	443	640	1,016
Exports	1,090	1,225	1,361	1,493	1,665	1,660	1,899
Ratio	26.2	27.3	30.5	28.1	26.6	38.6	53.5
Machinery, total:							
Imports	724	789	954	1,054	1,314	1,800	2,693
Exports	4,476	4,968	5,447	5,702	6,525	6,934	7,678
Ratio	16.2	15.2	17.5	18.5	20.1	26.0	35.1

E. *A long-range problem.*—The balance-of-payments problem has been with us for a decade. In our judgment, no long-range program for its solution has been developed by Government and yet it is clearly a long-range problem, not a short-range difficulty which lends itself to opportunistic, ad hoc, short-range palliatives. Not only does it not lend itself to this type of correction but the short-range prescription would be bad medicine in the long run. Not only has there been weakness in Government policymaking with respect to the long-range solution of this problem, but Government insists on trying to isolate from the balance-of-payments problem many domestic economic policies which have a direct and significant impact on our international payments position. Only when the administration desperately tries to find a new rationalization for a tax surcharge and avoid a substantial program of reduction in nonessential Government expenditures does it attempt in

its rationalization to relate domestic economic policy to international economic policy. On matters of domestic interest rates, for example, the Government posture is to proceed on the basis that the interest rate policy in this country must be set for domestic reasons irrespective of international balance-of-payments considerations. With respect to budgetary policy the same approach is adopted.

F. *An unbalanced program.*—The President's message of January 1 referred to a multifaceted program to deal with the balance-of-payments situation. From an implementation standpoint, the multifaceted program has, for all practical purposes, been discarded and reliance has been placed on controls, and in this respect controls primarily on private investment abroad. This is not a balanced program. It is not a program sound in its long-range implications. It even has strong disadvantages for the short run. And it would seem to reflect a preoccupation with control for control's sake.

G. *Bias against private investment abroad.*—Aside from the clear drift toward controls over private decisionmaking affecting private investment abroad, we are concerned that there is present in Government, at least to some degree, a tendency to frown upon private investment abroad, to punish it in some respects, and to attempt to direct, influence or control it for a variety of reasons. As we look back over the last several years, we believe that the record evidences these tendencies. For example, there is the attempt to control private investment abroad because of our policy with reference to developing countries. This involves a desire to direct private foreign investment into the developing areas and away from the developed countries, an objective which unfortunately not only is unrelated to balance of payments but is in conflict with balance-of-payments objectives because of the much greater ability of developed countries to produce a prompt and significant payback from investment therein. As previously suggested, the Revenue Act of 1962 is in some respects a control device with respect to private investment abroad. There have been statements made by Government officials to the effect that business has not done a good job in making its private investment decisions with respect to foreign countries, particularly in Western Europe in the last few years. This suggests that Government may undertake to second-guess decisions on matters as to which business is more experienced than Government; namely, where and why and how to invest their resources abroad.

Beyond this retrospective audit tendency, Government policy-makers have said on occasion that private investment abroad has been overdone. Such a statement, referring, specifically to the early sixties, was included in the 1967 Economic Report of the Council of Economic Advisers and quoted with approval by the "Blue Book" [1] of the Treasury just published. There undoubtedly is in the minds of some a conflict in reference to allocation of U.S. resources between domestic investment and foreign investment, be-

[1] "Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy," U.S. Treasury Department, January 1968.

tween domestic programs and projects abroad. And there undoubtedly are some in Government who would like to see Government reshape this allocation of resources to the detriment of private investment abroad and for the theoretical benefit of the domestic side. These tendencies, these signs, are not always crystal clear. But as we observe the Washington scene, as we read Government pronouncements, as we study the implications of the law and regulation affecting private investment abroad, we are obliged to assert that there is at least some evidence that the road along which we are now being led with reference to private direct investment is not only the wrong one but that our course is being fixed by considerations beyond balance of payments.

H. *Temporary or indefinite.*—In all candor, we have no confidence that Government has a determination to end this program of mandatory controls at the earliest possible date. As pointed out above, the record of Government with respect to such promises is poor. Moreover, as we have suggested, controls by their very nature seem to create an apparatus or bureaucracy which tends to perpetuate itself, and finally there is the built-in reluctance of Government to dismantle a program once it has been instituted. The judgments made here—which we believe to be widely shared in the business community, although not necessarily widely articulated—are underlined and strengthened by a conviction that there is no strong will to use this control program on a very short term basis, and to replace it at a very early date with something that makes more sense from a long-range standpoint. That something in the form of a long-range program does not appear to be on the horizon. We are not reassured by the exchanges between Ways and Means Committee members and administration witnesses on the issue of the temporary character of this program.

I. *Legal aspects.*—We are concerned as to the legal aspects of this program. At best it seems that the legal authority cited for the inauguration of this program without new legislation from the Congress is strained. It may be subject to challenge at least as to repatriation requirements. But let us take the more charitable view of the legal situation and assume that, by straining, the program can be justified on legal grounds and that furthermore there is realistically a natural reluctance on the part of business to try to assert contrary views on such a subject through lawsuits. Even if this is the case, we believe the administration should have accorded the Congress and the business community an opportunity to suggest alternatives to the mandatory program through public hearings or some other system of administrative procedure. In our judgment, whatever may be the answer to the legal question, to undertake a program of this type without hearings, without discussion of the issues, both from the Government and industry viewpoints, is unconscionable in terms of American institutions and American processes. We cannot overstate our deep concern with this aspect of the launching of this extraordinary system of controls on the part of the Federal Government.

J. *Administrative problems.*—Finally, no program, either in terms of conception or structure, particularly one involving con-

trols, can survive if it is bogged down by tremendous administrative problems. Although it is a little early to judge conclusively, there are signs that this program is almost unadministerable. In the first place, the processes of international investment are extremely complex. They involve foreign entities and foreign Government relationships. By their very nature these processes constitute a continuum over periods of years as distinguished from "stop and go," "in and out," moves which can safely be interrupted and turned on and off. As we will attempt to develop in discussing in more detail the structure of the control program, these characteristics of the foreign direct investment process, these complexities, these interrelationships make equitable, consistent, and reasonable administration almost impossible. And this difficulty is aggravated by the fact that the objectives of the program of controls are mixed, even partially contradictory, and are not exclusively tied to balance-of-payments considerations.

K. *Basic decision should be reevaluated.*—In the net, what is really needed is a reevaluation of the original basic policy decision. If Government is determined against that reevaluation, then clearly the structure of the control program itself must be thoroughly reevaluated and overhauled. Anything less than this will not only produce short and particularly long-range disadvantages to the public interest, but it may very well produce chaotic conditions in reference to the stream of business decisions which must go on. Those decisions, we should emphasize are not just cold, calculating, private decisions—they affect intercountry relationships, they affect employment here as well as abroad, they affect the balance of payments; in general, they affect the public interest.

Criticisms of the Structural Concept and Details of the Control Program and Regulations

General theory of the structure of controls.—The building blocks for the control structure over U.S. direct investments are these: First, the controls are addressed to capital outflows, reinvestment, repatriation of earnings, and the reduction and repatriation of certain liquid foreign balances. Second, restrictions on investment and mandatory requirements as to repatriation are defined by formulas which in turn depend upon the direct investor's experience during prior base periods. The base periods selected are 1965–66 for capital transfers and limitations on liquid foreign balances and 1964 through 1966 for repatriation of earnings by affiliated foreign nationals. Third, the countries of the world are divided into three schedules, with each schedule of countries given different treatment under the control formulas. For schedule C, consisting primarily of Western Europe and South Africa, there is an absolute moratorium on capital transfers from the United States and the toughest requirement as to repatriation is applicable. Schedule B, given a somewhat more moderate treatment, includes Japan, Great Britain, Canada, Australia, and certain oil-producing countries. Schedule A, for all practical purposes, consists of the so-called developing countries and they receive within the control system the most generous treatment. In applying the controls the company is required

to treat all of the countries in a given schedule as an aggregate. Four, it is the theory of the system that the impingement of controls on private decisions in the foreign investment field can be partially relieved by permission for companies to borrow abroad—or to guarantee borrowing abroad—with no immediate effect on the individual direct investor's current investment quota. Pertinent regulations contain, of course, detailed and complex provisions respecting application of the foreign direct investment program but the propositions just outlined comprise the heart of the control structure. In developing our criticisms of that structure, we give attention first to these basic elements and then turn to other aspects.

The base period.—Base periods arbitrarily selected for the application of controls always create inequities whether one deals with the excess profits tax, foreign direct investment controls, or any other area. The base periods adopted in this case are especially faulty because they discriminate against those companies whose performance under the Commerce Department's voluntary balance-of-payments program made especially important contributions to improvement of our international balance of payments. The base period for capital transfers discriminates against seasoned investors who did not substantially increase their foreign investment during 1965–66; similarly, the base period covering repatriation imposes a harsh standard on those companies which have good records of repatriation and especially when such a record is improved further by artificial increases during the base period in response to the voluntary program. Since so much of the inequity resulting from base period selection results from its identification with the period of the voluntary balance-of-payments program, it would seem that something approaching entrapment is involved.

The base period seems to have been chosen in part because certain aggregate data was available under the voluntary program for the base period years—a statistical reason that has no relevance to selection of a base for control purposes.

Aside from those inequities growing out of established base periods already cited, it may be useful to identify some additional problems from this source that have come to our attention. They include such cases as:

1. Direct investments before or after the base period which do not enter into calculation of the direct investment quota.
2. Abnormal earnings during the base period upon which the repatriation formula is based.
3. Ownership by two U.S. direct investors of unequal shares in an affiliated foreign national where both such investors have other foreign investments within the same schedule of countries. How are the investment and repatriation quotas to be distributed?
4. The latecomer to foreign investment with little or no investment during the base period and thus no base against which to work in the future.

Division of the world into schedules with preference for developing countries.—The adoption of the direct foreign controls program in one breath implies a balance-of-payments crisis but in another seems to say the situation is not so serious that we cannot accommodate the

policy objective of assisting developing countries. Doesn't the Federal Government have to make up its mind as to which policy objective is more important? The result is to blunt the objective of balance-of-payments improvement by accommodation of the developing country policy. The structuring of the program into schedules appears to reflect a determination to force a "retreat of American business from Europe," an area from which substantial dividends benefiting our balance of payments have been received. Paradoxically, the program gives favored treatment to investments in countries which are not, because of the stage of local economic development, capable of a quick and generous payout on such investments.

If there is to be a control program it would seem the administration should give absolute priority to the balance-of-payments objective. At the same time it should structure the control program in such a manner as to give business maximum flexibility with regard to its foreign investment decisionmaking. This argues clearly for abandonment of the schedule system and the adoption of a worldwide single application. Indeed, the voluntary program—acknowledged a resounding success by government—had the great virtue of preserving flexibility in corporate decisionmaking. With the mandatory program that flexibility is gone.

Obviously, a division of the globe, dictated by political considerations, arbitrarily prevents the normal flow of funds to those points which offer the greatest return on investment. Moreover, by "scheduling" the globe in the manner in which the regulation does, the administration has created a very great administrative problem for companies which have investments in more than one schedule because of the substantial lateral dealings between members of a group of affiliated foreign nationals across these arbitrary lines.

We are critical of the scheduled approach which compromises between the balance-of-payments improvement objective and the objective of favoring developing countries. We do not believe, for the reasons stated, that this further sacrifice of flexibility for American business within the control program can be justified and that the scheduled approach ought to be abandoned in favor of a single worldwide approach. Thus, assuming the controls program is continued, the total goal of the administration would not be changed. Business would be put in a more flexible position and the administrative nightmare created by the schedule approach would be avoided.

We recognize that the Federal Government has a longstanding national policy of helping developing countries which is believed to be in the interest of the United States as well as international development. We adhere without hesitation and irrevocably to the proposition that pursuit of this objective should not result in a further burden on, or creation of a further inflexibility for, business with regard to the total private investment effort, particularly under a control system. If the Government wishes to give some extra boost to the developing countries in the light of the imposition of a controls program, it should not discriminate against developed countries under the controls program but should provide some direct incentive for investment in the developing countries. This is already being proposed through negotiation of tax treaties and undoubtedly the Treasury Department, together with

other interested departments, could develop a more potent incentive in this respect. At the same time that we make this comment, we insist that first things must come first and if the administration feels that the balance-of-payments problem is the central problem, then it ought to treat it as such and not attempt to splinter its effort.

A realistic look at foreign borrowing.—A central part of the theory of the foreign direct investment program is the proposition that the program is designed primarily to reduce outflows and increase repatriation of earnings and that foreign direct investment may be carried on at a reasonably high level by recourse to foreign borrowing. This proposition stands up better in theory than it does in reality because of certain very important restrictions on borrowing facilities and on the borrowing freedom and capacity of companies involved:

1. In the first place capital facilities abroad are limited although they are developing. This is true even in sophisticated areas like Western Europe, and it is even more true in areas like Latin America and the Orient. Foreign capital markets obviously already serve domestic customers and as their requirements increase, so the load on the capital market from domestic institutions and companies grows. The United States, as a result of the pressures of the voluntary balance-of-payments program, has added very substantially to the burden on foreign capital markets. While the Eurodollar market is still available to larger companies at rates not greatly above those of the United States, it is not yet clear what the effect of increased borrowings by U.S. firms will be on the cost and availability of these funds. With respect to borrowings in national currencies, we understand that there is already speculation that some countries may be compelled to ration credit in the near future in ways that would adversely affect the access of U.S. companies to local capital markets.

2. Beyond these limitations in terms of size, flexibility, and similar factors, we understand that certain foreign countries have specific restrictions by law, regulation, or practice against borrowing for certain specific purposes; for example, borrowing to pay dividends may be limited or prohibited.

3. As previously indicated, many companies have already borrowed heavily abroad in response to the voluntary program. The servicing of these obligations will place a substantial burden on foreign affiliates' financial structure and to some degree the parent company, and might in turn require further borrowing when other factors are taken into consideration including the points below.

4. The repatriation requirement of the mandatory control program places an effective limit on all types of foreign borrowing in many cases. Clearly, payments of principal under foreign borrowing agreements are not accounting deductions prior to the calculation of earnings so that the foreign creditor and the United States—under the mandatory program—will be competing for the same dollars. The effect is to partially close the escape hatch presumably provided by foreign borrowing.

5. Because of the manner in which the repatriation requirement affects many, many companies subject to the mandatory controls program, the repatriation requirement plus debt service cannot

be met out of current earnings abroad. Thus, there will be additional pressure for this reason on borrowing outside the United States.

6. Further, one should not overlook the costs of borrowing—either in the form of increased interest charges to the parent corporation or in the form of reduced earnings of the foreign affiliates. At a time when the administration is addressing itself so persistently and strongly to the inflation problem and at a time when the administration is very much concerned about exports and the effect of costs increases on the ability of companies to increase their export position, the additional costs which will be involved in borrowing abroad are wholly inconsistent with either of these considerations.

Only in the light of these limitations and influences can one examine realistically the degree to which foreign capital markets will sustain—and foreign affiliates or their parents will have the capability and the flexibility to borrow to sustain—increased borowing by U.S. affiliates for necessary expansion or new investment in order to maintain a sound position in international trade.

To sum up, the ability and freedom to borrow abroad in order to compensate for the restrictions imposed by mandatory investment controls is limited. Moreover, it will be especially limited for the small-and medium-sized company. Further, the impact on the foreign countries may very well be adverse and produce restrictions or resentment and the impact on the total costs of the American worldwide operation could very well be substantial.

It should be said in conclusion with respect to the so-called borrowing alternative that these limitations on borrowing coupled with the severe restrictions of the direct investment program create an even more serious factor. American business just can't maintain its position in international trade in a total sense if a dynamic approach to foreign direct investment is thwarted. This point, of course, is relevant throughout our statement, but it is emphasized here in the context that borrowing is not the panacea which some in Government and other circles may believe to be the case.

Adverse effect on exports.—In the context of the structure of controls, and at the risk of repetition, may we emphasize again the perverse effects on exports. The overriding point is that there is a definite relationship between investment abroad and exports with the two rising together. Studies made by the Department of Commerce have documented this fact strikingly. ("U.S. Exports to Foreign Affiliates," *Survey of Current Business*, December 1965.) Reduced foreign investments cannot fail to affect exports unfavorably both in terms of sales to U.S.-owned affiliates and in terms of reducing foreign exchange availablity to foreign countries. Moreover, at least one element of the control program, specifically that provision of the regulation which is interpreted to mean that increases in open account balances between a U.S. parent and its foreign affiliate represent capital investment, will tend seriously to curtail exports. Indeed, it could tend to place a ceiling on exports to schedule C countries where there is a moratorium on capital outflows.

As we have indicated previously, and as the free trade philosophy of this country reflects, exports are limited by the ability of foreign coun-

tries to import. Both the direct foreign investment controls and the proposed tourism programs will reduce the capacity of foreign countries to buy from the United States. In conclusion on this point, it is our judgment that merely cleaning up technical points in the regulation cannot correct the inequitable conflict between a desire on the part of this country to increase its exports and net trade balance and the actions taken to restrict foreign direct investment and the proposals regarding tourist expenditures. We are obliged to observe that the administration ought to read its own pronouncements about the need for maintaining free flow of trade, about the interrelationship between various elements of trade, and about the fact that we cannot isolate the United States from the rest of the world and maintain our position in world trade and improve our balance of payments.

Other shortcomings.—There is a wide range of other deficiencies or fallacies in the structure of the controls program. They can be summarized as follows:

A. The foreign direct investment program clearly raises the possibility of foreign reprisals by countries disaffected or disadvantaged by one or more elements of the program. An example is provided by the requirement of repatriation of earnings. Foreign countries wishing to react against the U.S. interests could adopt any one or a combination of approaches. There could be an embargo or partial embargo placed on repatriation to the United States of an affiliated foreign national's earnings or a possible increase in taxes on such items as management fees and earned royalties, and, of course, a possible restriction on investments in the United States by foreign nationals. Clearly, forced and enlarged repatriation of earnings to the United States is disadvantageous to the host countries. We can't believe that foreign countries will not react by some means.

B. There will undoubtedly be special unfavorable impacts on some foreign countries. The Canadian problem which has already been recognized in a special statement by the Treasury Department is a perfect example.[1] Belgium may be another; England certainly another. It is not necessary to elaborate on the fact that England is already in serious trouble. The controls on investment and possible restrictions on tourist expenditures are certain to hurt England further. In addition, the general reduction in our capital flows abroad and the proposed restrictions on tourist expenditures will reduce foreign countries' ability to import from the United States.

Finally, it will be very difficult for this country to respond in an entirely even-handed manner to meritorious arguments ad-

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[1] Treasury Department release, Jan. 21, 1968:

"There have been reports that, during the past week or two, some Canadian subsidiaries of U.S. corporations have been transferring abnormally large amounts of funds from Canada to the United States and that these transfers have resulted in some pressure on the Canadian dollar in the exchange market.

"The new U.S. balance-of-payments program does not call for and is not intended to have the effect of causing abnormal transfers of earnings or withdrawals of capital by U.S. companies having investments in Canada. Moreover, the U.S. Government has already made it clear, and now repeats, that Canadian subsidiaries of U.S. corporations are expected to act as good corporate citizens of Canada. The new U.S. balance-of-payments program covering private capital flows and the Canadian exemption from the interest equalization tax provide scope for continued large flows of capital to Canada."

vanced by countries unfavorably affected by our new control programs. We have already responded to the Canadian difficulty and in a manner which is hardly consistent with the investment controls philosophy and approach. It is entirely possible that some private actions in the planning stage which will be interrupted, restricted, or canceled because of the new controls are of such significance to foreign governments that they will receive attention at the diplomatic level. The international politics will vary from country to country and from complaint to complaint as they develop among our friends abroad. It is absolutely naive to proceed on the assumption that our friends abroad will do nothing while being adversely affected by the controls program.

The relationship between U. S. direct investors abroad and the host country, both in the short and long term, is a very important factor in the ability of a company or an industry to operate flexibly and with dynamism in the foreign area. Sometimes clearances or government approvals abroad are necessary in order to establish the proper kind of relationship. When these procedures are interrupted or hobbled by withdrawal action of the U.S. Government affecting our U.S. direct investors, the impact will not stop with the short run. The relationship between the U.S. company or industry and the foreign host country may be interrupted or set back for a great many years to come. This, of course, is implicit in the whole process of international trade including direct investment abroad which cannot be operated on an "off-again-on-again" basis.

C. So restricted are the foreign direct investment regulations that they permit no credit to the direct investor's current investment quota for such inflows of capital as purchases by foreign affiliates of American equipment, receipts of royalties or management fees and receipts representing an increase in export sales. Each of these items makes a positive contribution to our international balance of payments and should, in our judgment, authorize at least a partially offsetting liberalization of the current investment quota. Indeed, if this program is to be continued in effect, this kind of safety valve could go far to mitigate the very harmful long-range effects of the mandatory program by providing an incentive for enlarged current contributions to our balance of payments which in turn would make possible current investments not otherwise authorized and which would yield returns in the future.

D. Now let us turn to a central problem with regard to the direct investment controls program; namely, its administrability, both from the standpoint of government and industry. Before proceeding with our criticisms, we should like to make it clear that the Institute is very much aware of the tremendous administrative burden placed suddenly—almost overnight—on the Department of Commerce. The personnel involved in this program are making a valiant try in administering what we consider to be a nonadministrable program and a program which is thoroughly fallacious in conception. They have been particularly zealous to try to assist in urgent situations where, as President

Johnson indicated, firm commitments were involved and almost immediate answers were required in the form of special authorizations. But we are obliged to conclude that no matter how conscientious or industrious the administrative organization within government is, it cannot possibly make this new creature of government work either in the public interest or in the private interest. The almost incredible variety of businesses and business situations to which this program must be applied makes it virtually impossible to come up with a single program fairly applicable to all. And it is our firm conviction that the program as originally announced cannot be patched up. It needs to be dismantled and reevaluated on a 100-percent basis.

It is by now obvious that issuance of a general authorization—for action not otherwise permitted under the regulations—is an excruciating experience for the Department of Commerce—made so probably for the very same reasons described above in respect to the difficulty in establishing a single broad program. As a result we have had to go the special exemption, case-by-case route and we shall probably have to continue on that basis under the present program.

The reporting burden on business will be immense. For example, there is the necessity of converting to accounting reports responsive to accounting principles generally accepted in the United States, the products of accounting systems responsive to foreign rules of accounting, the delays involved in the collection of information necessary to complete reports from all affiliated foreign nationals and the magnification of that latter problem in the case of those affiliated foreign nationals in which the U.S. direct investor has only a minority interest.

An obvious administrative problem involves a combination of two points already discussed. Where a U.S. direct investor holds a minority interest, he may find it impossible to comply with the repatriation requirement either because of foreign law or the intransigence of a foreign boards of directors. In either case, it will be necessary for him to obtain a specific exemption from the literal application of the regulations which adds in turn to the case-by-case administrative burden already noted.

E. Despite the fact that we have been encountering balance-of-payments difficulties for some years, the Treasury Department has not been as flexible as it might be in making tax changes with regard to section 482 and other aspects of the Code to encourage repatriation of foreign earnings on a purely voluntary basis.

Under the controls now in effect there will undoubtedly be some unfavorable tax impact on U.S. companies triggered by the repatriation requirements. This is discussed in more detail elsewhere in this statement. Suffice is to say that in some situations where, for example, manufacturing income abroad is involved and the repatriation is not voluntary but forced under the regulation, there will be tax consequences in the United States. There is no provision in the control program for relief from these effects. This problem is doubly serious from the standpoint of public policy because the program was instituted by government on the

basis of alleged legal authority grounded in an ancient statute and without consultation or approval by the Congress in which is vested the taxing authority. Finally, as indicated elsewhere in this statement, the administration has apparently dropped its tentative plan to offer tax inducements to repatriate accumulated earnings.

Affirmative Recommendations

We turn now to an identification and discussion of certain affirmative recommendations which we believe should be considered, first as an alternative to the controls programs that have been instituted or proposed, or as accompanying steps in the event the investment controls remain in effect for at least a limited period of time and the proposed tourist restrictions are legislated. We recognize, of course, that Congress may choose to permit the foreign direct investment program to continue solely as an executive branch effort, although it may see the need for legislation in some areas such as those aspects of the program involving taxation. We will deal first with the nontax aspects.

1. *A prompt return to a voluntary system affecting direct investment abroad.*—Although we have certain misgivings about even a voluntary system of restrictions on foreign investment, it is clearly preferable to mandatory controls. It preserves maximum flexibility for decisions to be made in the marketplace and for management to consider various approaches to meet established goals. It avoids the very costly machinery of control from the Government viewpoint and it relieves business of the tortured process of formal compliance, Government conferences, tedious paperwork, exacerbation of relationships with partners abroad, etc. By preserving an important degree of flexibility, it will make business better able to avoid some of the perverse effects of the mandatory program—as, for example, a reduction of exports and a disruption of total world trade planning—which will inevitably flow even in the short run from a rigid system of controls. Both from the Government and private viewpoint, it will facilitate the avoidance of gross inequities arising either from the fabric of the control system or from the varying circumstances attendant on individual company positions.

As already acknowledged by Government, a voluntary program can accomplish a substantial adjustment in the balance-of-payments situation at an acceptable cost in terms of both national policy and private impact. In sum, when all of the adverse factors of mandatory direct foreign investment controls, as outlined herein, are taken into consideration, it is our firm belief that the net performance of the voluntary system will be at least as productive as that which can be achieved under mandatory controls. We recommend, therefore, that the spectacular move which the administration felt obliged to take on January 1 should be reversed at the earliest possible date.

2. *Foreign investment and domestic fiscal policy.*—Up to a point we agree with the administration's position concerning the fiscal situation in the United States. We accept the proposition that perhaps the most serious aspect of our balance-of-payments problem is to be found in domestic policy. Continuing budgetary deficits—huge deficits—which inflate the economy and thus raise the costs of exporting companies are a grave threat to our international competitive position.

We do not accept the proposition that the 10-percent surcharge is necessarily the keystone of a program of correction of deficiencies and fallacies in our domestic economic policy. On the contrary, we believe that the weight of Government action in this area should be placed on substantial, very substantial, reductions in nonessential Government expenditures. We do not believe that the administration has gone far enough in this direction and we sympathize with the attitude of the Ways and Means Committee as reflected in its deliberations thus far which seem to conclude that:

> First, a clear and unmistakable economic case must be made in terms of business conditions in the United States for a tax increase; and, second, that even with such an economic case persuasively made any tax surcharge must be conditioned upon a substantial decrease in nonessential Government expenditures.

The institute feels that a much more substantial reduction in nonessential Government expenditures must be promptly undertaken. If a tax surcharge is enacted, it is to be hoped that expenditure reductions would at least equal revenue from the tax increase.

In brief retrospect, the exports of the United States have been maintained at a remarkable level when one considers the disadvantage at which U.S. exporters are placed by domestic economic policies which include high-wage policy, inflationary fiscal policies, and an inescapable subordination of international commercial policies. As previously indicated, until the administration sought a new argument for its surcharge proposal and pressed for the tax surcharge as the centerpiece of its balance-of-payments program, the general posture of the Federal Govcernment has apparently been to consider the domestic economy in isolation from international economic commercial considerations.

3. *Prompt implementation of export expansion proposals.*—The President's program, as outlined in his message of January 1, includes a number of recommendations affecting export financing, including a special $500 million fund for liberalized export insurance and export credit guarantee facilities, and prompt development of improved rediscount facilities. In addition, intensified export promotion activities under the aegis of the Department of Commerce was proposed.

All of these ideas, all of these recommendations, have been urged upon Government by business for a number of years. They have not been dynamically implemented, in some respects they have not been implemented at all. One is entitled to ask whether there is an element of window dressing in the current revival of these proposals.

The President's message acknowledged that the United States was at a disadvantage because of the practice of foreign countries, permitted under GATT, to provide export rebates of indirect domestic taxes. The testimony of Ambassador Roth before the Ways and Means Committee is not reassuring as to the likelihood of early action for improvement in this area. This problem has existed for a decade or more. The fact that nothing has been done about it is unmistakable evidence that the Federal Government has not attacked the balance-of-payments problem on a consistent, hard-hitting, long-range basis. On the contrary, when an aggravation occurs it is dealt with on an ad hoc, panic basis.

Why have these export assistance objectives and programs referred to in the President's message not been fully implemented before? Why has this problem of nontariff barriers not received more attention? Why does this practice of foreign countries with respect to export rebates or border taxes go unattended from a policy viewpoint for so many years?

We can only conclude as we have already stated that these problems have been brushed under the rug and they are now being restated and related programs revised in order to provide a sense, and we believe an artificial sense, of balance to this program of controls on foreign direct investment and tourist expenditures. Without going into detail, obviously action should be taken along these lines particularly with regard to the export assistance programs, but the fact that such action is taken is neither an excuse nor a rationalization for the controls aspects of this program. Nor should they be permitted to obscure the fact that the heart of the new balance-of-payments program is the control structure which applies primarily to direct investment abroad and banking activities.

4. *Modification of the control structure if it is continued.*—We have already alluded to certain points which we believe should be given central attention if a control system on direct investment abroad is to be continued even for a short period of time. If the administration is unwilling to acknowledge its mistake, scrap the mandatory system of controls and revert to voluntary controls or none at all, then it should dismantle the present structure of controls and do the job all over again, allowing sufficient time and thought to develop something a great deal more equitable in concept and workable in practice. The notion of segmenting the globe into schedules of countries should be scrapped. In restructuring the controls, if they are to be continued, a group of incentives should be built into the system. For example, a bonus or special allowance for private investment abroad—in terms of increased investment quotas or reduced repatriation requirements—might be granted to the company which improves its export position. Some direct allowances or bonuses in the system should be given to increases in royalties and licensing fees which are returned to the United States. In brief, a company's total performance in contributing to improvement of the Nation's balance of payments should be given direct and express recognition.

5. *Tax aspects of the required repatriation of foreign subsidiary earnings.*—In his message on the balance-of-payments problem, the President reported that he had directed the Secretary of the Treasury, in effect, to consider the possible desirability of legislative proposals to induce or encourage the repatriation of accumulated earnings by U.S.-owned foreign businesses. We understand from the administration testimony before the Ways and Means Committee that Treasury has looked into the problem and has decided not to make any such proposals, at least not at this time. We think that this is unfortunate because there are obviously a number of things that can be done to encourage American companies to repatriate pre-1968 accumulated earnings which are not subject to the requirements of the mandatory direct investment control program. These same measures could also be used to lessen the tax impact on current earnings that are subject to the mandatory controls.

The Department of Commerce regulations require what it describes as repatriation of earnings. So far as we know, there is no requirement that such earnings necessarily be remitted in the form of dividends. This apparently means that loans or advances from the subsidiary to the American parent company would satisfy the requirements of the Commerce regulations. However, in many situations the payment of such advances or loans would be impossible or impractical from the viewpoint of the foreign subsidiary because of the laws or policies of the country within which it is located, and also because of financial and other operating considerations relating to the subsidiary itself. In any event, we think that certain things might well be done by the U.S. Government to make it easier for companies to comply with repatriation requirements. We suggest that the Treasury and the Internal Revenue Service should issue an official announcement to the effect that interest-free advances from a subsidiary to the parent would not be considered "constructive dividends," at least to the extent that such advances were made pursuant to the direct investment control program. In addition, the Treasury might well attempt to persuade foreign governments to follow policies which would permit companies within such jurisdictions to make loans or advances to American shareholders in connection with the U.S. balance-of-payments program in cases where such loans or advances might not be permitted at the present time.

Where because of foreign law or because of other circumstances the repatriation of funds must be in the form of a dividend, it certainly would be appropriate to permit deferral of the U.S. tax on that dividend. Such deferral might extend for a stated period of time such as 5 years or possibly even for a period of time that would be determined for each individual company on the basis of its past experience with respect to dividend payments from foreign subsidiary earnings. Here we are talking about dividends from foreign subsidiary earnings that are not "foreign-base company income" and therefore are not taxable to the American parent company until received in the form of dividends. If for some reason it is determined that such deferral is impractical or undesirable, the Government should consider granting some type of tax reduction with respect to foreign subsidiary dividends.

6. *Tax incentives for exports.*—Just over 2 years ago the Action Committee on Taxation of the National Export Expansion Council, chaired by Mr. Carl A. Gerstacker, board chairman of the Dow Chemical Co., presented to the Department of Commerce and the President a series of proposals relating to taxation and designed to encourage U.S. exports. In brief, these proposals were as follows:

> We recommend three specific areas of administrative action which will help to remove tax barriers to exports:
>
> 1. The realistic administration of laws providing for reallocation of income and expenses between related companies: Recent Treasury efforts to clarify practices in this area have been helpful but guidelines on the reasonableness of selling prices are needed.
>
> 2. The adoption of rules on the repatriation of funds and the use of foreign tax credits when reallocations have been

made by the Internal Revenue Service between related companies, consistent with policies now governing tax years prior to 1963.

3. More liberal policies on the transfer of industrial property to foreign corporations in tax-free exchanges to permit favorable rulings in more cases.

We also recommend four specific areas for legislative changes in the tax provisions:

1. Less complicated and more liberal rules for export trade corporations under section 970 of the Internal Revenue Code.

2. An additional capital allowance for equipment producing goods for export.

3. An incentive deduction for promotion expenses in connection with export sales.

4. The extension of the investment tax credit to purchases of U.S.-produced equipment abroad.

The administration has taken at least limited action in response to the committee's recommendations for administrative action. With regard to the second administrative recommendation, the Treasury has extended special procedures relating to repatriation of funds and us of foreign tax credits following a "section 482" allocation to 1963 and 1964. We strongly urge that such procedures be extended to all periods prior to the promulgation of new section 482 regulations which the Treasury has not yet issued.

However, the administration's reaction to the first three of the legislative proposals has been negative—at least there has been no official comment on them, much less any indication that the administration will support them. We note that in this connection Senator Smathers of Florida, a senior member of the Senate Finance Committee, has introduced S. 2574 which would implement that part of the committee's proposals relating to the liberalization of the present Internal Revenue Code provisions relating to export trade corporations. We think that favorable action along the lines of this set of proposals would do much to stimulate U.S. exports which cannot fail to be adversely affected by the direct investment control program.

SUPPLEMENT TO MAPI STATEMENT

THE U.S. BALANCE OF PAYMENTS AND THE GOVERNMENT'S MANDATORY RESTRICTIONS ON DIRECT PRIVATE INVESTMENT ABROAD—A DETAILED EXAMINATION

INTRODUCTION

The administration's U.S. balance-of-payments program announced on January 1 represents but another in a series which have entailed progressively more restrictive controls over the movement of dollars in international markets. The major difference in the latest program is that the measures just taken far exceed anything which has been attempted heretofore. They are mandatory and unprecedented. These steps were taken, of course, in response to a renewed attack on the dollar and a deteriorating balance-of-payments situation which accelerated sharply in the fourth quarter of last year. In light of this deterioration, and if one accepts a continuation of the enlarged U.S.

military commitments abroad as essential, it would be irresponsible to oppose any or all measures to halt and reverse this decline in our payments position. The question is whether these particular measures are sound. When viewed within the context of the Government's approach over the past decade toward this country's chronic balance-of-payments problem, the current program has, in our opinion, serious implications for the future. Certain elements are in our judgment particularly regrettable and could, in the retrospect of the early 1970's, prove to have been tragically wrong.

MAPI has, of course, reviewed this problem on several occasions.[1] However, the extent and the nature of the actions just taken are sufficiently serious that it is desirable to reconsider once again the nature of the problem we are facing. This analysis is confined to the mandatory controls over direct private investment abroad.

MAJOR SHORTCOMINGS OF THE CURRENT PROGRAM

Program Deals With Symptoms Rather Than Causes

Our basic concern about the current program is that it is directed at symptoms rather than the causes of the problem. This is not new. It is the history of the Government's approach toward the recurring U.S. balance-of-payments difficulties.

The assumption appears to be that we are dealing with a temporary phenomenon which presumably calls for short-term restrictive measures. (Indeed, the current program, as in the case of earlier programs, was announced as a temporary one.) But history shows us that this is not the case. The U.S. balance of payments was first recognized as a serious problem following the huge balance-of-payments deficit incurred in 1958. More than a decade has passed and we are still seeking ways to correct it. More than once we have been led to believe that the restoration of a healthy payments position was imminent, but that hope never has been realized.

The problem has been attributed to various causes from one period to another. At one time a declining trade surplus was fingered as the major difficulty. At another time rising capital outflows were assigned the blame. Most recently, of course, our difficulties have been attributed to the Vietnam war. The persistence of the deficit, however, makes it clear that we have been suffering from a basic imbalance—that is, our international commitments consistently have exceeded our current resources. We have, in a very real sense, been continually drawing on our capital without, in the interim, taking steps to match our commitments to our current availabilities.

Given the fact that we are confronting more than just a short-term problem calling for temporary emergency measures, it should be clear that palliatives are insufficient, and that our basic economic policies must be responsible and realistic. In this connection, it is regrettable, for example, that at a time when unemployment remains relatively low and we have suffered a particularly rapid increase in costs and prices we are simultaneously experiencing a domestic budget deficit of huge proportions which only can have further damaging effects in terms of the international competitiveness of the U.S. economy.

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[1] See, for example, *U.S. Manufacturing Investments Abroad and the Government Program for Balance of Payments Improvement*, Machinery Institute, 1965.

Our concern would be somewhat relieved if the current program were really a temporary measure designed to buy time while we "get our house in order" or until there is a lessening of Vietnam war requirements. However, even should we attribute most of our current difficulties entirely to the Vietnam war, there is as yet no clear indication that this war will be any less of a drain on our resources in the foreseeable future. More important, the balance-of-payments problem long preceded the Vietnam war, and there is no solid evidence to indicate that it will not outlast it. We have entered the 11th year of deficits which have been considered unacceptably large, and a solution is not yet in sight. Such a history, together with the new program, provides ample evidence that the Government has not taken sufficient advantage of the time purchased by earlier programs.

Hasty Action; Widesweeping Coverage

Of further concern to us is the apparent haste with which the current program was drawn up and its broad coverage. It is particularly difficult to understand, with respect to controls over sectors which do not appear to have been under any undue pressure, why more time was not taken to consider their positive contribution in the light of all the facts. At the very least, greater deliberation in the drafting of additional controls would have avoided many of the administrative problems which have already arisen.

The current program, which was undertaken in response to a huge fourth quarter deficit of $7.3 billion (at seasonally adjusted annual rates), was drawn up so hurriedly that not even preliminary figures were publicly available for the fourth quarter at the time of its announcement. Indeed, preliminary data were not made publicly available until February 15 or 1½ months following the initiation of the program.

While the preliminary data fail to identify movements in certain sectors, including the direct investment sector, they do show that an important part of the fourth-quarter deficit resulted from a nonrecurring type transaction, namely the liquidation by the British Government of some $500 million of U.S. securities in order to defend the exchange value of the British pound. Another important factor was a $720 million decline in our non-military merchandise trade surplus reflecting a sharp rise in imports and a small decline in exports.

These two items account for some two-thirds of the total deficit. While other major adverse movements have not yet been identified, there is no reason to suppose that capital outflows into direct private investment (that is, investment in brick and mortar as opposed to portfolio investments and the buildup of other dollar assets abroad) contributed to the large adverse movement in the fourth quarter. On the contrary, one would expect direct investment, unlike other types of private capital, to be generally insensitive to currency devaluations. Accordingly, it is particularly unfortunate that the administration applied hastily devised controls to the direct investment sector. Indeed, there is still no indication that stringent direct investment controls were called for at all. Developments in this sector were very favorable in the first three quarters of last year, as described below.

Growing Controls Over Private Sector

This is the crux of the problem in our view. Recent history leads us to question whether the Government really has the will to make and execute the difficult decisions necessary to assure a healthy payments position in the absence of controls. A more likely prospect seems to be a continuation of strict controls on the private sector while the Government attempts some restraints in certain areas within the public sector but continues to increase its overall world commitments.

Certain steps have, of course, been taken from time to time within the government sector but they have been entirely inadequate as is conspicuously demonstrated by recent events. Further, prospects are not good for a matching of commitments with availabilities in the foreseeable future.

The Vietnam war has, of course, resulted in a rapid acceleration in our international commitments. At the same time, there has been no clear evidence that, prior to the new program, any really strong efforts were made to cut back significantly in other public sector areas. We may note, for example, that U.S. Government grants (excluding military) and long-term capital outflows increased from $4.2 billion in 1964 to $4.4 billion in 1966 and to an annual rate of $5.6 billion in the first three quarters of 1967. While much of this was probably Vietnam related, the fact that the size of last year's increase was so large suggests that efforts to undertake cutbacks in other areas probably were minimal. Yet, additional steps could have been taken as evidenced by the fact that several measures have just been initiated. But, relying in part, no doubt, on beneficial effects from the voluntary balance-of-payments program, the Government simply had an inadequate sense of urgency until it felt forced to take further strong measures, and again the major burden of these measures is placed on the private sector.

There is little reason to believe, against this background, that Government intends that the present controls will be lifted in the near future. Insofar as U.S. international commitments are concerned, there is certainly nothing on the horizon to indicate that they will be reduced any time soon. Indeed, the contrary would seem to be indicated in view of the continuing Vietnam conflict, trouble in Korea, and Britain's increasing withdrawal from world commitments which creates strong pressures for a corresponding increase in U.S. commitments. Further, the longer controls on the private direct investment sector remain in effect the more difficult it will be for control-minded Government to rationalize removing them. For the favorable impact of such investments will tend to diminish with time as a result of their reduction, while the potential investment opportunities will accumulate. It follows that the adverse short-run effects of removing the controls will increase over time.

Danger of Restricting Ability of Private Sector To Contribute to Reductions in Payments Deficits

The tragedy of maintaining these controls over an extended period is evident. As our international commitments continue to mount, a major means of supporting them (in the form of currency inflows generated by direct investment activity abroad) is being seriously impaired. This fact, combined with the lack of an adequate sense of

urgency on the part of the Government and the consistent tendency to act belatedly and with insufficient vigor to correct our basic payments imbalances, can ultimately have serious repercussions.

By way of pointing up our concern about the continuing ability of the private sector to support public commitments abroad we should point out that our balance of payments was already showing a deterioration prior to the fourth quarter due in a major degree to the increasing deficits in the public sector accounts. The overall deficit (on a liquidity basis) has shown some decline in 1964 and 1965 but reflected no further improvement in 1966 and then moved in a strongly adverse direction in the first three quarters of last year to a seasonally adjusted annual rate of $2.3 billion, and increase of $0.9 billion over the entire year 1966. (See table below.)

SELECTED U.S. BALANCE-OF-PAYMENTS TRANSACTIONS

	1966	1967 [1]	Change
Merchandise trade surplus	+3.66	+4.35	+0.69
Capital outflows into direct private investment, net	−3.46	−2.89	+.57
Income from direct private investment (including fees and royalties)	+5.09	+5.40	+.31
Other long-term private capital outflows, net	−.26	−1.14	−.88
Short-term private capital outflows, net	−.41	−1.02	−.61
Government grants and capital outflows, net [2]	−3.45	−4.25	−.80
Military expenditures	−3.69	−4.25	−.56
Military sales	+.85	+1.17	+.32
Overall balance [3]	−1.36	−2.28	−.92

[1] First 3 quarters at seasonally adjusted annual rates.
[2] Excluding "Military grants of goods and services," "U.S. Government pensions and other transfers," and "Official reserve assets."
[3] Detail does not add to total because only selected items are shown.

This overall deterioration in our payments balance occurred despite a major improvement in the first three quarters of 1967 in both the merchandise and direct investment sectors. Our merchandise trade surplus (converted to a seasonally adjusted annual rate) showed an increase of $0.7 billion over 1966. At the same time, capital outflows into direct private investment abroad declined by $0.6 billion, and income from direct private investment (including fees and royalties from such investment) rose by $0.3 billion for a net improvement of $0.9 billion in the direct private investment sector. These improvements were more than offset, however, by large adverse movements in other sectors. There was a major adverse movement in Government grants and capital outflows which increased by $0.8 billion in the first three quarters of last year (at seasonally adjusted annual rates) over 1966, and there was a large increase in the rate of military expenditures abroad (by some $0.6 billion) although this was offset to a significant degree by an increase in the rate of military sales abroad ($0.3 billion).

Adverse movements were also experienced in "other private capital outflows" with other private long-term outflows increasing by $0.9 billion and short-term outflows by $0.6 billion over 1966 in the first three quarters of last year (both at seasonally adjusted annual rates). These offset in part the favorable movements in the trade and direct private investment sectors. It can be seen, however, that major elements contributing to the adverse movements were in the Government sector.

Inasmuch as the Government sector continued to be the prime con-

tributor to the balance-of-payments deficit (the merchandise trade and private investment sector together have consistently contributed to the plus side of the payments balance) and in light of the large increase in the payments deficit on Government account last year, the Government should, in our view undertake further intensive efforts to reduce the deficit in its own sector. We so conclude even though we must recognize the necessarily adverse effects of Vietnam developments on the Government sector.

More importantly, in view of the private sector's historic role in reducing the payments deficit incurred in the public sector, the Government should be careful to avoid taking steps which will impair the ability of the private sector to fulfill that role in future years, particularly since the history of the last decade strongly supports the proposition that that role will be at least as essential and probably more so in the future.

A CLOSE LOOK AT DIRECT PRIVATE INVESTMENT ABROAD

In seriously restricting direct private investments abroad and, more specifically, in flatly prohibiting further direct private capital outflows to most of Europe (excluding the United Kingdom and certain less advanced countries) the Government is taking a step which could have most unfortunate effects for the future of this country's international payments position.

Role of U.S. Corporations in Minimizing Payments Deficits

It is ironic that the Government should be taking such drastic action against U.S. corporations at this particular juncture. According to President Johnson's statements and the U.S. Department of Commerce reports on the Government's voluntary program to improve the U.S. balance of payments, American business has cooperated closely and has stayed well within the targets set under that program. Further, corporations made a substantial contribution toward minimizing the balance-of-payments deficit in 1967, as noted earlier, with direct private capital outflows declining significantly and remittances from direct investment abroad continuing their long-term climb. Finally, there is every indication that capital flows to Europe, which have been heavy in recent years but which appear to have declined sharply last year from 1966, will continue at more moderate levels in the future. There is a growing consensus that Europe's future growth rates will be markedly slower than they were prior to the 1966–67 recession. This should be reflected in reduced U.S. corporate investments in that region. The latter is suggested, for example, by recent surveys (e.g., the U.S. Department of Commerce) indicating a reduced rate of expansion in plant and equipment spending by U.S. subsidiaries and affiliates in Europe in 1967 and very little growth in 1968. At the same time, remitted earnings from past investments in Europe could have been expected to continue their rapid increase with a reduction in European capital requirements, particularly as recent investments became seasoned and hence more profitable.

It is true, of course, that U.S. capital outflows to Europe in the first three quarters of 1967 ($1.5 billion at annual rates) continued to exceed remittances from such investments ($0.7 billion at annual rates)

but the size of the difference is diminishing as outflows are beginning to decline and remittances are continuing to show substantial increases. Further, this difference is highly misleading because dollar inflows generated by investment in Europe exceed dollar outflows into such investments by a substantial volume when one takes account of the export impact of such investments and of royalties and management fees deriving from these investments.

For example, we estimate that U.S. exports to European affiliates of U.S. companies exceeded $1.5 billion last year and this estimate excludes exports that would have occurred in the absence of these affiliates.[1] This itself is far greater than the adverse differential between remittances from and outflows to direct U.S. investments in Europe last year. Further, there is the added income in the form of royalties and management fees from direct European investments which were at an annual rate of some $450 million in the first three quarters of last year. Hence, it is clear that the positive contribution to the balance of payments deriving from direct European investments is very large indeed.

A Strong Adverse Impact Can Be Expected From Controls on Direct Investment

It is perfectly apparent that a flat prohibition on capital outflows to Europe will have an immediate favorable impact on the U.S. balance of payments by eliminating outflows while inflows continue. This favorable impact must be discounted even in the short run because of detrimental effects on exports which will flow from the control program. Moreover, given the long-term nature of our balance-of-payments problem and the unfortunate fact that payments controls, once established, often take on a permanent aspect, the ultimate effects of the mandatory controls on direct investment can be highly detrimental. For they will reduce the ability of this key sector to help in offsetting the large Government sector payments deficits which have trended strongly upward and, on the basis of the historic record, can be expected to continue in that direction.

By way of illustration, we will consider the new controls on foreign investments. We recognize, of course, that conclusions drawn from a partial analysis of the balance-of-payments accounts must necessarily be qualified because of the interdependence of the various sectors. For example, restrictions on the outflows of direct private investment capital tend to lower interest rates in this country by increasing the supply of domestic funds, thereby discouraging the inflow of foreign capital. Similarly, to taken another example, a cutback in Government aid programs overseas tends to depress exports to the extent that they are tied to the purchase of U.S. goods. (Indeed, we feel that the President's objective of an overall improvement of $3 billion in our payments balance as a result of the new program is far too optimistic because it is based on this sector-by-sector approach.) Nonetheless, despite the limitations of a partial analysis, it should give some indication of the self-defeating aspects of the proposed controls insofar as the direct investment sector is concerned.

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[1] We developed a rough estimate of $1.7 billion using U.S. Department of Commerce data. This represents only the roughest of approximations but does give some notion of the order of magnitude of the export impact. Assumptions underlying these estimates and other details concerning their derivation are described in the attached appendix and tables.

We will further confine our attention to controls on European investments since this has been the area of greatest investment activity in recent years and is now subject to the most rigid controls. We pose the question, "What would have been the result had the controls instituted on January 1 of this year been introduced on January 1, 1959, following the large balance-of-payments deficit in the preceding year?" (These controls prohibit capital flows to direct investment in most European countries, excluding the United Kingdom and certain less-advanced countries, and permit reinvestment of earnings in an amount no more than 35 percent of average annual investments in Europe during 1965–66. The remainder must be remitted to this country.) The consequences of introducing this program 9 years ago, when the U.S. balance of payments was first recognized to be a problem, would have been roughly as follows.[1]

Adverse impact on balance of payments.—The book value of direct investments in Europe (excluding the United Kingdom) would have been in the neighborhood of $4 billion at yearend 1966 instead of $10.5 billion. Earnings from such investments would have been about $517 million in 1967 instead of actual earnings in the neighborhood of $750 million. Remittances would have totaled $233 million in 1967 instead of roughly $473 million. Exports to European affiliates of U.S. companies would have totaled some $417 million instead of roughly $1.1 billion. (We have excluded from both export estimates, those which could have been expected to take place in the absence of U.S. affiliates.)[1a] Management fees and royalties from U.S. investments in Europe (excluding the United Kingdom) would have been roughly $119 million instead of $297 million.

In 1967 the dollar inflow from these three factors combined—i.e., remitted earnings, royalties and management fees, and exports would have been in the neighborhood of $769 million instead of some $1,878 million. Assuming actual outflows in 1967 of $1,129 million to Europe (excluding the United Kingdom) the balance-of-payments effects would have been only slightly more favorable if the ban on capital outflows (inflows totaling $769 million) had been instituted in 1959 than they actually were in the absence of the controls (i.e., $1,878 million income less $1,129 million outflows for a favorable balance of $749 million).[2]

It is true, of course, that our international reserve position would have been somewhat improved inasmuch as the net impact of the con-

[1] It should be stressed that these figures represent only the roughest of approximations. Again, our purpose is only to give some general notion of the magnitudes involved. Assumptions underlying these computations are described in the appendix. Results are shown in the tables attached to the appendix.

[1a] We should note in this connection that, given the nature of the export impact, even the immediate effect of the ban on capital outflows is vitiated to a marked degree by a significant reduction in the exports that otherwise would have taken place. This is because a significant portion of U.S. capital invested in U.S. affiliates abroad has been in the form of capital equipment for installation in new, expanded, or modernized facilities and there has also been a substantial export of materials, parts, and components for further processing or assembly in U.S. facilities in Europe.

[2] Less onerous restrictions have been applied to investments in other developed countries including the United Kingdom, Canada, Australia, Japan, and the oil-producing countries of the Middle East. The adverse impact would have been correspondingly less than that for investments in continental Europe. For example, rough estimates suggest that if these controls had been instituted on Jan. 1, 1959, the value of direct U.S. private investments in these countries at yearend 1966 would have been roughly $21.8 billion instead of an actual value of some $26.8 billion. It appears on the basis of historical data that the restrictions on investments in countries other than those comprising these two groups would have a minimum impact on the investments of a majority of companies.

trols would have been favorable in the earlier years. Indeed, although the favorable differential diminishes under our hypothetical illustration during the period under review,[3] it persists through 1967. Nonetheless, our present posture would have been far worse. Our cumulative deficit on direct investment account (in the absence of offsetting reactions in other sectors) would have been reduced by about $3.1 billion from the end of 1958 through the third quarter of last year (from $22.2 to $19.1 billion). The nature of the deterioration in our international reserve position since yearend 1958 suggests that some 36 cents out of every dollar accumulated abroad was converted into gold (with much of the remainder held in the form of dollars and short-term dollar claims).[4] On this basis we may speculate that our gold holdings would have been about $1.1 billion greater and our short-term liabilities about $2 billion less at the end of last year's third quarter than they actually were. Our gold holdings would have declined from $22.5 to $16 billion (instead of to $14.9 billion) and our short-term liabilities would have grown from $15.4 to $26.8 billion (instead of to $28.8 billion).

This difference of $3.1 billion out of a cumulative deficit of $22.2 billion would hardly have been sufficient to set at ease the world's concern about the U.S. position in view of our immense international commitments and the direction in which we have been moving. Further, this favorable cumulative differential would have been increasingly dissipated as the favorable annual differential turned adverse. The favorable annual differential would have virtually disappeared in 1967, and almost surely would have turned adverse this year based on our illustration. And, of course, if such rigid controls over direct investment had already been instituted along the lines of our assumption, the Government would have been unable to fall back on such controls (voluntary or otherwise, permanent or temporary) in an attempt to alleviate the situation which we face today.

One final point should be made concerning our hypothetical illustration. It might be argued that, being unable to use U.S. capital and for accomplishing their investment objectives in Europe, U.S. companies and their affiliates would have borrowed abroad to this end with favorable effects for the U.S. balance of payments. Such borrowing would not have been reflected in increased book values of U.S. investments, inasmuch as the Commerce Department treats foreign loans as liabilities to foreigners rather than U.S. companies. However, it might have served to increase earnings to book value ratios to the extent that the added earnings attributable to the use of the borrowed funds exceeded interest costs and it might also have raised somewhat the ratio between U.S. exports to European affiliates and the value of their investments in those affiliates, insofar as the borrowed funds

[3] This favorable differential is, of course, less than the difference between the actual value of investments at the end of a given year and what that value would have been under the controls. That is to say, the reduced level of investment values resulting from the controls is by no means a measure of the improvement in the payments balance that we might have expected as a result of their imposition. The reduced investment resulting from an elimination of capital outflows brings in its wake a comparable reduction in earnings and a corresponding reduction in funds available for reinvestment (and for remittance to the United States) leading in turn to a further reduction in investments greater than the reduction in capital outflows resulting from the controls. This adverse effect is cumulative, of course, as the divergence between actual foreign earnings and those which would have occurred in the absence of controls becomes ever wider. Eventually, the adverse effects from the reduction of earnings from which remittances (and reinvestments) can be made more than offsets the favorable effects resulting from the prohibition of outflows and the controls thereby prove ultimately to be self-defeating.

[4] See appendix for explanation.

facilitated increased purchases from the United States. On the other hand, some companies presumably would have been unwilling to borrow abroad, more would have at least reduced their commitments, and companies without established reputations or contacts abroad would simply have been unable to gain access to foreign capital. Indeed, given the limited development of capital markets in Europe and elsewhere, capital would not have been available on anywhere near the scale needed to replace U.S. sources and the borrowing costs would, of course, have been increased, perhaps sharply. Finally, we feel that we have, in any case, been very conservative in our estimates to the point where we have tended to understate the adverse effects that could have resulted from the controls. In short, we do not consider that including the effects of foreign borrowing in our illustration would have significantly modified the conclusions.

We do not wish to unduly labor the point insofar as our specific illustration is concerned. We feel, however, that the thrust of our argument is so important that it was better brought home when stated in specific terms, thereby indicating the dimensions of the problem that could be created if such a program were maintained for longer than a short period of time. On the basis of this illustrative example, and given further growth in U.S. international commitments and the glaring failure of the Government to correct the basic causes of the current problem over the past decade, it would be appropriate to ask how in the light of the new program, the private sector could be expected indefinitely to continue to offset the deficits caused by the public sector.

Adverse Impact on International Competitiveness of U.S. Industry

While the direct balance-of-payments impact of the restrictions is of major importance in considering the significance of the new controls, other factors are of at least equal weight. The inability to invest any capital in European facilities from the United States reduces very greatly the flexibility of response essential for U.S. industry if it is to maintain its competitiveness against foreign industry in both domestic and foreign markets. The inability, for example, to establish new plants abroad in order to serve areas which can no longer be served from U.S.-based facilities because of cost or other considerations enables foreign companies to move at once to preempt that market. Or, to take another example, the inability to enter into a partnership or joint venture with a foreign firm whereunder each partner supplies new capital to the venture, may result in the prospective foreign partner's turning to another foreign company to serve this objective. In this connection, it should be stressed that such a total ban on capital outflows can seriously damage the international position of U.S. companies even if it is of relatively short duration. Timing is a central ingredient in maintaining a company's competitive position, and an opportunity not grasped when it presents itself is often lost forever.

As such lost opportunities accumulate, we will find a greater portion of the imports into this country and of sales into third country markets will be from foreign-owned industry, and the earnings and dividends deriving from such sales will accrue to foreign companies rather than U.S. companies to the detriment of the U.S. payments balance and the strength of U.S. industry. By the same token, we will find that a greater proportion of equipment, components, and parts will

be purchased from other than U.S. suppliers. The results will be strongly adverse for the U.S. balance-of-payments position and the international competitiveness of American industry.

Further, it is those industries which are not yet established abroad but which are finding foreign operations increasingly necessary in the face of stiffened foreign competition which will be hindered most by these restrictions because more often than not they will have less access to foreign capital markets and, of course, internally generated funds from their foreign operations are minimal. Yet, it is these very companies whose need is greatest for establishing themselves in foreign markets in order to maintain a competitive position both abroad and at home in the face of rapidly increasing foreign competition.

Conclusion

In conclusion, we cannot emphasize too strongly two of the basic underlying reasons for our grave concern over these developments; namely (1) the indefinite nature of the controls and (2) the inability or unwillingness of Government authorities to take adequate steps to develop a healthy balance-of-payments position within the context of freely competitive markets, and to set realistic public policy objectives consonant with available U.S. resources. Considering the first, one has only to look at the history of controls over the past decade. Once imposed they have normally been maintained. This has been the case, for example, with the interest equalization tax and the voluntary program to improve the balance of payments which were both introduced as "temporary" measures and which have evolved into the rigidly restrictive mandatory programs which have now been imposed.

As to the question of developing a healthy balance of payments, the Government seems incapable of bringing itself to undertake in a vigorous manner the necessary steps to this end. Instead of adequately using the time purchased with the increased restrictions to pursue policies which can increase the international competitiveness of the U.S. economy (or, alternatively, to cut back on our international commitments), the Government seems to find temporary improvements in the payments balance resulting from such restrictions and excuses to continue on the same economic course only to conclude that controls have to be tightened even further at a later time.

It must, of course, be recognized that the Vietnam war is an important factor underlying the present difficulties and, unfortunately, there is no clear indication that the resources directed to this war can or will be reduced significantly in the near term future. However, this is almost beside the point. While the extent of our foreign commitments have no doubt been increased because of Vietnam, they have been heavy throughout the post-World War II period, taking the form or large-scale military and economic commitments in extended areas of the world.

It has long been apparent that even the United States has limited resources and that realistic public goals must be established with this fact in mind in order to avoid sapping the strength of the private sector in the pursuit of short-term goals to the point where there will ultimately be no alternative to a sharp, involuntary reduction in international commitments to the detriment of the country. We must find a proper balance between our foreign and domestic objectives.

If we feel certain international requirements to be sufficiently urgent we must either accept certain sacrifices on the domestic front or cut back on other international objectives. We must, in short, establish a realistic scale of priorities in terms of available resources, and postpone less urgent requirements.

Our major concern is that we will continue to put too great a burden on the private sector in order to carry out publicly established objectives both at home and abroad without regard to the adequacy of our resources. In so doing we may place such a burden on the private sector as to significantly impair its ability to compete commercially and to support important publicly established objectives in the future.

It is our contention that we are doing precisely that today. We are impairing the future ability of American industry to support important public policy requirements. In accord with this general line of thinking, and the recent course of history, it appears likely in our view that, in lieu of easing controls with a lessening of Vietnam war requirements, the U.S. Government may well, on grounds of urgency, take on added international (as well as domestic) obligations and maintain the present controls with unfortunate effects both for industry and the country over the longer term. We are convinced that if these controls are maintained beyond the very near term future the effects will be very serious.

APPENDIX

ESTIMATED BALANCE-OF-PAYMENTS IMPACT FROM INSTITUTING CONTROLS OVER DIRECT PRIVATE INVESTMENTS IN EUROPE AT YEAREND 1958

The following is a description of the methods used in estimating the impact on the U.S. balance of payments that would have occurred had the new controls over direct private investments in most of Europe been established at yearend 1958. Results from our computations are shown in the attached tables.

1. The new controls specify the following: New capital outflows from United States to direct private investments in most of continental Europe are prohibited. Earnings in excess of 35 percent of average annual investments in 1965–66 (or the percentage of earnings remitted during 1964–66) must be remitted annually from most of continental Europe. The larger figure is controlling.

2. It was assumed that the current program was instituted at year-end 1958 and maintained to the present time. This would have meant (*a*) that new capital outflows to Europe were prohibited beginning in 1959, and (*b*) earnings in excess of 35 percent of average annual investments in 1956–57 had to be repatriated or the same percentage of each year's earnings had to be repatriated as was repatriated during 1955–57. The larger figure is controlling. (In our computations it developed that the 35 percent requirement was controlling through 1964 when the percentage of earnings requirement became controlling.)

3. It was assumed that U.S. corporations remitted only the minimum required amount. This amounted to $191 million annually for the years 1958 through 1964 and $202 million, $217 million, and $230 million in 1965, 1966, and 1967, respectively. The remainder of the earnings from these investments was reinvested.

4. The rate of return in each year was assumed to be 13 percent as measured against book value at the beginning of the year in question. The actual annual rate of return averaged 13.2 percent during 1956–61 and then began to decline, reaching 8.2 percent by 1966; it averaged 10.5 percent during 1962–66. Part of the decline was a result of the large increase in investments during this period which led to an increasing proportion of facilities which were not yet fully pro-

ductive. Another part can be explained by some decline in the rate of return on European investments generally during the last few years. Of course, the increase in U.S. investments would have been reduced in the face of the above investment restrictions, thereby reducing the extent of the decline in the rate of return. Hence, we simply assumed that the rate of return was 13 percent throughout. The volume of earnings so computed less the volume of computed remittances was added to beginning-of-year book value to estimate book value at the beginning of the following year.

5. A relationship between U.S. exports and U.S. investments in Europe (excluding the United Kingdom) and the value of these investments at the beginning of the year in question was "guesstimated" on the basis of data published by the U.S. Department of Commerce covering the years 1962, 1963, and 1964. Department of Commerce data show estimated total exports to U.S. affiliates in Europe (including the United Kingdom which is not shown separately) in those 3 years. (Sample data were expanded to estimated totals by the Commerce Department.) We deducted from the estimated totals one-half of the value of exports other than exports of capital equipment and parts, components, and materials for further processing or assembly in the case of exports to affiliates other than trading affiliates, and we deducted two-thirds of exports other than capital equipment and parts, components, and materials for further processing or assembly in the case of exports to trading affiliates.

The deductions were made on the basis that they would have taken place even if said foreign affiliates had not been established. This admittedly involved guesswork. However, we feel that the deductions were more than adequate. The local incorporation of U.S. affiliates to promote greater local identification and greater acceptance of the company and its products, and the creation of a permanent interest on the part of the company in European markets unquestionably have been important elements in the export volume enjoyed by those companies. Further, such local acceptance no doubt helped to promote the sale of U.S. manufactured goods through channels additional to those included in the Commerce survey.

We then computed the ratio of the residual exports values in each year (1962, 1963, and 1964) to the value of total U.S. investments in Europe at the beginning of the year in question and averaged the three ratios. Estimated exports derived on this basis were $860 million, $880 million, and $1,103 million in 1962, 1963, and 1964, respectively, and the computed ratios were 11.1, 9.9, and 10.7 percent, respectively, for an average of 10.6 percent (rounded to 10.5 percent). On the basis that the ratio for total Europe was reasonably representative of that for Europe excluding the United Kingdom we applied it to beginning-of-year investments in Europe excluding the United Kingdom for each year including in our review to estimate the volume of exports generated by such investments over this period which would not have taken place in their absence.

6. Finally, we computed the ratio of fees and royalties from U.S. investments in Europe (excluding the United Kingdom) to the beginning-of-year value of such investments for each year from 1960 through 1966. Such data are not readily available for the years prior to 1960. The ratio was 2.8 and 2.9 percent in 1960 and 1961, respectively, and ranged from 3.2 to 3.4 percent thereafter. We used a figure of 3 percent which we applied to the estimated book value data to get estimated royalties and fees.

Estimated Effect on U.S. International Reserve Position From Instituting New Controls at Year-End 1958

It was assumed in the discussion of the U.S. international reserve position (pp. 9–10) that 36 percent of the increase in foreign dollar holdings resulting from the cumulative deficit between yearend 1958 and the end of September 1967 was converted into gold with the remainder held in the form of dollars and short-term dollar claims. This assumption was derived in the following manner:

The cumulative deficit from the end of 1958 through the third quarter of 1967 ($22.2 billion) has been accompanied by increased short-term liabilities and reduced gold holdings of a comparable magnitude over this period (i.e., an increase of $13.4 billion in short-term liabilities and a decline of $7.6 billion in gold holdings for a total adverse movement in our reserve position on this account of $21.0 billion). On the basis that the relative change in dollar liabilities versus gold holdings over the period reflects the propensity of foreigners to hold dollar claims in lieu of presenting such claims for gold, it follows that 36 percent of this cumulative deficit was converted into gold with the remainder being held largely in the form of short-term dollar claims.

Thus, the statistics show the following:

[In billions of dollars]

End of period	Short-term liabilities	Gold	Net adverse change
1958	15.4	22.5	
September 1967	28.8	14.9	
Net change	+13.4	−7.6	21.0

Note.—Of the total net adverse change, 36 percent ($7,600,000,000) comprised a reduction in gold, the remaining 64 percent ($13,400,000,000) comprising an increase in short-term liabilities.

TABLE I.—U.S. BALANCE OF PAYMENTS ON DIRECT PRIVATE INVESTMENT ACCOUNT WITH EUROPE EXCLUDING UNITED KINGDOM—RELATION BETWEEN BOOK VALUES, EARNINGS, REMITTANCES, AND REINVESTMENTS UNDER HYPOTHETICAL ILLUSTRATION

[In millions of dollars]

Year	Beginning of yearbook value (value in preceding year plus reinvestments (col. 5))	Earnings (0.13 ×col. 1) [1]	0.45 ×col. 2 [2]	Minimum remittance requirements [3]	Earnings less remittances [4] (reinvestment or additions to book value)
	(1)	(2)	(3)	(4)	(5)
1959	[5] 2,426	315	142	191	124
1960	2,550	332	149	191	141
1961	2,691	350	158	191	159
1962	2,850	370	166	191	179
1963	3,029	394	177	191	203
1964	3,232	420	189	191	229
1965	3,461	450	202	191	248
1966	3,709	482	217	191	265
1967	3,974	517	233	191	284

[1] Assume return on investment equals 13 percent. (See appendix text.)
[2] Assume 45 percent of earnings must be remitted if this exceeds 35 percent of investment in 1956–57. (See appendix text.)
[3] Assume 35 percent of investment in 1956–57 (or $191,000,000) must be remitted unless or until 45 percent of earnings exceeds $191,000,000; 45 percent of earnings exceeds $191,000,000 beginning in 1965 and hence the larger amount must be remitted. (See appendix text.)
[4] Col. (2) less col. (4) or col. (5). (See footnote 3.)
[5] Actual value.

TABLE II.—U.S. BALANCE OF PAYMENTS ON DIRECT PRIVATE INVESTMENT WITH EUROPE EXCLUDING UNITED KINGDOM DOLLAR INFLOWS AND CAPITAL OUTFLOWS—ACTUAL AND HYPOTHETICAL SITUATIONS COMPARED

A. ACTUAL

[In millions of dollars]

Year	Actual beginning-of-year book values	Estimated exports (equal 0.105 ×col. 1)	Actual royalties and fees	Actual remittances	Actual outflows	Balance (col. 2+ col. 3 ×col. 4—col. 5)
	(1)	(2)	(3)	(4)	(5)	(6)
1959	2,426	255	[1] 73	162	−294	196
1960	2,846	299	80	171	−373	177
1961	3,451	362	100	240	−528	174
1962	4,171	438	143	309	−697	193
1963	5,106	536	147	308	−800	281
1964	6,168	648	197	378	−1,174	49
1965	7,562	794	242	498	−1,162	372
1966	8,862	931	306	475	−1,421	291
1967	10,548	1,108	[2] 297	[2] 473	[2] −1,129	749

B. ESTIMATED

Year	Estimated beginning-of-year book values	Estimated exports (equal 0.105 ×col. 1)	Estimated royalties and fees (equal 0.03 ×col. 1)	Estimated remittances [3]	Hypothetical outflows	Balance (col. 2+ col. 3 +col. 4—col. 5)
	(1)	(2)	(3)	(4)	(5)	(6)
1959	2,426	255	73	191	0	519
1960	2,550	268	76	191	0	535
1961	2,691	283	81	191	0	555
1962	2,850	299	86	191	0	576
1963	3,029	318	91	191	0	600
1964	3,232	339	97	191	0	627
1965	3,461	363	104	202	0	669
1966	3,709	389	111	217	0	717
1967	3,974	417	119	233	0	769

[1] Estimated at 3 percent of beginning-of-year book value. Actual figure not available for 1959.
[2] First 3 quarters at annual rates.
[3] See table I.

TABLE III.—U.S. BALANCE OF PAYMENTS ON DIRECT PRIVATE INVESTMENT ACCOUNT WITH EUROPE EXCLUDING UNITED KINGDOM—ACTUAL AND HYPOTHETICAL FLOWS COMPARED

[In millions of dollars]

Year	Book values		Outflow, income and balance						Cumulative balance	
	Estimated	Actual	Estimated			Actual			Estimated	Actual
			Capital outflows	Return dollar flow	Balance (col. 4 —col. 3)	Capital outflows	Return dollar flow	Balance (col. 7 —col. 6)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1959	2,426	2,426	0	519	519	294	490	196	519	196
1960	2,550	2,846	0	535	535	373	550	177	1,054	373
1961	2,691	3,451	0	555	555	528	702	174	1,609	547
1962	2,850	4,171	0	576	576	697	890	193	2,185	740
1963	3,029	5,106	0	600	600	800	1,018	218	2,785	958
1964	3,232	6,168	0	627	627	1,174	1,223	49	3,412	1,007
1965	3,461	7,562	0	669	669	1,162	1,534	372	4,081	1,379
1966	3,709	8,862	0	717	717	1,421	1,712	291	4,798	1,670
1967	3,974	10,548	0	769	769	[1] 1,129	[1] 1,878	749	5,567	2,419

[1] First 3 quarters at annual rates.

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

By GROVER W. ENSLEY, EXECUTIVE VICE PRESIDENT

In the expectation that other aspects of the President's and Council's 1968 Reports will be considered elsewhere, this statement will be directed primarily to the President's recommendations for improving the flow of residential mortgage credit, and particularly to his recommendation that the Federal savings institutions bill (H.R. 13718) be enacted as a means of accomplishing this vital goal of national policy. This major and urgent piece of legislation deserves full and prompt consideration by the Congress.

It would go a long way toward mitigating the basic problem of the residential mortgage market which, stated quite simply, is a tendency to swing rapidly between periods of abundance and periods of scarcity. While mortgage flows have always been sensitive to cyclical developments in the economy, this sensitivity has significantly worsened during the 1960's. It was, of course, most dramatically evident during the great financial squeeze of 1966. And today, little more than a year after homebuilding began to recover from the depths it had plumbed in late 1966, concern is once again growing over the possibility of yet another decline in mortgage flows and housing.

While the major recent and prospective concern centers on the problem of mortgage credit scarcity, it should not be forgotten that only a few short years ago the principal problem was an overabundance of mortgage money relative to basic housing demand. This led not only to a significant reduction in the quality of mortgage credit in some areas of the country, but also strongly affected the ability of many institutions having narrow investment powers to extend mortgage credit during the subsequent period of financial stringency in 1966. Since scarcity is likely to be the major mortgage market problem in the foreseeable future, attention in this statement will be directed toward this serious aspect of the problem, with the reminder that any long-range program to counter the worsening cyclical instability of mortgage credit must also be responsive to the problem of potential overabundance as well.

The problem of cyclical swings in residential mortgage credit, and particularly the danger of a chronic shortage of mortgage funds in the years ahead, has worsened during the 1960's primarily because the major suppliers of residential mortgage credit—mutual savings banks and savings and loan associations—have found it increasingly difficult to generate funds for mortgage lending in the new economic, financial, and savings market environment that has appeared in recent years. Both types of institution channel almost all of their savings growth into residential mortgages. Together, during the postwar period, they have supplied almost three-fifths of the total increase in residential

mortgage credit, with savings banks dominating FHA and VA mortgage markets and savings and loan associations dominating the market for conventional loans. As 1966 so graphically demonstrated, when they are unable to compete for lendable funds, the flow of mortgage credit and the level of homebuilding are severely restricted.

Short-Run Policy Implications

The immediate short-run cause of savings institutions' and housing's troubles in 1966 was the failure to adopt adequate fiscal restraints to dampen inflationary pressures in a full-employment economy. This forced the Federal Reserve to shoulder most of the responsibility for containing inflation, with the result that open market interest rates were pushed to levels not seen in more than a generation. The rise in open market rates in turn triggered a massive round of "financial disintermediation," as individuals shifted a record volume of funds from savings accounts into direct open market instruments.

This process was temporarily reversed in 1967 as short-term open market rates fell sharply earlier in the year, but by yearend individuals were again responding to rising interest rates by shifting funds into open market investments. Preliminary data for the Federal Reserve's flow of funds accounts, for example, indicate that households channeled almost $15 billion into such direct investments (at seasonally adjusted annual rates) in the fourth quarter of last year, only slightly less than the peak volume reached in the second quarter of 1966. Flows into savings accounts at thrift institutions and commercial banks, by contrast, fell by more than half to an annual rate of less than $18 billion in the fourth quarter of 1967, slightly less than the low reached in the fourth quarter of 1966. Savings flow data for January, moreover, indicate that savings and loan associations experienced a net savings outflow of more than $200 million—the largest net outflow for the month on record—and that the net savings gain at mutual savings banks was almost two-fifths less than the January 1967 record.

A repetition of the 1966 mortgage credit squeeze in 1968 hopefully can be avoided, however. Thrift institutions have strengthened their liquidity and are not so heavily committed as they were in 1966, while the Federal Home Loan Bank System is also in a substantially stronger position to extend needed assistance. Nevertheless, the current high level of short-term open market interest rates, and the possibility of further increases under the pressures of a stronger shift to monetary restraint and continued heavy Treasury deficit financing in the short-term area, indicate that financial disintermediation and renewed declines in housing may well be a serious matter of concern in 1968. Together with the prospects for strong inflationary pressures outlined so clearly in the President's and Council's reports, and the need to maintain international confidence in the strength and stability of the dollar, these considerations strongly reinforce the need for a tax increase in 1968 combined with strict Federal expenditure control.

In this regard, our soundings of the 1968 economy are generally in accord with the picture outlined by the President and the Council. Gross national product should rise by about 8 percent this year, in contrast with last year's increase of about 5½ percent, with more than 3 percent of the increase representing inflation. While business activity

should be slightly stronger in the first half of the year, second-half activity should also advance significantly. This would be particularly likely should defense outlays rise more rapidly than anticipated in the fiscal 1969 Federal budget, a growing possibility in the light of recent developments in Vietnam and Korea.

The economy, in our opinion, therefore, will be strong enough to absorb a tax increase needed to restrain inflationary pressures and strengthen the dollar. Without such action, the Federal Reserve will be faced with a number of cruel and conflicting policy choices in 1968: It will have to facilitate the financing of yet another massive Treasury deficit, bear the major responsibility for containing inflation and an accelerating wage-price spiral, guard against the danger of a possible crisis of confidence in our balance of payments, and consider the effect of its actions on financial institutions and homebuilding. Given the necessity of balancing these conflicting goals, the probability is that all will suffer to greater or lesser degree, and that, as in 1966, housing will suffer more than most. A better balanced fiscal-monetary policy mix, on the other hand, would contribute significantly to an easing of all of these problems, and to the maintenance of a stronger, better balanced economy not only in 1968 but in subsequent years. It would lessen, moreover, the possibility that other, less palatable and more direct means of restraint might have to be implemented in the future.

The Need for Longrun Structural Change

While shortrun considerations point to the need for a better balanced fiscal-monetary policy mix, the fact remains that housing activity will be unduly vulnerable to cyclical developments in the economy until basic changes are effected in the Nation's home mortgage financing system. Although by far the most important in terms of dollar volume, the mortgage sector has increasingly become the stepchild of the capital markets. It is highly encouraging, therefore, that the President's and the Council's reports place so much emphasis upon the need to strengthen the channels of residential mortgage credit. Indeed, as outlined on pages 92–95 of the Council's report, the administration's approach to the problem of assuring an improved flow of residential mortgage credit is quite similar to the comprehensive tripart program outlined by the National Association of Mutual Savings Banks and included in "A Study of Mortgage Credit," published in May 1967 by the Subcommittee on Housing and Urban Affairs of the Senate Committee on Banking and Currency.[1]

The administration correctly recognizes that there is no one quick and easy solution to the ills that periodically beset the residential mortgage market, and that a coordinated, multifaceted approach is required. The three basic elements of the similar programs outlined in the Council's report and by NAMSB include:

—the strengthening of mortgage-oriented savings institutions;
—the development of new types of mortgage instruments to tap new, supplementary sources of mortgage funds; and
—the termination or relaxation of Federal and State interest rate ceilings on mortgage loans.

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[1] "A Study of Mortgage Credit," Subcommittee on Housing and Urban Affairs, Committee on Banking and Currency, U.S. Senate, 90th Cong., 1st sess., May 22, 1967, pp. 289–301.

In view of the central role played by mortgage-oriented savings institutions in residential mortgage financing, it is obvious, as the Council recognizes, that any program to strengthen the flow of residential mortgage credit must be anchored to a strengthened thrift and home-financing system. As noted earlier in this statement, and as indicated on pages 71–76 of the Council's report, savings institutions have found it increasingly difficult to compete for savings in the new environment that has emerged in recent years. In part, as indicated, this reflects their increased vulnerability to high and rising open market interest rates. As the Council points out on page 93 of its report in reference to the 1966 mortgage market crisis:

> Because their funds are primarily invested in mortgages with fairly long maturities and fixed interest charges, the thrift institutions were unable to raise their earnings enough to permit payment of interest rates in line with those available from [commercial] banks and open market instruments.

The Council's reference to commercial banks highlights the other major development of recent years that has adversely affected the flow of residential mortgage credit. And this, of course, is the new, intense commercial bank competition for savings as a major source of lendable funds. This revolutionary departure from past tradition and practice, underway for more than a decade now, is traceable to the 1951 Treasury-Federal Reserve "accord" and to the slowdown in commercial bank demand deposit growth that resulted from the subsequent rising trend of open market interest rates and implementation of a flexible, contracyclical monetary policy by the Federal Reserve.

Faced with this challenge, and aided by successive increases in the regulation Q ceiling on their savings and time deposits, commercial banks responded by competing vigorously for savings and time deposits through interest rate increases and effective promotion of the wide range of financial services that they are able to offer savers. As a result, they have succeeded in sharply increasing their share of savings account growth, which rose from 29 percent in the 1946–56 period to 43 percent in the 1957–67 period. As shown in the revealing table on page 73 of the Council's report, moreover, the commercial bank share has risen sharply further during the past 3 years of full employment and high interest rates, averaging well over half of total savings account flows.

The implications for housing of this diversion of savings from mortgage-oriented thrift institutions to commercial banks are obvious, in view of the fact that commercial banks channel only a fractional share of their savings gains into residential mortgages while savings banks and savings and loan associations channel almost all of their funds into housing. In this regard, it is hardly a coincidence that the share of total savings account growth absorbed by the residential mortgage market fell from more than nine-tenths in the 1946–56 period to only three-fifths in the 1957–67 period.

As the implications of the basic changes in the economic, financial, and savings market environment since the late 1950's became more fully realized, support for legislation to strengthen savings institutions and the flow of residential mortgage credit grew and became more widespread. Until 1967, this effort centered largely on Federal savings bank legislation, first introduced in the Congress in 1957. During the

ensuing decade, this legislation gained the support of all of the major national housing, mortgage, and real estate groups, was recommended by the privately sponsored Commission on Money and Credit in 1961 and by President Kennedy's Cabinet Committee on Financial Institutions in 1963, and became an administration-sponsored and drafted bill twice specifically endorsed by President Johnson in his January 1966 and January 1967 Economic Reports.

The 1966 mortgage and housing crisis intensified the urgency of achieving legislation that would strengthen the Nation's thrift and home-financing system. Following congressional hearings on Federal savings bank and alternative legislation in July 1967, a unified approach toward this goal was embodied in the Federal savings institutions bill through the joint efforts of thrift industry, congressional, and administration leadership. This administration-sponsored and drafted legislation was introduced in the Congress in September and reported favorably by the House Banking and Currency Committee in late November 1967. It is due to be considered by the full House of Representatives in the present session of the Congress.

Like the predecessor Federal savings bank bills, the Federal savings institutions bill (H.R. 13718) enjoys widespread public-interest support, including major mortgage, real estate and housing groups, the savings bank and savings and loan industries, Congressmen from both parties, and key Federal agencies with responsibilities in the economic and financial areas. And it is particularly gratifying that President Johnson urged enactment of H.R. 13718 in his February 1968 Economic Report. (See page 22.)

This bi-partisan, public-interest support reflects a recognition of the fundamental ways in which the bill will help strengthen the flow of residential mortgage credit. In this regard, we strongly recommend the House Banking and Currency Committee's Report on H.R. 13718 as "must reading" for those interested in meeting the problems of housing and residential mortgage credit in the critical years ahead.[2] As the committee noted in its report, the bill will benefit the residential mortgage market in three inter-related ways:

—it will encourage an increased and better distributed flow of financial saving;

—it will channel an increased share of the enlarged savings pool through savings institutions and into housing; and

—it will help even out the flow of residential mortgage credit over the course of the business cycle.

The bill will accomplish these goals by authorizing the Federal Home Loan Bank Board to charter Federal mutual savings institutions—either newly organized institutions or converting mutual savings banks and mutual savings and loan associations—having the modern and flexible powers needed to compete for savings in the new, intensely competitive savings market environment of the 1960's and beyond.

The long record of actual experience shows, and scholarly studies have substantiated, that the presence of vigorous, competitive thrift institutions in a community stimulates an increased volume of locally

[2] Federal Savings Institutions, report on H.R. 13718 of the Committee on Banking and Currency, House of Representatives, 90th Cong., first sess., Dec. 13, 1967.

held savings. By promoting such institutions, the bill can be expected to increase the total volume of financial saving. Such a result would have great benefits not only for the housing market but, more broadly, for the economic health and stability of the Nation as a whole, since private saving is the lifeblood of noninflationary economic growth, productivity increase and real capital formation. While always important, encouraging an increased flow of private saving assumes an even more critical role under conditions of full-employment such as we have now are likely to have in the foreseeable future.

And perhaps never before in our history as a Nation has it been more important to channel an increased volume of savings into housing. As noted by the President on pages 21 and 22 of his report, and by the Council on pages 92 to 95 of its Report, the demands for residential mortgage credit in the years ahead will be truly staggering. The rate of household formation, by far the single most important determinant of housing and mortgage demand, is projected to rise steadily through the last years of this decade and all of the 1970's. Based on the two alternative projections published last year by the Census Bureau, for example, the annual rate of household formation during the last half of the 1970's will range between three-tenths to almost one-half higher than the average annual rate of the 1960–67 period.

And government demands for private mortgage credit will also be rising sharply as Federal, State, and local programs expand and multiply in the drive to rebuild our cities and realize the national goal of providing "a decent home for every American." As President Johnson states on page 22 of his 1968 Economic Report, providing for 20 million new privately financed homes over the next decade" . . . will balloon the need for mortgage money." And the 10-year goal of providing 6 million new federally assisted housing units for low- and moderate-income families, first outlined by the President in his 1968 state of the Union Message, will require an additional large infusion of private capital if heavy and perhaps unacceptable strains on the Federal budget are to be avoided.

But even as the demand for mortgage funds mounts in the years ahead, basic population trends during much of this period will be relatively unfavorable for savings growth at mortgage-oriented savings institutions, with the number of low-saving young adults growing rapidly and the high-saving 30 to 59 age group growing much more slowly.

Against this projected background of sharply rising mortgage demands and shifting population composition, moreover, it is reasonable to expect continuation of a generally high level of economic activity and of intense commercial bank competition for savings as a major source of lendable funds. While it is true that commercial banks have increased their interest in mortgages somewhat, it is also true, as noted previously, that the diversion of savings from savings institutions to commercial banks represents a substantial net diversion of funds from the residential mortgage market. And this will be particularly true during periods of relatively high economic activity and strong business loan demands, for commercial banks remain essentially oriented to supplying short- and intermediate-term business credit.

Thus, demographic, political, and competitive considerations all

highlight the urgency of channeling a larger share of savings back into the residential mortgage market through savings institutions. Failure to do so could well mean that the realization of vital national housing and urban revitalization goals will be thwarted by a chronic shortage of mortgage money. The Federal savings institutions bill will help to forestall such a potentially serious development by providing savings institutions with the flexible and modern deposit and investment powers they will need to attract an increased volume of funds for investment in residential mortgages in the years ahead.

In a very real sense, the savings account instrument offered by thrift institutions is an extension of the mortgage instrument and the flow of mortgage credit. Improving the one, therefore, will surely improve the other. In this regard, the Federal savings institutions bill provides for a wide variety of savings accounts bearing varying rates of interest, for the right to contract in advance the rate of interest on certain types of accounts, for savings certificates that can be issued to individuals or business organizations, and for the right to use modern banking nonmenclature. These provisions will enable savings institutions to tailor savings plans that will appeal to all segments of the savings market, and thereby generate an increased volume of savings. The right to use modern banking and deposit terminology in their operations will be of particular value to the many savings and loan associations that are currently denied this opportunity.

Equally important, the Federal savings institutions bill will provide savings institutions with needed investment flexibility, and with the ability to offer a wider and more attractive range of financial services to individuals and their families. This too will increase their ability to generate an increased volume of funds for residential mortgage investment. As the Council notes on pages 93 and 94 of its report:

> The scope for improved portfolio structure of thrift institutions would be enlarged through the chartering of Federal savings associations . . . Adoption of the legislation would increase the institutions' over-all efficiency and competitive strength . . . To the extent that thrift institutions shift to more diversified portfolios, the amount of funds available to the mortgage market will be initially reduced. *In the longer run, however, the savings and loan associations will better serve the mortgage market by maintaining a steadier inflow of funds and by strengthening their own competitive position.* [Emphasis added.]

The bill's provision of limited consumer loan authority is particularly crucial, since the availability of consumer credit will be essential if savings institutions are to maintain their role as the Nation's leading suppliers of housing credit. In this regard, it is essential to recognize that savings institutions can only lend out in mortgages what they are able to attract as savings, and that provision of a more comprehensive range of family-oriented financial services will be one of the most effective means of increasing their attractiveness to savers.

It is widely recognized that consumer credit is one of the most important financial services required by young people, and by families in the earliest stages of the economic life cycle. Meeting the needs of young people, always important, will be more important than ever for savings institutions in the years immediately ahead. In the dec-

ade ending in 1975, the number of people in the relatively low-saving 20 to 29 age group will have grown by almost 12 million, compared with an increase of less than 4 million in the relatively high-saving 30 to 59 range. In the following decade, however, the picture will be reversed, with the number of young adults growing by about 5½ million and the number of people in the 30 to 59 age group increasing by almost 13 million.

The implications of these figures are clear. If savings institutions can provide the financial services needed by the rapidly growing group of young adults in the years immediately ahead, their chances of gaining the savings of this same group in later years will be substantially enhanced. And this would mean a significantly increased longrun flow of housing credit, since savings institutions would continue to channel the bulk of their savings growth into residential mortgage loans—the single most important family financial need.

The increased investment flexibility provided by the Federal savings institutions bill would also promote a more stable flow of housing credit over the business cycle, thus alleviating the chronic and worsening tendency of the residential mortgage market to swing widely between conditions of feast and famine. In part, this would result from an increased ability to strengthen earnings and maintain savings growth and mortgage flows over all stages of the business cycle. In addition, with more flexibile loan and investment powers, savings institutions would be able to supplement reduced saving flows in periods such as 1966 by converting nonmortgage assets into mortgage loans, thereby cushioning the decline in mortgage credit and housing during such periods. On the other hand, in periods when savings growth is large relative to basic mortgage demands—such as in the early 1960's—savings institutions could continue to promote thrift by channeling funds into alternative investments, funds which could later be converted into mortgage loans should be need arise.

As the House Banking and Currency Committee stressed in its report on the Federal savings institutions bill, these advantages of flexibile investment powers for the flow of residential mortgage credit were dramatically demonstrated during the mortgage credit squeeze of 1966. Reflecting their relatively broader and more flexibile loan and investment powers—including the right to make consumer loans in 10 States—mutual savings banks were far better able to maintain savings growth and a high level of local mortgage flows than were savings and loan associations. Local savings bank mortgage lending was further bolstered during this period of severe financial strain through the conversion of other assets into mortgage loans, as savings banks channeled an amount equivalent to 108 percent of savings growth into mortgages. Savings and loan associations, by contrast, were able to channel only 89 percent of the combined increase in their savings and borrowings into mortgages in 1966.

In view of the bill's likely benefits for housing, it is little wonder that the House Banking and Currency Committee Report summed up the need for H.R. 13718 in the following manner:

More money for housing. Those four words sum up the primary basis of the need for this legislation. Its passage is badly needed, and long overdue, to help the average American family obtain a decent place to live at a price it can afford.

And it is hardly surprising that the Council of Economic Advisers echoed this view in its 1968 Annual Report, summing up on page 92 the need for the bill in this fashion:

> The recent sharp fluctuations in the availability of mortgage funds have demonstrated the need for action to reduce the excessive vulnerability of the mortgage market and the home building industry to variations in monetary conditions. The basic demand for mortgage financing is expected to grow rapidly in the next few years, while the ability of thrift institutions to meet this demand may diminish as commercial banks compete more effectively for time deposits. *Thus both long-term and cyclical considerations suggest the need to strengthen the thrift institutions which supply the bulk of mortgage funds and to devise new means of attracting funds into mortgages.* [Emphasis added.]

The Federal savings institutions bill will not be a panacea for the problems afflicting the residential mortgage market. But it will go a long way toward alleviating many of the worst aspects of these problems. As noted earlier in this statement, other measures will also be required to improve the flow of residential mortgage credit. As the Council notes on page 94 of its report, devising new security-type mortgage instruments that will appeal to pension funds and trust accounts is a highly promising approach. Similarly, as noted by the President on page 22 of his report and by the Council on pages 94–95 of its report, prompt action to remove or relax statutory interest rate limitations on mortgage loans is clearly required. Originally enacted to protect borrowers, these provisions are self-defeating in the new high-interest-rate environment. Their major effect is not to protect borrowers but to prevent them from obtaining the credit they need to provide a home for their family.

Given a tri-part program along the lines outlined by NAMSB and by the Council in its report, there is good reason to hope that the Nation's crucial housing and urban revitalization goals can in fact be realized in the years ahead. Mutual savings banks, as the Nation's leading suppliers of FHA and VA housing credit, have long been in the forefront of urban renewal efforts and of Government programs to provide housing for low- and moderate-income groups. Together with the savings and loan industry, they are currently considering ways in which the joint efforts of both industries can be applied to meeting the problems of our urban society in the years ahead. Passage of the Federal savings institutions bill would provide the logical framework for such a joint thrift industry effort to advance the public interest.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

By C. Wilson Harder, President

Our comment will be based on information secured from the federation's annual economic surveys of its members in all 50 States, who number now almost one quarter of a million independents. It will be limited to points critical to the successful financial operations of small business.

We believe that small business, being the relatively more marginal sector of our business structure, provides general lead indicators of economic contraction and lag, but solidly confirmatory, indicators of economic expansion. This theory has been borne out, in part at least, by experience during the past several years.

For instance, survey responses through 1964 to mid-1966 provided indicators suggesting strong economic expansion. As we wrote to your committee about this same time last year, however, about 1966, second quarter, these indicators commenced suggesting a cresting out of the rise. Later on in 1966, they showed definite signs of economic contraction, followed by a precipitous drop exiting 1966 and entering 1967. Through 1967 the indicators drifted sidewise, bumping up and down as against a ceiling.

Entering 1968, however, the response—January sample—provides mixed indicators.

On the one hand, there is tentative suggestion on the part of three indicators—inventories higher than 1 year earlier, purchased equipment during the past year, and receivables higher than 1 year earlier—of a renewal of the expansionary trend, with two of these three up sharply from December 1967, levels. There is improvement in a fourth indicator—that dealing with job formation.

On the other hand, there is continuing evidence of the mounting cost squeeze reported through the past year. While 81 percent of January respondents reported cost of goods higher than 1 year earlier, and 78 percent reported labor costs higher, only 59 percent reported selling prices higher than 1 year earlier. At the same time, interest rates continued at the high 6.7 percent average characteristic of 1967. And the proportion of respondents reporting collections slower than 1 year earlier stood at 34 percent, equal to the highest proportion of respondents reporting difficulties with collections during the latter part of 1966. Against all this, over half of these respondents reported their business dollar volume the same as or lower than 1 year earlier—a figure less favorable than in 1966, first quarter. Indicated spending on plan and equipment continued falling.

Consideration of these factors, plus recognition of the additional burdens placed on smaller business by social security tax increases, and State and local tax increases, leads the federation to question the Council's position that "the economy is in a strong position to move

into its eighth year of uninterrupted expansion." As previously stated, our behalf is that no recovery or expansion is solidly based until it is shared in by the small business sector—and we question whether small business is so sharing at present.

In view of the foregoing, we do not think this is quite the time to rock the boat by enactment of the recommended across-the-board surtax, the "improvement" in the unemployment compensation system, and the further speedup in corporate tax payments, each and all of which would definitely further drain the already strained resources of small business.

For instance, based on data on hand concerning corporate income tax burdens, it would appear that a 10 percent surcharge would increase the cumulative financial liability of corporations with tax liabilities of $5,500 or less by $110 million a year or more.

This is to say nothing of the burden that would be added to proprietorships and partnerships. It is to say nothing, either, of the fact that social security revisions of the past year are already increasing the employer's tax burden by a maximum $53.20 per employee. It must be kept clearly in mind that independents, according to the Small Business Administration, employ—and pay social security taxes on—34,000,000 or more wage and salary earners.

It seems to us, too, that these recommendations should be considered from the standpoint of what they will gain Government in revenues against the damage they stand to do small business—which has been likened, truly, to the "seed-bed" of our economy. For example, according to data available, 76 percent of all corporations have tax liabilities of $5,500 or less—these are typically the small business corporations—but they account for only 5 percent of corporate tax payments. Intensification of the tax drain on these firms would seem much akin to squeezing the turnip dry.

Our Washington office is requesting that if corporate tax collections be speeded up, there be provided an exemption for the first $25,000 of tax liability. Such an exemption would shelter smaller firms which account for between 87 percent and 98 percent of all corporations, which average between $10,000 or less than $40,000 or less in tax liabilities, but which account for only between 7 percent and 19 percent of all corporate tax collections. This would seem small enough price to pay for maintaining the financial stability of these firms which are vital to our economy, but who stand to lose the most.

We might mention, that in seeking the exemption mentioned above, the federation is not making a special plea for corporations at the expense of proprietorships and partnerships. We are asking only for maintenance of the status quo, and for recognition of the fact that historically the corporate form of organization has been treated differently taxwise from other forms of business organization.

Rather than acting on these recommendations of the council, we would urge that action be taken to invigorate and strengthen small business. Among the many things which must be done:

1. In order to ease current threats to small business liquidity, pressures for higher taxes must be eliminated, and pressures on interest rates relieved, through the deepest possible reductions in Federal spending programs;

2. In order to improve the financial position of small business, earliest possible attention must be given to "plowback" legislation, such as in H.R. 4105 (Corman, Calif.) applying to increases in investment in inventories and accounts receivable;

3. In order to strength the job creating potential of small business, insofar as the marginal and submarginal workers are concerned, the minimum wage burden be eased by enactment of H.R. 6967 (Anderson, Ill.) which would amend the Fair Labor Standards Act to maintain at $500,000 the annual volume test;

4. In order to stem the migration from rural to urban areas, job opportunities must be enlarged in the former; to this end there must be enacted legislation such as H.R. 9060 (Evins, Tenn.), which would provide incentives for business expansions in rural areas;

5. In order to provide a more equitable climate of competition for small business growth, there must be enacted bills such as H.R. 6843 (Patman, Tex.), which would require sellers to notify their customers of changes in price schedules for any buyer, and H.R. 9048 (Patman, Tex.), which would make it possible for businessmen to sue for damages suppliers who violate the Robinson-Patman Act by selling at unreasonably low prices; and

6. In order to provide more effective representation in the Congress for small business, steps must be taken to raise both the Senate and the House Small Business Committees to the status of standing committees, with the same responsibility and authority in their areas as are enjoyed by the Labor, Agriculture, and other standing committees in their areas.

Finally, we commend the Council for its attention to the economic adjustments which are bound to follow peace in Vietnam—a peace which we hope will come sooner than anticipated. This is as we suggested to both the President and the Council over 2 years ago.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS—COMPARISON OF STATISTICS, 1966, 1967 AND 1968

	1966 (cumulative)				1967				1968 (January)
	1st quarter	Half	3d quarter	Full year	1st quarter	2d quarter	3d quarter	4th quarter	
Business volume compared with 1 year ago:									
Same (percent)	30	31	31	32	(1)	(1)	(1)	(1)	26
Higher (do)	51	48	48	47	(1)	(1)	(1)	(1)	49
Lower (do)	17	18	19	20	(1)	(1)	(1)	(1)	24
Inventories compared with 1 year ago: Higher (do)	40	39	39	36	23	23	23	23	32
Receivables compared with 1 year ago: Higher (do)	43	41	41	40	20	18	18	17	38
Purchased equipment during past year (do)	55	54	53	52	46	46	47	45	60
Difficulties with collections (1968 question: Are your collections slower than 1 year ago?) (percent)	30	32	34	31	(1)	(1)	(1)	(1)	34
Employment same as 1 year ago (do)	69	71	69	70	72	73	71	70	70
Job formation indicator	+2.7	+2.5	+2.2	+1.8	+0.8	+0.6	+0.3	+0.1	+0.5
Average additional investment in business (billions)	$9.2	$8.8	$9.6	$8.6	$10.9	$10.4	$9.9	$9.8	$7.5

[1] Not availale.

UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)

By Walter P. Reuther, President

There is an anxiety in the Nation, strangely mingled with complacency and an indifference to the unsolved social and economic problems that contribute to our troubled mood. The President defined the mood as restlessness and questioning in his state of the Union message, and touched upon some of the reasons for it in listing a number of our persisting problems, including:

> * * * the gulf for some Americans between the promise and the reality of our society.

Stating that we could not "change all of this in a day," the President added:

> The issue is not whether we can change this; the issue is whether we will change this.
> I know we can. I believe we will.

In confronting these two gaps—the gap between promise and reality and that between "can" and "will"—we reach the heart of the American dilemma. It is inescapable. It crops up in every issue before the Congress. It is implicit in every assumption underlying every budgetary allocation. It surfaces on every page of the Economic Report. It haunts our preoccupation with "crime in the streets"; it is at the center of the racial crisis; it dominates the national debate over our proper course in Southeast Asia.

It is not an economic dilemma, although it involves economic choices. It is not a technological dilemma, although it has to do with our response to the new technologies. It is not a military dilemma, although it is expressed in our attitudes toward what President Eisenhower called the military-industrial complex. It transcends partisan political alinements, although all parties, major and minor, who recognize its existence may claim a monopoly of wisdom in dealing with it.

It presents itself to us in all these aspects because it permeates the body and soul of the Nation. It is a crisis of values and purpose, of ends and means. It poses the question: What kind of America do we really want? It asks: What do we seek to do with the unprecedented wealth and power at our disposal? It demands to know if we really believe in a constitutional democracy with equal justice under law, or only in an "I'm all right, Jack" regime of selfishness, a feudalism of special interests in which the poorest and weakest among us are ignored, neglected, or driven to the wall.

The answers cannot be indefinitely evaded or postponed, for several good reasons:

1. The argument that we lack the resources to fulfill our commitments is not valid.
2. The problems thrown up by our reckless and shortsighted exploitation of science and technology do not go away. They remain, and worsen.
3. The victims of the gap between promise and reality are no longer docile and reconciled to their fate. They impatiently demand fulfillment of the promise. This is true in a double sense. This wealthiest of nations has an unfulfilled responsibility to the poor of our cities and rural areas and to the struggling peoples of the have-not lands where peace depends on greater assurance of social and economic development.

The rub here is not lack of progress, as doctrinaire extremists allege. There has been much progress, and progress continues. The rub lies in the relativity of progress. There is a revolution of rising expectations here in the United States as well as in Africa, Latin America, and Asia. It derives from a quickening sense on the part of the poor, the deprived, and the discriminated against, concentrated in our cities and scattered in rural areas, that science and technology have put material affluence within the reach of all. That they are still denied it, they now understand, is not the fault of science and technology but of economic policy and political decision.

The progress of recent years, while real, has constituted only a slow-moving, marginal attack on poverty, unemployment and underemployment, inferior education and housing, the general deterioration of our urban centers, and the patterns of discrimination and segregation that keep racial and ethnic minorities from equal opportunity and first-class citizenship. We are not moving fast or far enough to correct the injustices and inequities that frustrate and embitter their victims and divide our communities.

The presidential messages are replete with evidence of the volume of unfinished business on the national agenda.

The President reminds us:

> Despite our prosperity, there are still more than 10 million families whom we classify as poor.
>
> * * * whether we will move constructively to deal with the urgent problems of our cities and compassionately to bring hope to our disadvantaged; or whether we are willing to risk irreversible urban deterioration and social explosion.

With respect to unemployment, the President states:

> The question for our day is this: in an economy capable of sustaining high employment, how can we assure every American, who is willing to work, the right to earn a living?
>
> We have always paid lip service to that right. But there are many Americans for whom the right has never been real * * *

The President notes that the United States ranks 15th among the nations of the world in saving the lives of babies. Regarding housing, he reports:

> New housing construction is far less than we need—to assure decent shelter for every family.

Regarding our living environment, he tells us:

> Many rivers—and the air in many cities—remain badly polluted.

Referring to the responsibilities of government in promoting the general welfare, the President states:

> I regard it as a primary purpose of government to expand the opportunities for all citizens to share in our economic and social progress. For most, this means the opportunity for rewarding employment. For millions who are retired, disabled, or otherwise unable to seek active work, a share in prosperity requires wise and humane programs of income maintenance and social insurance. For all, it means full access to education and to health care.

This is an all-too-familiar inventory, partial and restrained, of the flaws and anomalies that mark our state of general material affluence. It understates the magnitude and urgency of our situation, because it scants the elements in our dilemma which cannot be measured statistically—and because it takes insufficient account of the degree to which the life of the whole Nation, of affluent majority and deprived minority alike, is improverished, degraded, and distorted by our common failure to set our national house in order.

This common failure, and our awareness of it, are surely among the chief sources of the spiritual disquiet that reigns among us, alienating ghetto youth and the youth of the affluent suburbs alike, infecting all of us but the incurably complacent with an irritable frustration at the thought that we, citizens of this wealthiest and most powerful of nations, do not live up to the most elementary and fundamental of our democratic professions and commitments.

This malaise lies deeper than governments, budgets and gross national product. Government alone cannot cure it. Yet governmental leadership and initiative, governmental planning, and adequate budgets to meet priorities, must inevitably play a key role in any genuine, practical efforts to make America whole by coping with the many problems that beset us.

What, then, are our true priorities? What must we do that we are not doing to make America whole and to promote our true national interest?

We have increasingly allowed ourselves to be ruled by two assumptions:

1. That the future of America is more at stake in the cities of Vietnam than in the cities of the United States—to the point that in the next fiscal year the Federal Government will be spending in Vietnam—in 1 month—almost twice its contemplated annual outlay to improve the elementary and secondary education of children from low-income families; and
2. That our outlay for war in Asia requires a reduction in our commitment in Detroit, Newark, Watts, and the other American centers of poverty, discontent and incipient rebellion.

Surely the greatest threat to American democracy today lies in our failure here at home to sense our true priorities and to mobilize our resources to keep our commitments to our own people.

Yet, whatever may be said of the first assumption—it is being ventilated in this election year—we should all be clear about the second; it is false.

American wealth and power are unique in world history and in the world today. There is enough wealth in this country, enough slack and

fat still in our economy, and enough leeway in the Federal budget—as indicated below—to do what we are doing in Vietnam without gutting and scuttling our domestic efforts to bring the benefits of democracy, advancing technology, and rising productivity to the over 30 millions of Americans who remain poor by conservative definitions.

Our preoccupation with Vietnam has offered a convenient and dramatic pretext for cutting back on domestic spending for what until lately were known as Great Society programs. The pretext was avidly seized upon by those forces in the country and the Congress who stubbornly resisted progressive social legislation long before our Vietnam involvement gave them what they regarded as a respectable excuse. These forces instinctively look for militaristic solutions, at home and abroad, to deal with problems which are essentially political and social. Before this suicidal impulse brings catastrophe on all of us, we should awaken to the fact that outlays for Vietnam amount to but 3 percent of GNP. In the 97 percent that remains, our computers—and our common sense—can certainly manage to identify a comparable amount which can be diverted from less essential purposes to the high-priority ends of saving America from large-scale disintegration and chaos.

We have demonstrated over the past 7 years of economic growth uninterrupted by recession that the so-called new economics gives us the means to manage economic expansion. If we use these tools with precision and compassion to enhance the quality of American life—rather than handling them as blunt instruments merely to raise total production without regard to the social utility and human value of its component parts—then there is no doubt that we can pay our way toward the Great Society out of the annual increment in productivity and GNP. An annual real GNP increase of 5 percent—a rate that is well within our capabilities—would mean an increase in gross national product of $150 per person. If this increase, instead of going indiscriminately to fat around our already comfortable middle, were channeled into critical sectors such as jobs, housing and quality education in our central cities, and income maintenance for those unable to work, we could more than match our Vietnam outlay, and escalate the war against poverty and despair in our own backyards.

We don't have to beat the Russians to the moon. We can wait a little longer for supersonic transports. We can slow the pace of converting the countryside into concrete. It has even been observed by some Senators that we can cut our troop strength in Europe without precipitating the end of the world—considering the fact that we and the Russians have long had enough destructive capacity in the form of nuclear missiles to destroy each other many, many times over. We should also draw back from the expensive fool's errand of seeking security from a Chinese ICBM attack in the proposed ABM defense system. As analyzed by Ralph Lapp, long a nuclear specialist for the Defense Department, the defensive possibilities of such a system are questionable, and the Sprite missiles that would be used for atmospheric interception pose the threat of wholesale mutilation and incineration of our own population.

In addition to changing priorities and removing fat on the spending side of the budget, attention could also be usefully devoted to the fat

on the revenue side. For what else are the notorious tax loopholes which annually add to the riches of many of the richest among us and cost the Government billions of dollars?

We can do these things, and more, to check the creeping demoralization of our national spirit and make this Nation whole. We can change our priorities and thereby divert resources to more essential purposes. We can manage our economy to assure optimum growth, in order to meet whatever commitments, at home or abroad, we deem essential.

Let us not delude ourselves, however, that these changes can be made by continued recourse to the slapdash, piecemeal, business Keynesianism of the recent past, in which our essential benchmark has been gross national product, whether increases in GNP came from more napalm and cigarette advertising or from cleaner air and better education. We need to plan according to a standard of social accounting in which our performance is measured not by the buying and selling of the market but by such progress as the number of mothers and babies we save at childbirth; the number of dropouts we prevent or lure back to school; the number of decent homes we build in decent neighborhoods; the number of children we rescue from malnutrition in Mississippi or India; the number of job opportunities we create; the number of sick we heal; the number of poor, here in America and throughout the world, we help in their efforts to raise themselves above the degrading experience of economic and spiritual poverty.

To plan for the purpose of improving the quality of life, government must do more than step in when the private sector falters; we must accept the need for a continuing, conscious guidance of investment and resource allocation in the public and private sectors, with decisions democratically involving the regular participation of all functional groups in the society. It is only through this kind of deliberate, comprehensive yet democratic planning that we can have assurance that both private and public needs will be met.

Large corporations not only plan, they are essentially planning organizations. Democratic states, however, rarely went beyond piecemeal planning except for the emergencies of war—until the devastation and massive dislocation of societies and economies brought on by the Second World War forced at least the beginnings of comprehensive forms of planning on the nations of Western Europe. The United States encouraged such planning as a necessary counterpart of the Marshall plan, and cooperated in creating not only national but international planning through the Organization for European Economic Cooperation.

We have also encouraged forms of national planning as a condition for allocation of our foreign aid in underdeveloped countries. We continue, however, to live by the delusion that the United States is the sole exception to the general rule that complex, dynamic, advanced industrial (or post-industrial) societies must plan or invite equally complex troubles.

The troubles we thus invited are upon us. They cannot be papered over with good intentions or camouflaged by a bland recital of our wealth and achievements. We will not be saved by past accomplishments, only by present decision and effort.

We must translate our good intentions into appropriate priorities. We must plan to fulfill the promise of American life, or all our

wealth and power will not save us or serve a wholesome purpose in the world.

America in this crisis must demonstrate the maturity and sophistication to free itself from the economic folklore that would have us believe all the answers will be found in the wondrous workings of the marketplace. Our marketplace economy has contributed much to America's progress and continued major reliance upon its operation is justified. However, exclusive reliance upon the blind forces of the marketplace would be dangerous, irresponsible, and even disastrous.

We must recognize that no one is challenging or threatening our economic system. A free society whose genius has achieved unity in diversity must demonstrate the capability of making compatible public planning to meet public needs with private planning for private gain. If we should fail, the serious gap between private affluence and public neglect will inevitably worsen and place our free institutions in grave jeopardy.

Balance of Payments

The main factor that today blocks progress toward genuine full employment and full use of our resources to meet our urgent national needs is fear generated by the balance-of-payments deficit.

We in the UAW have repeatedly called attention to the exaggerated emphasis the Council of Economic Advisers places on a deficit in the balance of payments amounting to a fraction of 1 percent of the gross national product. On reading certain parts of the Council's report it is hard to resist the conclusion that there has been a reversal of two centuries of progress in economic thought—a retreat from the new economics to a new mercantilism in which the payments balance and the stock of gold displace full employment, growth, and the proper allocation of resources as the prime concerns of economic policy.

Emphasis on the payments deficit as a major determinant of economic policy is all the less justifiable for two reasons. First, the size of the deficit in 1967 was based on an unusual combination of factors, most of which are not likely to be repeated. Among them were transactions connected with the devaluation of the British pound, a decrease in exports due to the slowdown in the economies of our major trading partners, and an increase in imports due to the copper strike and in anticipation of a possible steel strike. Moreover, the war in Vietnam, which hopefully is not to become a permanent feature of our national life, accounted directly for more than two-fifths of the total deficit (on a liquidity basis) and probably a significant additional proportion indirectly.

Second, as President Johnson pointed out in his Economic Report, we do not have a deficit in the true sense but rather a shortage of liquidity such as a prosperous businessman might suffer who "has been borrowing extensively at short term to help finance his long-term investments." Liquidity is measured essentially in terms of the national stock of gold in relation to potential claims against it.

We do not agree that the United States must sacrifice the growth of its economy, and the welfare of its people and those of the developing countries, as well as its domestic tranquility, solely in order to conserve its hoard of a myth-encrusted metal that has very few practical uses. The time has come, in our judgment, to think—and to do—the unthink-

able in order to prevent mankind here and abroad from being crucified upon a cross of gold—a phrase that is becoming increasingly relevant today even though it may not have been when first uttered.

We congratulate Congressman Reuss for his courage and imagination in holding hearings of the Subcommittee on International Exchange and Payments of the Joint Economic Committee at which opportunity has been given for the presentation of bold proposals to win freedom from the shackles of the gold myth. More particularly, the Nation owes him a debt of gratitude for the daring he displayed, in his press release of December 12, 1967, when he offered concrete proposals to deal with the gold problem. Faithfulness to its obligations under the Employment Act would require the Council to show comparable courage and imagination rather than retreat headlong into advocacy of damaging, negative, and restrictive policies as solutions for the payments deficit.

The position of the present members of the Council stands in sharp contrast to that taken by two former members who made up the majority of President Kennedy's original Council. Neither of them has been afraid to suggest that serious consideration should be given to breaking the link between the dollar and gold. Walter Heller, former Chairman of the Council, wrote recently:

> . . . we need to think about the unorthodox:
>
> Perhaps we should go beyond saying that our $12 billion-plus of gold is fully available to defend the dollar and, in effect, invites the world to "come and get it" as a demonstration that the dollar is not only as good as, but better than, gold.
>
> Perhaps we also need to expose gold speculators, both official and unofficial, to a down-side risk—one approach would remove our pledge to buy gold at $35 an ounce (while maintaining our pledge to sell at that price)."

This, in essence, is also the approach Congressman Reuss suggested to "dethrone" gold.

Former Council member James Tobin was quoted in the Wall Street Journal for February 5, 1968, as saying:

> The outlook for the world economy would be very much brighter today if the dollar were once and for all cut loose from gold.

The Journal article continued:

> Much more traumatic than the uncertain fluctuations of a floating dollar, say Mr. Tobin and other analysts, are the financial disruptions caused by the currency devaluations—such as the recent devaluation of the pound—that periodically occur under the present monetary system. In passing, it is noted that the Canadian dollar 'floated' freely for about a dozen years after World War II and that Canada prospered greatly in those years. A further claim: Other countries would not permit a floating dollar to depreciate drastically in relation to their own currencies—as some authorities fear might happen—because such a dollar would give Uncle Sam too great an advantage in world markets.
>
> Without the "discipline" of gold, is it not likely that American politicans in power would pursue dangerously inflationary economic policies? Not at all, say some economists. "In effect, U.S. policy makers were under no constraint from gold from 1933 until the late 1950s," claims Yale's Mr. Tobin. "Yet, the country's economic policies were hardly reckless during that time." In those years, it is noted, U.S. prices generally were more stable than those in any other major country.

While not advocating complete elimination of gold from the world monetary system, even so conservative a spokesman for the financial community as the Chairman Martin of the Federal Reserve Board

agrees on the irrelevance of the gold "mystique and fetish" to economic discipline. According to the New York Times, Mr. Martin said:

* * * that the United States "must not bow down to the idol of gold" as the only discipline against inflationary national economic policy.

He scored the reliance on gold * * * as "the be-all and end-all" of national monetary policies.

* * *

"I think it's barbarous to think that we haven't got the intelligence to manage our economy so that we have to depend on a metal—this barbarous metal," he said.

When confronted with restraints on capital exports—which affect their interests—leading private bankers, also, have been led to acknowledge that there are some things more important than the link between the dollar and gold. Early in April 1967, the Chase Manhattan Bank published a suggestion that ". . . the United States could cease buying and selling gold." Two days later, President Rudolph A. Peterson of the Bank of America suggested "a gold strategy that embraces a variety of tactics." One of the tactics was the same that proposed by Congressman Reuss to "dethrone" gold. As Mr. Peterson put it, this tactic:

* * * recognizes that, while we are committed to maintaining the gold value of the dollar there is no overwhelming reason why we should sustain the dollar value of gold; that is, we may have to reconsider our gold *buying* policy." [emphasis in original]

The proposal that the United States cease buying gold has highly reputable academic origins. One means of implementing the proposal, and some of its probable effects, were spelled out by Congressman Reuss in the press release referred to above:

The United States could announce that all foreign monetary authorities holding dollars—which they have at least in part acquired as a result of the U.S. commitment to turn them into gold—have a set period of time in which to demand gold. This announcement should be accompanied by an announcement that the United States no longer agrees to buy gold at $35 an ounce, and will not make gold available for official dollar holdings to be acquired in the future. In all likelihood, only a small fraction of the roughly $15 billion in official dollar holdings would be presented for gold—because the future of the gold price would become extremely dubious, and because most foreign official dollar holdings are necessary either for current transactions or will be held because their holders have confidence in the dollar, and wish to take advantage of the interest rate that is payable on dollar holdings. The present parity values of the dollar would then be supported, under International Monetary Fund rules, not by gold but by exchange operations, just as all other exchange rates are now maintained.. If we maintain an economy aimed at full employment without inflation, there is no reason why the current exchange value of the dollar with other currencies cannot readily be maintained. If France, for example, thinks that the dollar should be devalued, let it press its position within the International Monetary Fund. I doubt very much that it would wish dollar devaluation, since this would simply cut down on American tourism into France, and on the sale of French wines and perfumes in this country.

Under these circumstances it would soon become clear—perhaps even to General de Gaulle—that, in Walter Heller's words, "the dollar is not only as good as, but better than, gold." As the Chase Manhattan Bank pointed out:

Gold has an intrinsic value far below that of the purchasing power of the dollar. Yet, because of the belief that its official price might rise, gold is the only international asset that can compete with the dollar. No sophisticated investor or central banker, if he were certain that the price of gold in terms of dollars would

not be officially raised, would regard gold as a better store of value than the dollar, which, in addition to its relatively stable purchasing power, also can be invested to earn interest.

We concur with the bankers quoted above that there are some things more sacred than the link between the dollar and gold. We would give top priority, in that regard, to full employment, growth, and the allocation of our resources to relieve poverty at home and abroad and to improve the quality of life in America.

We are not prepared at this time to espouse any specific method of divorcing the dollar from gold. *We are convinced, however, that study of alternative methods, and prompt action on the conclusions that emerge from study, are matters of the highest urgency which should be pursued with all possible speed and vigor.*

A multilateral solution of the gold problem, developed by, and applied with the concurrence of, the great majority of nations, obviously would be preferable to unilateral action by the United States. But the auguries for such an outcome are not favorable. Agreement on the very modest reform of the international monetary system represented by the creation of IMF Special Drawing Rights was slow and painful in coming, has yet to be ratified, and is still further away from implementation. A clearly expressed determination on the part of the United States to dethrone gold unilaterally—if it cannot be done by international agreement—may be the catalyst required to induce cooperation in working out an agreement.

Meanwhile, we emphatically reject the notion that the gold problem requires adoption of a restrictive budget, which would deny or delay solutions of pressing social problems.

We in the UAW have stressed repeatedly the necessity for a response to the balance-of-payments deficit that would be compatible with the Nation's domestic needs and goals and its obligations to the peoples of the developing countries. We have warned that the deficit must not be met by a panicky retreat to restrictive and repressive fiscal and monetary policies. We have urged instead that (primarily to eliminate it as an excuse for such policies) the deficit be attacked by selective, direct measures less costly in human hardship, economic waste, and social disruption than restraints on domestic demand imposed while we are still short of genuine full employment. In particular, we have urged mandatory action to cut off the flow of capital exports to industrialized countries.

The steps taken and proposed by the President to reduce the deficit conform, in general concept, to the prescription proposed by the UAW. They are selective and they include controls on capital exports, both direct investment and loans. Although we believe that the President's measures could be improved in a number of respects, they should provide all the breathing space necessary to permit us to push on toward full employment while we work toward freeing the world from its obsession with gold. In fact, one of the President's proposals, removal of the gold cover requirement against Federal Reserve notes, could be a useful first step toward dethroning gold. It would enable us to follow the suggestions of Congressman Reuss and Walter Heller that we invite the world to "come and get it."

We do not intend to engage here in a detailed analysis of the President's package of balance-of-payments measures. A few brief comments seem to be in order, however.

We regret that mandatory action with respect to capital exports was so long delayed. Had the capital export controls been instituted when we in the UAW first proposed them in March 1964, the cumulative payments deficit of recent years would have been much smaller and, in consequence, the Nation's international monetary reserves would today be much larger. There would therefore be less pressure for repressive fiscal and monetary policies. Moreover, the effects of capital export controls on other developed countries which have relied upon our deficits for their liquidity might have impelled them to cooperate sooner and more wholeheartedly both in reducing their payments surpluses (which are the obverse side of our deficits) and in reforming the international monetary system.

While favoring effective controls on capital exports, we find it difficult to understand some of the details of their present application. We do not see why the military dictatorship in Greece is favored with an exception from the prohibition against direct investment applicable to the rest of non-Communist Europe. We question the necessity to give the feudal oil-producing countries the same relatively liberal treatment accorded to certain developed countries with special problems such as the United Kingdom and Canada. We doubt the wisdom of a flat formula limitaiton on investment in the developing countries. We believe it would be sounder to establish machinery for case-by-case review of proposed investments in such countries, with approval granted for investments which would contribute to development and denied for those which are essentially exploitative. Considering the reluctance of U.S. corporations to invest in developing countries, it is (unfortunately) unlikely that the aggregate capital outflow under such a review procedure would be significantly greater than under the formula now in effect. But there would be less danger of hampering the progress of some of the recipient nations. We hope the administration will reconsider these matters.

Insofar as the deficit on tourism is concerned, we are in accord with the administration's preference for restricting spending abroad rather than restricting freedom to travel. We believe, however, that more equitable means could be applied to accomplish the desired result than the tax measures that the administration has proposed. The proposed tax on plane and ship tickets obviously would be uneven in its impact, depending upon the income of the would-be traveler. It could deter—and would most certainly restrict the extent of—travel by those with low incomes, no matter how legitimate their reasons to travel. The tax would have no effect at all upon the wealthy, no matter how frivolous the purpose of their travel.

The proposed tax on spending abroad is a form of progressive spending tax proposed later in this statement for application to the domestic economy. It is questionable, however, whether the proposed spending tax on tourists is the most equitable and effective measure to restrict tourist spending. Much has been published already about the difficulties of administering such a tax (difficulties that would not apply to the Treasury and UAW proposals outlined below); and the wealthy will more easily find the methods, and have readier access to the means, for evasion than travelers in the low- and middle-income brackets. Moreover, even the 30-percent top rate proposed would have

little or no effect on amounts spent by the wealthy. This point was forcefully expressed by an executive of a travel agency, quoted in the Wall Street Journal for February 6, 1968, who said:

> It's not going to deter the Jet Set . . . They'll pay the tax. If you've got $1,000 a day income, what's the difference?

If the sole effect of the tax on the wealthy is to increase their contributions to the U.S. Treasury, it will have failed to accomplish its purpose. The objective is not to raise revenue, but to deter excessive tourist spending.

While administrative difficulties will beset any attempt to restrain tourist spending, we believe a search should be made for alternatives to the administration proposal that would be both more likely to achieve the intended purpose and more evenhanded in their impact upon individuals at different income levels. One device that deserves consideration is setting a reasonable flat limit on the amount permitted to be spent per day abroad, with fines heavy enough to hurt (perhaps expressed as percentages of the traveler's total annual income) for each day spent on any trip during which the average daily amount spent exceeded the the limit. The flat limit would apply equitably to all, while the severe penaltlies involved would help to deter evasion. In a democratic society, the need to restrain tourist spending does not remove the requirement that any form of restraint must apply equitably to all citizens, regardless of income.

The details of measures applied to reduce the payments deficit, however, are far less important than a clear understanding, by the public and in Government circles, that the deficit need not and should not inhibit us in the pursuit of our national goals. The strength of the dollar depends upon the strength of the American economy. People and governments all over the world will continue to want dollars—whether or not exchangeable for gold—so long as those dollars will buy American goods and services. This does not mean that we are free of any necessity to seek to maintain reasonable price stability. Avoidance of inflation is desirable for reasons more important than the payments balance. But we should not forget that the record of U.S. prices compared with those of other countries shows that the dollar is a better store of value than any other important national currency—and, in most cases, by a wide margin.

We learned during the past 7 years that the sacrifices of wealth and jobs and the welfare of our people made during the 1950's in misguided efforts to avoid deficits in the Government budget were wholly unnecessary. It is time now that we learn the same lesson about the payments deficit.

The Council's Negative Policies

The fixing of national priorities is essential if we are to make an effective attack on our pressing problems. Yet the fixing of priorities will not by itself assure rapid progress toward our goals. For that we need positive policies directed toward maximum sustainable growth. Although much can be accomplished by reallocation of existing resources in accordance with national priorities, vigorous growth provides additional resources with which to attack priority needs. But growth cannot be sustained if income imbalances are permitted to arise which cause misallocation of resources and the generation of

inflationary pressures which lead, in turn, to repressive and restrictive policies. Positive policies are needed to assure that growth is vigorous and sustained, and that it proceeds in balanced fashion.

The policies advocated by the Council, unfortunately, have been negative on both counts. The Council has consistently tended to be less expansionary or more restrictive than the economic circumstances of the time required. It has advocated a negative wage policy (as well as certain tax measures) that have encouraged imbalances in income distribution. Those imbalances have contributed toward unsustainable investment and inventory booms which facilitated and stimulated inflationary price increases; and fears of further inflation were made the basis for more restrictionism.

RESTRICTIVE EMPLOYMENT POLICY

The Council has always been more afraid of possible inflation that of existing unemployment. True, the Council has given recognition to the goals of full production and full employment, but the Council's fear of seeing the economy move forward as far or as fast as it could have been implicit in the policies it has advocated, at least for the past several years. It was in 1962 that Council first proposed an "interim goal" of reducing unemployment to 4 percent—it then stood at close to 6 percent. This reduction the Council expected to see achieved by mid-1963, but the economic policies actually followed, largely on the advice of the Council, did not succeed in reducing unemployment to the 4 percent level until the beginning of 1966.

Even then, it is questionable whether the reduction of unemployment to 4 percent was due to the policies of the Council as much as to events in Vietnam completely outside its control or its ability to forecast. In its 1968 Report, summarizing economic developments of that period, the Council says:

> Around mid-1965, the growth of demand for industrial products suddenly accelerated as the direct and indirect consequences of the enlarged commitment of U.S. forces in Vietnam. Manufacturing output and employment spurted sharply in the last quarter of 1965 and the first quarter of 1966, and continued to rise steadily through most of 1966.

Early in 1966 the Council was beginning to back away from the goal of further reductions in the unemployment rate. It did not quite call for acceptance of 4 percent unemployment, but it did suggest "prudent . . . reduction in the unemployment rate to a level below 4 percent" and "a cautious move toward lower unemployment . . ."

By 1967 the Council had fully retreated from the goal of reducing unemployment below 4 percent, and had indeed announced that 4 percent unemployment constituted "essentially full employment." The first paragraph of its report read:

> The United States in 1966 enjoyed the benefits of the fullest employment in more than a decade. The unemployment rate reached a 13-year low of 3.9 percent. At that level, demand finally matched supply in most labor markets, a situation which most economists define as essentially "full employment."

Subsequently, in discussing the economic outlook for 1967, the Council said:

Finally and most important, the Nation should continue to experience substantially full employment in 1967. The unemployment rate should be essentially the same as in 1966, when it averaged 3.9 percent.

The Council's forecast was correct. In both 1966 and 1967 the final figure for average unemployment was 3.8 percent rather than 3.9, but the difference represented merely a change in the statistical method of counting the unemployed.

In 1968, the Council has reaffirmed its contention that 4 percent unemployment constitutes "full employment." As in previous years, it has accepted the concept that "potential GNP" can be achieved with 4 percent of the labor force still unemployed, and it forecasts that in 1968, if its advice is accepted, "the unemployment rate for the year as a whole should be essentially unchanged from its present level."

Ironically, this prediction is made in the face of achievements that should make possible a continuing reduction in the unemployment rate. In its 1962 Report the Council said:

If we move firmly to reduce the impact of structural unemployment, we will be able to move the unemployment target steadily from 4 percent to successively lower rates.

A major purpose of the various manpower programs is to reduce structural causes of unemployment. This year's report of the Council says:

In the last four years, manpower programs tailored to the needs of the economically disadvantaged have been greatly expanded. During the fiscal year 1968, close to a million persons, most of whom are disadvantaged, will be served by the Manpower Development and Training Act, the Job Corps, and similar programs.

According to the budget, the number served in fiscal 1967 was even larger—1,062,000. Granted that these programs are not 100 percent effective, nevertheless they should have made considerable impact on the structural problems which the Council considered in 1962 to be the major obstacle to be overcome before we could expect to "move the unemployment target steadily from 4 percent to successively lower rates."

WE HAVE OPPOSED SUCH NEGATIVISM

The UAW has consistently opposed this negativistic approach. As early as 1962 I said to this committee:

The programs presented to Congress by the present Administration to establish a national purpose and meet the needs of our people represent a vigorous and imaginative advance in leadership, both in terms of restoring health and strength to our economy and of finding compassionate answers to the needs of human beings in trouble. But even those programs fail to comprehend either the full magnitude of the problems we face or the full dimensions of our potentalities.

We have raised our national sights, but we have not raised them nearly enough. We are still aiming far too low. We are still accepting ideas of what the economy can and should do at levels which fall far short of our true capacity, levels which would leave far too much of our productive resources, both human and physical, unused or underused. [Emphasis added.]

Those words could be repeated today, except that, if we accept the advice of the Council of Economic Advisers, we are no longer raising our sights. We are declaring that they are already high enough. And behind that declaration lie policy proposals which will mean in practice that we are lowering our sights, that we are prepared to restrict our growth and to see unemployment rise again.

COUNCIL'S WAGE POLICY NEGATIVE

A second negative aspect of the policies advocated by the Council is its wage policy—which has contributed to imbalance in the distribution of income and, in consequence, to other distortions in the economy. There is no need to repeat here at this time the battle of the guideposts. Suffice it to say that the Council has consistently insisted that, in order to achieve price stability, labor must be prepared to accept an annual rate of increase in current dollar wages no greater than the trend rate—variously defined from time to time as suits the Council's purposes—in national output per man-hour.

True, in this year's report the Council does admit that:

> In calling for restraint in wage and price decisions, the Council recognizes that, in 1968, as in 1967, it would clearly be inappropriate to set the trend of productivity as a numerical target for wage increases. In the face of the 3-percent increase of consumer prices that occurred during 1967, it would be patently unrealistic to expect labor to accept increases in money wages which would represent essentially no improvement in real hourly income."

However, the Council continues:

> Nevertheless, despite the justification for compensation increases in excess of the productivity trend, such increases are inevitably inflationary. As the Council stated in its 1967 Report:
>
> "The only valid and noninflationary standard for wage advances is the productivity principle. If price stability is eventually to be restored and maintained in a high-employment U.S. economy, wage settlements must once again conform to that standard."

In other words, the Council reaffirms, price stability can be restored and maintained only if labor is prepared to permit its share of productivity advance to be eroded away by the price increases currently taking place. Behind its position lies the implicit assumption that, although money wage increases in excess of the rate of productivity advance must push prices up, the reverse is not necessarily true—price increases need not be reflected in corresponding wage increases.

This insistence that labor must bear all the sacrifices required to restore price stability has been a cornerstone of the Council's wage policy. It continues to be so. Thus, for example, although the Council in this year's report discusses the guidepost question under the heading, "Incomes policies," and in the opening paragraphs gives passing recognition to the principle that such policies should apply to "industry, labor, and possibly other groups," as soon as it gets into the substance of the discussion, everything is focused on wages, and the necessity for a policy that will apply to the incomes of "other groups" than labor is forgotten. The Council continues to ignore the crucially important point made by the President's Advisory Committee on Labor-Management Policy, which, on August 18, 1966, in a report on the Council's guideposts, said:

> We believe that in a free society any policy to achieve price stability will be acceptable and effective only if it bears equitably on all forms of incomes.

The Council's contrary attitude is best illustrated in the bland, nonjudgmental manner in which it describes the sharp and sustained increase in cost of medical services. Treating the doctors as tenderly as any doctor ever treated a patient, the Council makes elaborate detours to avoid arriving at the essential point: physicians as a group—although with honorable exceptions—seized upon the introduction of medicare and medicaid to increase their fees unconscionably. The Wall Street Journal for February 27, 1968, recites in appalling detail how

doctors, including those who opposed the legislation, have taken advantage of medicare and medicaid to enrich themselves.

This is a clear case of one group, with maximum power to make unilateral price decisions, using that power to take advantage of a market situation for its own benefit, and in so doing perverting the purpose of an essential social reform. The Council passes no judgment whatsoever. But when organized workers attempt merely to protect their standards of living and their share in advancing productivity against the inroads of just such price increases, the Council condemns their action as "inevitably inflationary."

The matter of salaries paid to corporate executives is also pertinent. The Council is troubled by the fact that average hourly employee compensation—wages, fringe benefits, and employer contributions for social insurance—for all employees in the total private economy rose 6 percent in 1967. Included in, and affecting the size of that figure, is executives' compensation about which the Council, to our knowledge, has never uttered a word or offered a single statistic. The Wall Street Journal for February 27, 1968, however, reports on a survey of executives' salaries in 600 companies which show that such salaries far outdistanced the average worker's gains in 1967 and have done so for many years. The survey, according to the Journal:

> * * * shows management salary increases last year averaged the lowest since 1961.

How low was that? The Journal went on to say that the survey:

> * * * put the average executive pay boost at 8.7 percent, down from 10.8 percent in each of the prior two years.

Executives' salaries are included not only in "employee compensation" but also in the Council's figures on unit labor costs. According to the Council's theory, therefore, such sizable increases in executives' pay must have contributed to the upward movement of prices. Why, then, does the Council reserve its admonitions about "inflationary" wage gains exclusively for lower echelon workers—particularly organized workers?

LABOR COSTS DID NOT TRIGGER INFLATION

Implicit in the Council's approach is the assumption that if only workers would accept money wage increases in line with the rate of productivity advance, without insisting on compensation also for rises in living costs, then the upward pressure on prices would be relieved and price stability would be quickly achieved and easily maintained. If that were not implicit in the Council's approach, it would mean that the Council was not asking labor to accept a temporary sacrifice, but rather a permanent sacrifice of part of its share of advancing productivity to compensate for the actions of others in continuing to force up prices.

Yet, table 18 of the Council's own report makes it clear that prices from 1947 to 1966 in fact rose consistently faster than—or despite declining—unit labor costs, both in the private domestic nonfarm economy as a whole, and in all but one of the major industry divisions.

For the period as a whole, in the total private domestic nonfarm economy, the table shows that unit labor costs rose at an average rate of 2 percent per year, while prices rose at an average rate of 2.2 percent per year. For each of the subperiods it also shows that overall prices rose 0.2 percent per year faster than unit labor costs.

A difference of 0.2 percent may seem small, but this is a cumulative

figure. It means that over the entire period prices rose by over 7 percentage points more than unit labor costs. The BLS release from which the data were taken shows that for the period, while unit labor costs rose only 45 percent, unit nonlabor costs, including profits and interest, rose by 65.5 percent—almost half again as fast. As a result, prices as measured by the GNP deflator rose 52.1 percent.

Of the nine industry divisions shown in the Council's table—in five, prices rose faster than unit labor costs for the entire period; in two more, prices rose even though unit labor costs fell; in one, prices rose at the same average rate as unit labor costs; and in one, prices rose a little more slowly than unit labor costs.

Since there were nine major industry divisions and three subperiods, there were industry data for a total of 27 subperiods. In six subperiods, prices rose even though unit labor costs fell; in one, prices averaged no change while unit labor costs fell; in 10, both rose, but prices rose faster; in one, both fell, but unit labor costs fell faster. Prices either rose faster or failed to fall as fast as the movement of unit labor costs would have justified. In two more, both rose at the same rate, and in seven, unit labor costs rose faster than prices.

Nothing in these data suggests that, if unit labor costs had remained stable, prices would also have achieved an equal stability, or that, in industries where unit labor costs fall, price reductions can also be counted on.

PRICE BOOSTS PRECEDED LABOR COST INCREASES

A unique opportunity to determine whether it is prices or wages that initiate the upward movement of a price-wage spiral is to be found in the relationship between wholesale prices of manufactured goods and unit labor costs in manufacturing over the past several years, because the upward movement of prices which began to accelerate early in 1965 did so from a condition of almost complete and long-sustained price and labor costs stability.

As shown in the chart on the following page, from the middle of 1958 through August 1964, both prices and unit labor costs were remarkably stable. During this period, wholesale prices of manufactured goods rose only 0.9 percent, from an index of 100.1 (1957–59=100) in July 1958 to 101 in August 1964. Prices had in fact been relatively stable even prior to July 1958, but unit labor costs had shown some fluctuation due to the adverse effects of the 1957–58 recession on productivity. By July 1958, however, these fluctuations had diminished, and between July 1958 and August 1964, while more volatile than prices—because of both statistical error and productivity changes associated with changes in volume and rates of capacity utilization—unit labor costs fell by 0.6 percent, from 100.3 (also 1957–59=100) at the beginning of the period to 99.7 in August 1964, and during this time fluctuated only between a low of 97.5 and a high of 102.8.

After August 1964, however, the picture changed drastically. Prices began to rise, slowly at first, then more rapidly. By July 1966 prices had reached 106.4, an increase of 5.3 percent.

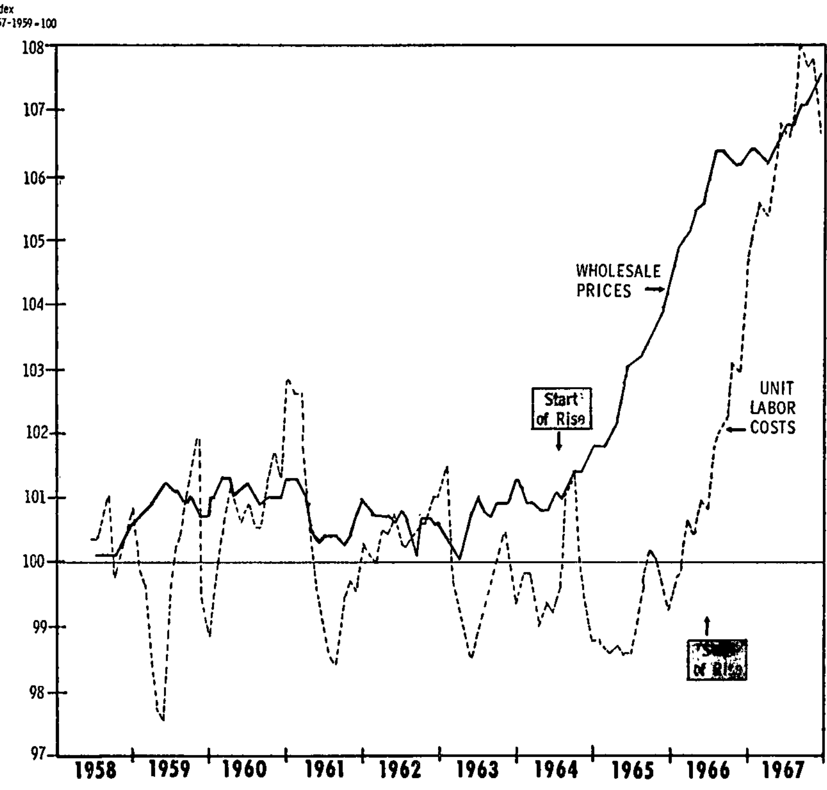
Unit labor costs, however, continued to remain stable, and even to fall farther for a time. In July 1965 they stood at 98.6, 1.1 percent below the August 1964 level. By March 1966 they were still only at 99.9, only two-tenths of 1 percent above August 1964. After that, how-

ever, they began to rise more rapidly as workers found it necessary to compensate for rising living costs. Between March 1966 and January 1967, unit labor costs rose 4.9 percent. The rise continued in 1967, but this was in considerable part due to the sharp falling off in the rate of productivity increase resulting from the 1967 economic slowdown.

The picture is remarkably clear. After nearly 6 years of stable prices and actually declining unit labor costs, prices began to rise. The cause certainly was not wages, since unit labor costs had been falling. For more than a year after prices had begun to rise, unit labor costs remained stable, but eventually they also began to rise. Quite clearly, it was not wages that pushed up prices, it was prices that pulled up wages. If the Council of Economic Advisers had been as assiduous in discouraging unnecessary price increases as it has been in discouraging quite justifiable and, in fact, necessary wage increases, the price-wage spiral might never have started on its upward course.

Wholesale Prices of Manufactured Goods and Unit Labor Costs in Manufacturing

July 1958 - December 1967



Data: BLS Handbook of Labor Statistics, 1967;
Bureau of the Census, Business Cycle Developments, January 1968

CONTRIBUTION TOWARD IMBALANCE

The Council's negative wage policy contributed to an imbalance as between income from employment and income from property. (This imbalance was compounded by the tax reduction of 1964 which favored corporations and the wealthy, liberalized depreciation treatment, and the investment tax credit.) As a result, profits (and corporate and upper bracket family savings) soared. The sharp increase in profits stimulated and financed an unsustainable investment boom. When matters threatened to get out of hand, monetary policy intervened to put on the brakes with drastic adverse effects upon growth and upon high-priority spending for housing and by State and local governments. The inflationary spiral had gathered momentum, however, and the Council now calls for the blunt instrument of a tax surcharge to slow it down.

Defects of Aggregative Approach

The distortions and imbalances that have led the Council to urge negative and restrictive policies are in large part the result of the blunt instrument approach to guidance of the economy. Monetary and fiscal measures have been framed, advocated, and applied primarily on the basis of their effects on the level of total demand and the size of total GNP. The Council has tended to be concerned mainly with how much was being produced without paying enough attention to what was being produced, for what purpose it was being used, and who was getting it.

When, as in the early 1960's, expansion was the goal, the main policy instrument was a tax cut—without too much concern as to the distribution of the benefits. As already noted, corporations and families in the upper income brackets got the lion's share both of the tax cut and other tax changes. When, partly as a result of the nature of those tax measures, investment began to get out of hand and the price level began to rise, the blunt instrument of monetary policy was brought into play by the Federal Reserve Board. When tight money plunged housing into a depression, hampered State and local governments in fulfillment of their obligations, threatened to strangle many small businesses, and began to stifle growth—without accomplishing very much in the way of retarding price increases—the Council responded with advocacy of another blunt instrument. According to both last year's and this year's reports, an across-the-board tax surcharge is the sovereign remedy for what ails the economy.

What is forgotten in the concern with aggregates—total demand and total GNP—is that distortions and imbalances can accompany either a planned step-up or a planned slow-down of the overall rate of growth. Balanced growth and, in particular, protection of the priority areas of the economy, requires attention to the composition as well as the total of demand and GNP.

A long list could be made of the distortions, imbalances, and setbacks to priorities resulting from inattention to the composition of demand, while gross monetary and fiscal policies were applied in an effort to manipulate the total. The following are a few examples.

DISTORTIONS OF INCOME DISTRIBUTION

A major imbalance has resulted from the distortion of the income distribution which has favored property incomes at the expense of

labor incomes and has favored wealthy individuals and big corporations at the expense of those with small and moderate means.

Department of Commerce data show that, between the second quarter of 1960—the peak of the last previous expansionary period—and the third quarter of 1967, employee compensation in private industry rose by 55.9 percent. But in the same period corporate profits after taxes rose by 69.4 percent, dividends rose by 73.3 percent, and personal interest income surged upward by 102.2 percent. As we pointed out in making a similar comparison for this committee a year ago, the discrepancy was even greater for the period from the second quarter of 1960 to the second quarter of 1966, because subsequently the pressure of rising living costs finally forced wages up at a faster pace. In addition, the business slowdown of 1967, a consequence of the imbalances which had developed in the economy, resulted in some drop in profits.

DISTORTION IN RESOURCE ALLOCATION

The distortion in income distribution has led in turn to imbalances in the allocation of resources. Typically, increases in incomes of those with small or moderate means go primarily into increased consumer spending. Wealthy individuals, on the other hand, already have sufficient income to meet their personal needs, and corporations do not engage in consumer spending at all—if you except expense account spending and similar indulgences extended to top executives. Thus, increased incomes of wealthy individuals and corporations primarily go to increased investment, both at home and abroad, or into speculation or savings, neither of which add to the stream of job-creating demand.

This is not to say that investment is not *per se* as economically useful and necessary as consumer spending; of course it is. But the two must be kept in balance in order to provide market outlets for additions to supply resulting from investment. It is no coincidence that, as a result of failure to achieve balance, our economy repeatedly suffers from the chills and fevers of insufficient consumer spending not adequately offset by Government spending and unsustainable booms in investment and inventory speculation which collapse into recession. The overall results have been slower growth than we should have enjoyed; higher and longer lasting unemployment than we should have suffered; and substantial underutilization of our productive capacity.

As the year 1967 began, we had just emerged from 3 years during which business fixed investment grew twice as fast as GNP, and an unprecedented rise in business inventories. A collapse was avoided (although we did go through what has come to be called a minirecession); but rates of capacity utilization fell sharply; and unemployment was on the rise during the first 10 months of the year. Now, although capacity utilization is still low and many workers still idle, the Council, anticipating a repetition of the old familiar pattern, feels it necessary to advocate a tax surcharge to head off a new, unsustainable burst of business spending on plant, equipment, and inventories.

BALANCE-OF-PAYMENTS EFFECTS

Not all of the excessive income siphoned off into corporate treasuries and upper bracket family accumulations during the past 7 years has gone into domestic investment. In recent years there has been a

persistent outflow of capital for investment in other developed countries which has contributed substantially toward our balance-of-payments difficulties. Clearly there has been a misallocation of resources resulting from the basic maldistribution of income as between those who primarily spend and those who primarily save, invest, and speculate.

SHORTAGE OF HOUSING

Another serious distortion to which monetary policy, in particular, has contributed is the chronic shortage of housing—certainly one of our top-priority needs—and the failure of the economy to remedy it. In his first "state of the Union" message, on January 30, 1961, President Kennedy said:

> Twelve long years after Congress declared our goal to be "a decent home and a suitable environment for every American family," we still have 25 million Americans living in substandard homes.

And, in his budget message this year, President Johnson said:

> Most Americans lead a comfortable life, in comfortable homes and comfortable surroundings. But millions of families are still crowded into housing unfit to live in, located in squalid surroundings, and burdened with wornout facilities and inadequate services. Without some assistance and the development of new techniques, our private economy cannot now provide good housing at costs these families can afford.

It is true that some progress has been made, but not nearly enough. The report of the Council, after summarizing the developments of the past 17 years, states:

> Despite these developments, the number of occupied dilapidated units apparently declined by less than 100,000 a year in the 1950's, and by only about 60,000 a year in the 1960's. Moreover, virtually all of this decline occurred outside metropolitan areas. Detailed data for the 1960's are not available for most areas, but surveys of New York City and some areas in Los Angeles indicate an actual increase in the number of occupied dilapidated units in those cities. The results suggest that, in large cities, much of the improvement in housing quality from new building in excess of the rate of household formation is offset by the deterioration of existing housing.

In other words, construction of new housing, especially in our large cities, has not been sufficient to offset the combined effects of population growth and deterioration of existing housing.

Nor is the situation improving. The trend line (computed by the method of least squares) for private nonfarm housing starts actually declined between 1960 and 1967 at a rate averaging approximately one-half of 1 percent per year. The number of private nonfarm housing starts in 1966 was the lowest in 20 years, and the 1967 rate was lower than that of all but 3 of the last 20 years.

The problem is not merely one of dilapidated and substandard housing, but of insufficient housing, resulting in overcrowding. The 1960 *Census of Housing* showed that 11.5 percent of occupied housing units were overcrowded to the extent of having more than one person per room. But we are not even approaching a remedy for this problem. According to the data in the Council's 1968 report, the country's total stock of housing increased between 1960 and 1966 by an amount barely sufficient to keep pace with population growth. Our total housing stock increased by 9.5 percent, but our population grew by 9 percent.

The housing problem is not a problem of the poor alone, as President Johnson recognized in his budget message when he called for a new

program to build 6 million new housing units "for low- and middle-income families" over the next 10 years. The fact is that housing has become so expensive that many families with moderate incomes have been priced right out of the market, while many more have had to settle for smaller, less adequate, quarters than they actually needed.

There are numerous causes of our failure to produce houses in the numbers needed and at reasonable prices. They include the depredations of land speculators, obsolescent local building codes, and obsolete technology in the construction industry. But a major cause of the shortage of decent housing is the *devastating effect of gross monetary policy upon the housing market.*

Housing is perhaps the classic example of the defects of the blunt instrument approach. The money managers are motivated to tighten the money supply and to raise interest rates by what they consider an excess of aggregate demand. But tight money and high interest rates do not operate evenhandedly upon all components of the aggregate. Home construction is the most vulnerable victim.

The enormous backlog of unfilled needs for housing is without question attributable in large part to efforts to regulate total demand in the economy by raising interest rates and restricting the supply of credit. These actions periodically plunge housing starts to recession and even depression levels—both by restricting the availability and by raising the cost of credit. The impact of what may seem like small increases in interest rates upon the cost of housing is often not fully appreciated. A family which can afford to pay only $100 per month in principal and interest payments, for example, could finance a 30-year mortgage of approximately $15,670 at the present FHA maximum interest rate of 6½ percent (including insurance premium). Raise the interest rate to 8 percent, and the same monthly payment will finance a mortgage of only $13,510—over $2,100 less.

It is no coincidence that the rising interest rates of the past 2 years (and the monetary crunch of 1966) have been accompanied by a sharp decline in private housing starts from the levels of the preceding 3 years.

Yet, despite the urgent national need for housing, indiscriminate use of the tight money and high interest brakes is still widely regarded as an appropriate instrument of economic policy.

OTHER DISTORTIONS AND IMBALANCES

Other distortions and imbalances, not only in the economy as such but in the whole fabric of our national society, have resulted from our failure to recognize that the structure of demand is important as well as the volume of demand. This is true both of the balance between private and public demand, and of the composition of demand within each sector. It may be that the spending of $100,000 on a luxury yacht will in the long run create as many jobs as if the same amount were spent on a new school addition, or diverted by taxation to raise the incomes of the poor, but the value to society will be far different. The expenditure of some billions of dollars to put a man on the moon or land a ship on Mars may have the same effect on the national budget and on the volume of total demand as using the same money to help remodel our

cities, but the social consequences will not be the same. As was said earlier, this country has got its priorities out of order. It is time we put them right.

Priorities Require Selective Measures

Priorities in themselves are not enough. They are nothing more than expressions of good intentions if they are unaccompanied by effective tools to assure that priority needs do, in fact, exert priority claims upon resources. The aggregative fiscal and monetary policies of the new economics obviously are not the refined tools required to channel resources toward fulfillment of our priority purposes. Seven years of experience with the new economics has proved that a government applying the aggregative approach can determine how much is produced. But aggregative policies rely on the blind forces of the marketplace to determine what is produced, for what purpose, and by whom it is used. Those forces thave not served us well. Our national affluence is misallocated, and that misallocation is reflected in, among other things, the discontents, anxieties, frustrations and social tensions that pervade our society, and the persistence of poverty, the spread of environmental pollution, and the condition of our cities.

Our national priorities can be made meaningful and given practical effect only through development and use of a kit of selective economic tools adequate to shape the composition and distribution of demand and thereby of production. Monetary and fiscal measures need not be used as blunt instruments. They can be applied selectively and they can be supplemented by other types of measures to guard the health and stability of the economy and to assure that priority needs will be met before demands of lesser urgency.

Our government has not hesitated to apply selective monetary and fiscal policies for certain purposes. Consumer credit controls, which restrict spending by low- but not by high-income families, provide an example of a selective monetary measure which has been used. The investment tax credit is a selective fiscal measure designed to channel an increased flow of resources into business investment. The oil depletion allowance is not only a machine for making Texas millionaires but also a selective tax measure defended by those who benefit from it as necessary to channel resources into exploration and drilling for oil.

It is also true that there is a degree of selectivity in the effects of every fiscal and monetary action—even though often unintended and not infrequently in conflict with other objectives sought by government.

In the case of fiscal measures, the economic impact of government spending will be affected by what the Government buys, and the impact of taxation will be determined by who is taxed and what form the taxes take. A tight money policy is selective in that it has an impact on vulnerable industries such as housing and on the plans of State and local governments out of all proportion to its effect on, say, the plans of major corporations which are largely able to finance new investment from internal sources. What we have lacked, however, is a consistent policy designed to make deliberate use of selective fiscal and monetary measures so as to achieve predetermined goals based on a carefully-thought-out set of economic and social priorities.

It is not our purpose in this statement to enumerate and to describe in precise terms all the tools that should be in a kit of selective fiscal and monetary measures. We seek instead merely to show that we need not remain prisoners of market forces and that selective measures can be devised which are fully compatible with freedom. Outlined below are a number of suggestions (which could undoubtedly be improved upon) intended to illustrate those points. These suggestions are designed to guide the flow of resources rather than to coerce individuals. Other illustrations, with particular pertinence at this moment, are presented later in this statement as alternatives to the proposed income tax surcharge—which seems to be directed mainly toward preventing an unsustainable investment boom.

INVESTMENT RESERVE FUND

Restraining unhealthy investment booms, however, is only half the job of keeping levels of investment on an even keel. Equally dangerous to the economy is the sharp drop in investment which normally accompanies a recession and helps prolong it. What is needed here is a special inducement to businessmen to invest at such times, as well as to refrain from investing when the economy is threatened with overheating. Such inducements can be provided through the operation of an investment reserve fund such as has been established in Sweden.

In Sweden, a corporation is permitted each year to place up to a given percentage (the figure was 40 percent not long ago, but may have been changed) of its before-tax profits in a special investment reserve. No tax is paid on the funds going into this reserve, but a portion of it equal to the profits tax that would normally be paid must be deposited in a special non-interest-bearing account with the Central Bank.

In a year when the government determines that the economy is in need of an economic stimulus, it may permit all or part of these reserves to be withdrawn for the purpose of financing investment expenditures, and a corresponding amount of the money deposited with the Central Bank is returned to the company. The company is always free to withdraw its funds from the investment reserve, but if it does so at a time when the government wishes to discourage investment it does not get a return of the money deposited in the Central Bank. Instead, all or a portion of that deposit, equal to the normal profits tax on the amount withdrawn from the reserve, is forfeited. Thus, in effect, if the company restricts its investment of the portion of its profits subject to the reserve fund machinery to a period when the economy requires such investment, that part of its profit is free of tax; but if it chooses to invest those profits at any other time, it must pay the normal tax on them.

PROGRESSIVE SPENDING TAX

If the economy should become so overheated that measures to reduce consumer spending are necessary, there are methods of doing so much more equitably than through an across-the-board increase in the income tax. One of the deficiencies of the latter is that it taxes income which would otherwise be spent for necessities, as well as income that would be spent on luxuries. As an alternative, a progressive spending tax, which the Treasury proposed during World War II and the UAW

has urged on several occasions, would help to divert resources from luxury consumption to higher-priority purposes. Such a tax would allow tax-free exemptions, based upon the number of persons in each family, sufficiently high to enable the family to maintain a comfortable standard of living. Amounts spent by the family above its exemptions would be taxed at graduated rates which would increase as the amount spent per family member rose.

Such a tax would be desirable, within the framework of an overall fiscal policy aimed at full production and full employment, to achieve a useful and desirable reallocation of resources.

A progressive spending tax can be administered more effectively if it is kept in force permanently. If that were done, the tax rates could be varied from time to time depending upon whether national priorities (including full employment) called for more or less consumer spending. These factors suggest that consideration might usefully be given to enactment of such a tax now.

Although we do not now have full employment, and therefore have no present need to suppress nonessential consumption, the progressive spending tax might nevertheless be a useful tax today if the revenues from it were earmarked to be spent (in addition to what is already planned to be spent, so that there will be no reduction in total demand) for some purpose of high national urgency. Through such a tax, those who spent on luxuries could simultaneously be required to contribute, for example, to a stepped-up war on poverty—on the principle that those who enjoy a superabundance of cake should be mindful of their neighbors' needs for bread. To the extent that the tax deterred luxury spending, the resultant additions to savings could be channeled, through use of selective monetary devices, into housing and other social deficit sectors of the economy.

TAX REFORM

Another measure which equity demands and which has been far too long delayed is a reform of the tax system and plugging of loopholes which now permit some favored groups of citizens and corporations—many of them extremely wealthy—to avoid carrying their fair share of the tax burden. The Council recognizes this as a possible alternative to the proposed tax surcharge, but shrugs it off by saying that such reforms should be enacted on a permanent basis, not to meet a temporary need, and that it would take too long to get such reforms through Congress.

Of course, such reforms should be on a permanent basis. But that is no reason why they should not be started on today. As for the argument that it will take too long to get tax reform legislation through Congress, there is strong reason to doubt that it will be possible to get the proposed tax increase legislation through Congress at all, but that has not prevented the Council from proposing it. If the Council had been as assiduous in pushing for tax reform since President Kennedy first proposed it as it has been in supporting other more dubious proposals, such as the wage-price guideposts, we might have had tax reform on the statute books by now.

Here again, however, so long as we fall short of full employment, the revenues from loophole closing must be added to government

spending already planned in order to avoid reducing total demand and employment. On that basis, loophole-closing could speed our progress toward the Great Society.

MEETING THE REAL PRICE PROBLEM

Much of the inflationary threat to the economy, however, does not come from overheating at all, but from the unilateral actions of a comparative handful of giant corporations which have achieved so much economic power that they are able to dominate the industries to which they belong and virtually to insulate themselves from the effects of competitive market forces, especially in the area of price decisions. Such corporations are able to abuse their economic power by setting prices at levels higher than a free market would permit. Typically, they establish prices at levels which will protect them against loss even if the economy should dip into a recession. As a result, in periods of expansion their profits skyrocket to fantastic levels, helping to create some of the imbalances in the economy previously described. Year after year, in its discussion of price problems, the Council of Economic Advisers has had to lament the fact that such corporations, which frequently also enjoy above-average rates of productivity advance, have not made their proper contribution to overall price stability by reducing prices—thus offsetting the unavoidable price increases in industries with less-than-average rates of productivity advance—but instead have maintained prices at inordinately high levels, or even raised them.

Regrettably, one of the major offenders in this regard has been the auto industry. Not only has the industry failed to cut prices over a period of years when, as its fantastic profits show, it could well have afforded to do so, but it has twice announced price increases in the past 6 months. In addition, there has been a series of unannounced, stealthy price increases which the industry apparently hoped to put over without public knowledge of what was happening. Prices of replacement parts have been increased, formerly standard equipment has been made optional with no corresponding price adjustment, and buyer warranties have been diluted. On January 30 the Wall Street Journal reported:

> Since September, the auto makers have increased car prices twice, the first two-step increase in a model year since 1956. The first price boost averaged more than $100 a car and was the largest of three in the past three years. On Jan. 1 prices went up another $23 to $32 when the shoulder belts were installed to meet Federal safety regulations.
>
> In recent weeks Ford Motor Co. also dropped as standard equipment some devices on many of its cars without lowering the prices, making the devices extra-cost options. It also raised the prices of some models after making larger engines or other optional equipment standard. And all four auto makers have quietly raised parts prices from 4% to 7% since mid-November.

These price increases cannot be justified by financial necessity. FTC–SEC financial reports show that, in spite of a decline from the preceding year, auto industry profits in the first three quarters of 1967 were still running well ahead of the average rate of return on investment for all manufacturing. And the Wall Street Journal on February 13, 1968, under the heading, "Corporate Profits Again Appear To Be Heading From Record to Record," reported:

Industries such as autos and rubber that turned in a good profit performance in the fourth quarter expect to do still better now * * *.

Clearly, the increase in car prices is just another example of corporate greed on the part of the auto industry.

PRICE-WAGE REVIEW BOARD NEEDED

To counter such abuses of economic power, the UAW has long advocated the establishment of a Price-Wage Review Board. It would operate essentially as follows:

Whenever any corporation controlling, say, 25 percent or more of the sales of a major industry or product wished to raise its price, it would first have to notify the Board, and appear at a public hearing if the Board thought necessary.

The Board would hold public hearings, would have power to obtain all the pertinent facts, and would issue a report. The corporation would then be at liberty to raise prices, up to the limit of its proposal, if it saw fit. But if the facts were such as to persuade any reasonable man that a price increase was not justifiable, and if the public had access to those facts, we do not think any increase would take place. In most such cases, the mere existence of the hearings procedure would probably mean that the price increase would never be proposed.

CONSUMER COUNSEL WOULD WORK WITH BOARD

The Price-Wage Review Board machinery could be given added strength by the creation of a separate Office of Consumer Counsel, whose function it would be to represent the interest of consumers in hearings before the Board. He should also be given the authority to initiate hearings before the Board when a prima facie case could be made that prices charged by a corporation covered by the system were already too high in relation to costs. In such a situation, the Consumer Counsel, after making his own preliminary investigation, would lay the facts before the Board. If it agreed that there was substantial reason to believe that prices charged by a corporation covered by the law were unduly high, it would then notify the corporation and make arrangements for a public hearing.

Unions would also be subject to the hearings procedure. Whenever a corporation subject to the hearings procedure claimed that acceptance of any union demand would require it to raise prices, both the corporation and the union would be summoned to a hearing and required to produce the facts relevant to their claims. As the Council of Economic Advisers has acknowledged, there are, of course, situations where wage increases are justified even though they may require price increases. Where that was the fact, the hearing would reveal it. On the other hand, if the union's demands were not justifiable, the facts would show it. Or if the company's profit position were such that it could well afford to meet the union's demand without a price increase, the facts would show that. The parties would resume negotiations with the knowledge that an informed public was prepared to pass judgment on the outcome.

In a free society we must find a middle ground between a reckless, socially irresponsible, laissez-faire, "public be damned" attitude and

arbitrary action by Government to set the levels of prices and wages. The approach we propose stands on such middle ground and relies not upon the coercion of Government compulsion but upon the moral leverage of enlightened public opinion which, in a free society, must be the repository of authority in the broad area where private power and public responsibility must be equated and harmonized if freedom is to survive.

The establishment of the Cabinet Committee on Price Stability announced by the President indicates the administration's recognition that more effective means have to be found of curbing unjustifiable price increases. We urge this committee to recommend to the Cabinet Committee that it give serious consideration to the establishment of a Price-Wage Review Board and Office of Consumer Counsel.

MEASURES TO MEET HOUSING NEEDS

As indicated previously, the causes of our housing problem are multifarious, and there is no single, simple solution to them. A variety of selective measures are required. We need tax legislation designed to deter those who speculate in land and thereby drive up land prices or who milk slum properties for maximum profits without bothering even to keep them in a decent state of repair. We need to sweep away the multitude of local building codes, many of them obsolescent, which help to prevent the use of new methods, materials, and technologies in the building industry, and replace them with a national performance standards code—making allowance for regional climatic variations. And we need a new approach to the financing of housing, which for many families represents the major stumbling block in the way of getting a good home in a good neighborhood. In particular, we need to safeguard the availability of adequate mortgage funds at reasonable interest rates even when it becomes advisable to restrict the flow of credit to other sectors of the economy.

The Council of Economic Advisers has recognized the importance of providing adequate funds to finance housing. One of the reasons it gives in support of the proposed tax increase, in fact, is that, if the anticipated budget deficit is financed through borrowing, it will dry up the money market to the extent that the housing industry will be stifled for lack of mortgage money.

Again, we see the blunt instrument approach at work. Implicitly, the Council recognizes that all demands for credit do not have the same social utility or urgency as housing, and that the market cannot be relied upon to channel the flow of available credit in accordance with social considerations. The Council stops there, however. It seems to assume that nothing can be done to protect housing against competing demands for credit for purposes of far lesser utility or urgency—inventory, stock market or land speculation, for example, or disproportionate fixed business investment (in anticipation of the future growth of markets) which could be deferred until credit becomes more readily available. That assumption, obviously, is false. It is not beyond the imagination of the Council to devise, or the ability of the Government and the Federal Reserve Board to apply, selective measures to direct the flow of credit to where it will do the most good. What is required for the selective approach is an order of national priorities—on which housing would rank very close to the top. Given

those priorities, proper measures can and should be taken to insure an adequate supply of funds to finance the volume of housing required.

A variety of measures might be used to achieve that end. For example, ceilings on interest rates payable on commercial bank time deposits could be related to rates (fixed at reasonable levels) paid on deposits in savings and loan associations so as to assure an adequate flow of funds to the latter. Or, given whatever limits might be necessary on the total supply of credit, the government might channel an adequate flow of subsidized low-interest loans to mortgage lenders, using the mortgages as collateral, provided the lenders in turn made mortgage loans within a specified interest rate limit. Or the Government might act through the Federal Reserve Board to make more funds available. This was the intention of Congress in 1966 when it passed legislation authorizing the Federal Reserve Board to buy securities of the Federal home loan banks and the Federal National Mortgage Association. Unfortunately, the legislation left decisions whether to do so or not to the discretion of the Board, and its Chairman testified even before the legislation was enacted that he had not intention of doing so in any volume unless directed to. The legislation should be amended so as to require the FRB to take such action when directed to do so by the President.

Congress should not, however, adopt the remedy proposed in the budget message and supported by the Council of raising the statutory interest ceilings on FHA and VA loans, and on conventional loans in States now imposing a ceiling of 6 percent or less. Such action would open the way for market forces to play havoc with housing. Although it might temporarily attract more funds into the mortgage market, it would at the same time drive more borrowers out. And as Representative Wright Patman has pointed out, the competition of mortgage interest rates, which he predicted would go to at least 7 percent, would soon send other rates higher. On February 8, he told the House:

> As a result, rates on Treasury notes and PC's would skyrocket overnight to compete with the new 7 percent rate FHA paper backed by the government insurance. We would experience a quick leapfrogging of all government rates, thus costing the taxpayers billions of dollars in added costs on Treasury borrowings.
>
> After the Treasury notes and PC's have jumped, the FHA paper would again find itself in a disadvantageous competitive position. Once again, the lenders and the homebuilders would seek a new increase in the FHA rate.

We have serious doubts also about the proposal in the budget message for:

> An orderly transfer of ownership of the Government's activities in the secondary mortgage market to private hands, so that private capital can be raised and mortgages purchased as required by market conditions.

This proposal is so indefinite that it is difficult to know precisely what is contemplated. But surely the history of the past 20 years and more provides convincing evidence that if provision of funds to finance housing is left to the vagaries of the private money market, the funds will not be forthcoming at rates most families can afford, and the housing we need will not be built.

In his "Crisis in the Cities" message, the President proposes that 6 million homes be built in the next 10 years with Federal assistance, in addition to the 20 million he hopes private enterprise will build unaided. We believe the total goal is too low, and the expectation of what

private builders will do on their own is too high. It is disappointing also that in the first year of the program it is proposed to assist with only 300,000 units—just half the annual rate required to meet the 10-year goal.

The proposals to subsidize all but 1 percent of the interest charged on homes bought by needy families and on homes to be rented by families with incomes between $4,000 and $8,000 per year are sound and commendable in themselves. However, if at the same time these mortgages are transferred from FNMA to a private corporation, as is proposed, the Government might be exposed to excessive interest costs.

The President's proposal to "authorize Federal insurance of bond obligations issued by private mortgage companies or trusts holding sizeable pools of FHA and VA insured mortgages" seems to us to be a useful means to make more funds available for housing. But it need not be coupled with the removal of the ceilings on interest rates permitted to be charged on such mortgages in order to attract investment in such obligations by pension funds and other institutions desirous of avoiding "the bookkeeping and paper work associated with hundreds of individual mortgages."

MODERNIZE AND DEMOCRATIZE THE FRB

The refusal of the Chairman of the Federal Reserve Board to acknowledge the clearly expressed will of Congress with regard to provision of mortgage funds is just one example of the need to modernize and democratize the Board so that it will be more responsive to the needs of the people as expressed through their democratically elected representatives. Not only is the Board unresponsive to modern needs, but its power to seriously undermine the economic policies of the national administration has no place in a democratic society of the 20th century. Repeatedly the Board has insisted on following policies which pulled in the opposite direction from those of the administration in office at the time. In an economy as complex and as delicately balanced as ours, this is irresponsible and intolerable folly. We would urge that two basic changes be made. The Chairman should hold office only at the will of the President of the United States. And memberships in the governing bodies of the system, which are now dominated by bankers, big businessmen, and monetary experts, should be opened up to people from other sectors of the American economy, including the labor movement.

OUTLOOK FOR 1968

The Council's main policy proposal for 1968 is enactment of a 10-percent surcharge on personal and corporate income taxes. This recommendation is the combined result of a value judgment and an economic forecast, both of which are highly questionable.

The value judgment is that there is no urgency about reducing the unemployment rate below last year's level—that reduction of unemployment deserves only a low ranking on the scale of national priorities—that 3.8 percent unemployment is more tolerable than any additional price level increase that might be associated with a lower unemployment rate. That view, we submit, is in conflict with the basic

purpose of the Employment Act to which the Council owes its existence. It reflects a policy of attempting to buy price stability with the hardships of the unemployed and the risk of renewed disruption of the peace of our cities. For it is almost universally agreed that unemployment was a major cause of the urban riots that have marred every recent summer. As the Council well knows, the 1967 overall unemployment rate of 3.8 percent involved a 7.4-percent rate for nonwhites and a 26.5-percent rate for nonwhite teenagers. In the 20 largest Standard Metropolitan Statistical Areas (SMSAs) unemployment of nonwhite teenagers averaged 32.7 percent in 1967. It is perhaps not without significance that Detroit and Newark, the two cities that suffered the most devastating disturbances last summer, ranked third and fourth highest (with 10.9 and 9.8 percent, respectively) among the 13 SMSAs for which the Labor Department has published 1967 nonwhite unemployment rates.

The Council acknowledges that the tax surcharge would have the effect of eliminating job opportunities that would otherwise be available. In describing what would happen in the absence of the surcharge, the Council says that:

> * * * it might be possible to mobilize some additional manpower from among the remaining unemployed [and that] some poorly qualified workers would be hired.

The "remaining unemployed" and the "poorly qualified workers" are, of course, those for whom jobs most urgently need to be found both on humane grounds and in order to reduce the social tensions that pose a continuing threat to urban peace. They are the "hard core" unemployed for whom it is proposed to create 100,000 jobs by July 1969 through subsidies to employers at the rate of $3,500 per job. The Council has conceded that during 1968 "as a whole" the surcharge would cost the economy 150,000 jobs. (The number would be larger toward the end of the year and still larger later on because of the multiplier effect.) This is half again as many jobs as the subsidies are intended to create by mid-1969. As will be shown below, there is reason to believe that the surcharge will cause a loss of potential jobs in 1968 significantly greater than the 150,000 projected by the Council.

The loss of those jobs and continuance of last year's unemployment rate would be bad enough. But analysis of the Council's view of the economic outlook (as well as projections made by other economists and reviewed below) suggests a strong possibility that the tax surcharge which the Council urges could result not only in a loss of potential job opportunities but in significantly increased unemployment—and with only negligible gains in price stability.

LAST YEAR'S FORECAST

To begin with, the forecast the Council made in its 1967 report does not inspire much confidence in its predictions for 1968. It will be recalled that last year, also, the Council called for a tax surcharge to avoid "overheating" of the economy. It predicted that, if its surcharge proposal were adopted, real gross national product would be 4-percent higher in 1967 than in 1966. Presumably it anticipated a greater increase in the absence of the surcharge. The surcharge was not adopted,

and real gross national product grew only 2.5 percent—the smallest increase since the 1960–61 recession. (The difference can be accounted for only partially by the fact that Congress delayed enacting social security benefit increases which the Council had expected to be in effect by mid-1967). Had the surcharge been enacted, growth undoubtedly would have been less than 2.5 percent.

Looking back at 1967, the Council, which last year urged the fiscally restrictive surcharge, congratulates itself in this year's report on "the avoidance of recession (as) a major favorable development," and adds:

> It was only because fiscal and monetary policy were operating in a stimulative direction that the expansion endured. [Emphasis added.]

The Council turned out to be correct in predicting that unemployment in 1967 would be "essentially the same as in 1966." But it was correct on that score largely because the lower-than-expected rate of growth retarded the rise of productivity and resulted in a reduction in average weekly hours worked.

FORECAST FOR 1968

The Council foresees an uneven pattern of economic activity in 1968 and concedes that, under that circumstance, "forecasting involves special uncertainties." More than half of the increase in GNP which the Council predicts for 1968 is accounted for by its forecast of consumer spending. But the Council is careful to note that:

> For 1968, the consumer sector is clearly an area of particular uncertainty in forecasting private demand.

Since consumer spending will have an important influence on business spending, both for fixed investment and inventories, the uncertainties are compounded.

Given these uncertainties, it is reasonable to ask whether enactment of the tax surcharge would not involve a serious risk of raising the unemployment rate significantly above last year's 3.8 percent. The evidence suggests that the risk is very real.

The Council makes much of the "brisk pace" of the economy in the second half of 1967, noting, among other things, that "final sales increased substantially." The fact is, however, that in real terms the increase in final sales from the second to the fourth quarters of 1967 was only 1 percent—at an annual rate of only 2 percent. If allowance is made for the effects of the Ford strike—which the Council says "curtailed the annual rate of real growth by 1 percentage point over this period"—the annual rate of increase in real final sales would still be only 3 percent. This is a matter of some importance since the Council's case for the surcharge rests in large part on continuance of the impetus of the last half of 1967 into this year. That impetus was not very great.

Total GNP rose at a faster rate than final sales during the second half of 1967 because of a spurt in inventory accumulation during the last quarter of the year. In part, the additions to inventory were an aftermath of the Ford strike. They also reflect early preparations for a possible steel strike. The disappointing level of retail new car sales thus far this year suggests that further additions to the

stock of autos may be involuntary, with the result that production will be cut back. This could mean less buoyancy in the first half of 1968 than the Council expects. Steel inventories will continue to increase in the months ahead; but they will inevitably be reduced later in the year, either during a strike or following a settlement. Production, employment, and the general level of demand will all be adversely affected, whether or not a strike occurs. Thus, in the absence of other reasons for accumulation of inventories, the main source of the acceleration of growth during the second half of 1967 would be operating to retard growth in the second half of 1968. Enactment of the tax surcharge would compound the effects of inventory reduction.

Examination of the Council's sector-by-sector forecasts, which are premised upon enactment of the surcharge, adds to misgivings about the wisdom of the surcharge proposal.

BUSINESS FIXED INVESTMENT

The Council expects business fixed investment to be $4 to $5 billion higher in 1968 than in 1967. Insofar as the first half of 1968 is concerned, this forecast is based upon anticipated investment as reflected in the Commerce-SEC survey. In 1967, however, the anticipations reflected in that survey turned out, quarter-by-quarter, to be substantially overoptimistic when data on actual investment became available. In the first and second quarters of 1967, increases over the respective preceding quarters had been anticipated by actual investment decreased. The average error for the first three quarters (fourth quarter actual data are not yet available) was more than $2 billion at an annual rate.

Preliminary figures for 1967 (with the fourth quarter taken at the anticipated level) show an increase of little more than 1 percent over 1966 in current dollar business expenditures for new plant and equipment, which would mean a decrease in real investment. The reason is readily apparent. From 1963 through 1966, real plant and equipment investment had been increasing twice as fast as real GNP. Such a discrepancy was clearly unsustainable.

Excessive investment and lagging demand inevitably resulted in a sharp decrease in capacity utilization. In manufacturing, for example, Federal Reserve Board data show that capacity increased by 6.4 percent from the fourth quarter of 1966 to the fourth quarter of 1967. Output during the same period declined by one-half percent. As a result, capacity utilization dropped from 90 percent to 84.3 percent.

With a wide margin of existing capacity unused, it is not at all surprising that anticipated increases in plant and equipment spending fail to materialize. The Council may be in for a disappointment in the nonelectrical machinery industry, for example. This is one of the industries mentioned by the Council for which the Commerce-SEC survey "reported plans for considerable increases in investment in the first half of 1968." However (according to McGraw-Hill figures), the operating rate in nonelectrical machinery dropped from 93.5 percent of capacity in December 1966 to 80.5 percent in December 1967.

Given this 13-percentage-point drop in the operating rate, actual fixed investment expenditures in the industry in early 1968 could turn out to be lower instead of higher than in late 1967.

In broader terms, the Council's prediction of a $4 to $5 billion increase in total business fixed investment in 1968 is particularly surprising (except for such part of those figures as may be accounted for by price increases) in the light of the statement on page 125 of the report that "capacity utilization will show relatively little change" from 1967. The rate of capacity utilization in manufacturing averaged only 85.1 percent in 1967, according to the Federal Reserve Board.

It is not known, moreover, to what extent the respondents in the survey of investment plans for the first half of 1968 based their replies upon the assumption that the tax surcharge would be enacted. If any significant proportion assumed there would be no surcharge, the survey results would be overoptimistic in relation to the Council's forecast which is premised upon enactment of the surcharge. For the surcharge would have a double effect on investment expenditures. It would reduce directly the funds available for investment; and it would reduce incentives to invest by reducing both corporate and private demand for the output of new facilities.

The Council presents no quantitative estimate of the effect of the surcharge on fixed business investment. The forecast prepared by the research seminar in quantitative economics of the University of Michigan indicates that such investment would be reduced in real terms (measured in 1958 dollars) by $2.4 billion below the level that would be reached if there were no surcharge. Imposition of the surcharge, according to this forecast, would convert an increase over the 1967 level of real investment into a decrease. Thus, any current dollar increase in investment, if it occurs at all, would be very small.

HOUSING

The Council expects private nonfarm housing starts in 1968 to exceed 1½ million and total residential building and modernization expenditures to increase $5 to $6 billion over last year's level. This forecast assumes enactment of the tax surcharge early in the year, availability of sufficient mortgage funds, and, apparently, continuance of present high—or possibly even higher—mortgage interest rates.

Here, too, it is possible that the Council may be overoptimistic. That National Association of Homebuilders predicts 1,400,000 housing starts for 1968 and recent signs of a leveling off in starts and in permits lend support to a forecast lower than the Council's. Month-to-month changes in both starts and permits tend to be erratic, making it difficult to form firm conclusions from the most recent data. However, the data for December 1967 and January 1968 (which were not available when the Council's Report was prepared) suggest that the rising trend of earlier months may have come to an end. Total private starts (on a seasonally adjusted annual rate basis) decreased by nearly 350,000 between November and December and the 200,000 unit recovery in January did no more than bring them back to the September 1967 level. The average of 1,344,000 for the most recent 2 months was below the July level. Permits, which are a signal of future starts, took a reverse course, rising in December by 165,000 (also seasonally adjusted annual

rate) and declining in January by more than 210,000. The January figure was below that for August 1967 and only 2,000 above that for June 1967. The average for December and January, at 1,217,000 was only 5,000 above the level of October 1967. A leveling off at approximately that number of permits during the remainder of the year would be consistent with the starts forecast of the National Association of Homebuilders.

The Council attempts to minimize the effects of high interest rates on housing demand and actually proposes lifting the interest ceilings on FHA and VA mortgages. Its report says:

> The events of 1967 have shown quite clearly that housing demand is strong enough to support a high and rising level of building even when mortgage interest rates are high—provided funds are available at thrift institutions.

But the 1967 rise in housing starts prior to December may have been merely catchup for the immediately preceding period when home construction was sharply depressed by the restricted availability of mortgage funds. Families who could afford high interest rates could proceed with their housing plans as mortgage money became available in 1967; but many less well-off undoubtedly were kept out of the housing market by interest costs. Given the steady, sharp decrease in real housing expenditures after 1963 (which persisted into 1967) and the urgent need for housing, demand undoubtedly would have been significantly higher last year if not for the level of interest rates. The leveling off of housing starts and permits in the past 2 months may reflect the rise in mortgage interest rates which began in June 1967 after a decline earlier in the year. It may also indicate that the catchup phase is ending and that high interest rates are now becoming the predominant influence on home construction. If that should prove to be the case, fulfillment of the Council's apparent expectation that interest rates will continue to be high could result in a downturn rather than a mere leveling off of housing expenditures.

GOVERNMENT SPENDING

The Council predicts that State and local purchases of goods and services will rise at about the same rate as last year. Federal purchases, however, are expected to increase by only $6 billion as compared to $13 billion from 1966 to 1967. This marked slowdown in the rise of Federal spending will retard the growth of GNP both directly and indirectly. The 1967 increase in purchases by the Federal Government accounted directly for nearly one-third of the total increase in GNP and, indirectly, it undoubtedly contributed substantially to increases in other components of GNP. The much smaller increase in Federal purchases projected for 1968 will reinforce the factors tending to slow the rise in fixed business investment and inventory accumulation.

CONSUMER SPENDING

Of the $61 billion total increase in GNP that the Council projects for 1968, about $33 billion, or more than half, is expected to come from an increase in consumer spending. As previously noted, however, the Council concedes that the consumer sector is "an area of particular uncertainty." It acknowledges also that "the latest evidence indicates that consumers are still spending cautiously." Surveys of consumer

buying intentions indicate that they will continue their caution in the months ahead. Yet, the Council bases its surcharge proposal on the assumption that the rise in consumer spending will be large enough to trigger a capital goods boom and inventory speculation if the surcharge were to fail of enactment.

The Council's projected $33 billion increase in consumer spending assumes a small decline from the 1967 saving rate "essentially" as a result of a catchup in automobile purchases from the effects of the Ford strike. This view must be examined in the light of the facts that (1) the Council was grossly in error last year in predicting the 1967 savings rate; (2) savings were still on the rise at the end of last year and the continued caution of consumers reflected in the surveys provides no basis for projecting a decline; and (3) the expected catchup in auto sales does not appear to be materializing.

In its 1967 report, the Council predicted that:

> The saving rate in 1967 should remain close to the 1966 level of 5¼ percent, a little below the average of recent years.

As it turned out, the saving rate shot up to 7.1 percent, which was not only far above the average for recent years but, in fact, the highest rate since 1953. During the fourth quarter of 1967 the rate was 7.5 percent. The Census Bureau survey of consumer buying expectations certainly provides no indication of a spending spree that would reduce the saving rate in the months ahead. And Professor George Katona, who conducts consumer behavior studies for the University of Michigan's Survey Research Bureau, is quoted in Newsweek magazine for February 26, 1968, as saying that, in the absence of some dramatic news such as a Vietnam peace proposal, "we could have several quarters more of high savings".

The record of retail new car sales thus far this year provides little support for the belief that auto sales catchup will reduce the saving rate. During the first 20 days of January, when catchup should have been most strongly felt, seasonally adjusted unit car sales (excluding overseas imports) ran at an annual rate of only 7.8 million compared to actual sales of approximately 7.6 million last year. Subsequently, factory-promoted dealer sales contests were widely in effect. Despite the combined effects of catchup and the sales contests, the annual rate of sales from the start of the year through February 20 was only 8.1 million. This figure, boosted though it was by temporary factors, is nevertheless short of forecasts by the major auto producers which called for sales in 1968 of 8.2 to 8.5 million cars (again excluding overseas imports). Based upon the sales record thus far this year, Mr. Lynn Townsend, chairman of the board of the Chrysler Corp., has already reduced his original forecast for 1968.

The Council's forecast of a "sizeable advance in consumer spending" rests in part on expectation that:

> Expenditures on household durables should receive particular support from the continued high level of homebuilding.

However, homebuilding, as noted above, may fall short of the Council's expectations, and the census survey of consumer buying plans shows no signs of a spurt in purchases of durables. In fact, the survey (as analyzed by Prof. Paul W. McCracken for the Commercial Credit Co.) indicates dollar purchases of major appliances and furniture in

the first half of 1968 no higher than the average level of the second and third quarters of 1967, with purchases of other nonautomotive durables up only 1 percent for the same period. Measured in real terms, this would mean a decrease in spending on nonautomotive durables.

Taking the above durable goods outlook together with prospective new car sales of 8½ million (which works out to about 7.7 million excluding overseas imports) indicated by the census survey, Professor McCracken concludes that they present "a picture of sluggish, flaccid demand." [1]

The Council provides no clue to its expectations regarding 1968 consumer spending for nondurables and services. Spending in both areas will undoubtedly increase in 1968 because of population growth and price increases, if for no other reasons. But there are no strong indications that either will provide any special upward impetus to the economy. If the 1967 pattern persists, nondurable spending could be particularly disappointing. From the second to the fourth quarters of 1967, while the rise in GNP was accelerating from the laggard pace of the first half of the year, current dollar spending for nondurables slowed markedly. In real terms, nondurables spending was actually lower in the third and fourth quarters than in the second.

RATIONALE FOR SURCHARGE

At the very least, the evidence summarized above creates a reasonable doubt as to the likelihood of a dangerous upsurge of consumer spending. Yet, the Council appears to base its case for the surcharge on the theory that it is needed to siphon off potential consumer demand in order to avoid setting off an inflationary and unsustainable boom in business investment. The report says:

> Without the [surcharge] withdrawal from personal incomes, consumer spending in the second quarter and thereafter would be substantially higher than that contemplated in the forecast given in Chapter 1. Responding to the additional consumer demand, business would attempt to raise output and employment. The resulting increases in wages, dividends, and other income payments would swell consumer incomes, and, in turn, lead to still further additions to consumer expenditures. Rising consumer spending, together with the failure of corporate tax rates to rise, would add to after-tax profits, providing both incentives and means for financing more business investment expenditures than would be the case if the tax increase were enacted. It is likely, in addition, that the greater consumer and business spending would lead to more rapid accumulation of inventories.
>
> Thus the interacting forces of consumer and business spending would, via the wel-known multiplier process, generate increases in money income and total demand that would far exceed the magnitude of the surcharge.

EFFECT OF TAX SURCHARGE

The Council has never spelled out publicly the method by which it makes its forecasts. Nor has it, in this year's report, shown quantitatively the changes in the various components of GNP and in the unemployment rate which it would expect in the absence of the tax surcharge.

[1] The new census survey, published as this statement was being reproduced, shows only slight improvement in the outlook for consumer spending. By far the greatest change was an increase of 3.1 percent in expected home purchase expenditures as compared to the preceding survey.

At least two other reputable forecasting groups, however, have developed detailed projections for 1968, with and without the surcharge assumption. They are the Research Seminar in Quantitative Economics of the University of Michigan and the Econometric and Forecasting Unit of the Wharton School of Finance and Commerce of the University of Pennsylvania. Both of these groups develop their forecasts through the use of econometric models (systems of equations) carefully designed to project the fututre performance of the economy on the basis of past experience. The Michigan group, which has been making forecasts for a long enough period to permit evaluation of their reliability, has an outstandingly good record.

The findings of these groups do not agree in every detail. Despite the great progress made in recent years, forecasting is still more art than science. Significance must be attached, however, to the fact that the conclusions of both the Michigan and Wharton School groups are widely at variance with most of the Council on the two most crucial points. The first is the effect of the surcharge on employment and unemployment. The second is the effect of the surcharge on the price level. *The findings of both the Michigan and Wharton groups show that the surcharge would involve a heavy cost in unemployment (and GNP) in return for only a negligible gain in price stability.*

MICHIGAN PROJECTIONS

Certain of the assumptions made by the Michigan group (e.g., an increase in social security taxes from 4.4 to 4.8 percent) are now out of date. But the relevant general tendencies implicit in the forecast would not be affected by revision of those assumptions.

The Michigan model yields a 1968 GNP of $705.4 billion (in 1958 prices) assuming that the surcharge is not imposed and that monetary policy is consistent with a 3-month Treasury bill rate of 4.5 percent. Another projection which, in order to determine the effects of tight monetary conditions, substitutes 5 percent for 4.5 percent in the latter assumption, yields approximately the same GNP—$704.4 billion.

A third projection, with assumptions the same as in the first described above except for the addition of a 10-percent surcharge on personal and corporate income taxes, yields a GNP of $692.5 billion. Thus, enactment of the surcharge would reduce GNP for the year by $12.9 billion of 1968 purchasing power. The equivalent in terms of fourth quarter 1967 dollars would be $15.3 billion (probably close to $16 billion in 1968 dollars).

The three Michigan projections also show that the surcharge would be far more costly in terms of employment than has been indicated by the Council which, as previously mentioned, has stated that the surcharge would reduce employment growth in 1968 by 150,000 jobs. According to the Michigan model, the cost in 1968 would be 800,000 jobs—more than five times as large as the Council's estimate.

According to either of the projections which assume to surcharge, civilian employment would be 75.6 million. Addition of the surcharge to the first of the projections described above would reduce employment to 74.8 million. Unemployment would be 800,000 to 900,000 higher with the surcharge than without it. (The range is apparently

a reflection of rounding errors in the employment and labor force figures.)

The unemployment rate would be 3.6 or 3.7 percent, respectively, according to the first two (no surcharge) projections described. It would be 4.7 percent according to the projection which assumes the surcharge is placed in effect. The 4.7 percent unemployment rate is an average for the year. Thus, assuming the surcharge-based projection turns out to be reasonably within range of actual developments in 1968, the unemployment rate could well be above 5 percent by the end of the year. All the progress of the past 3 years in reducing unemployment would be reversed.

The impact of this unemployment would, of course, be borne disproportionately by the most disadvantaged groups in our society. The consequences for peace in our cities can readily be imagined.

We in the UAW do not believe that full employment is incompatible with reasonable price stability. We believe it is the responsibility of economists to develop and to propose means to promote such compatibility, and of the political authorities to work for the implementation of those means. We have outlined in this statement and in others submitted previously some of the measures that could promote price stability under full employment. We have made clear our conviction, however, that if there must be a trade off between full employment and price stability, priority must be given to full employment. The balance-of-payments deficit does not, in our view, provide sufficient reason to surrender that conviction.

But how much gain in price stability would be bought in 1968 at the cost of an 800,000 to 900,000 increase in unemployment? According to the Michigan projections, enactment of the surcharge would lower the 1968 rate of rise in the GNP implicit price deflator by only 0.3 percentage point. The rate of rise in the implicit deflator for consumer expenditures would be reduced by only 0.4 percentage point.

We ask: *Would such a negligible gain in price stability be worth the sacrifice of 800,000 jobs and $15 to $16 billion in GNP?* To ask that question is to answer it.

WHARTON SCHOOL PROJECTIONS

As noted, the Wharton School projections do not agree in all details with the Michigan projections. But, in view of the elaborate and careful analyses of past experience upon which both the Michigan and Wharton School models are based, it would be perilous to ignore dangerous tendencies signaled by both.

The Wharton projections show less—though still very substantial—losses in GNP and jobs resulting from the surcharge than do the Michigan projections; but they also show even less gain in price stability.

As of the fourth quarter of 1968, the Wharton projections show that the GNP annual rate (in then current dollars) would be $9 billion less with than without the surcharge. The unemployment rate would be 4.5 percent with the surcharge instead of 4.1 percent without it—a difference of more than 300,000 jobs. The GNP implicit price deflator (1958 equals 100) would be 122.5 with the surcharge and 122.6 without it—an improvement of only 0.1 percentage points.

Without the surcharge, the increase in the deflator from the fourth quarter of 1967 to the fourth quarter of 1968 would be 3.1 percent—no greater than between the same quarters of 1966 and 1967.

THE RISKS

No one is in a position to say today which group of forecasters will turn out to have been most accurate when the final economic score for 1968 comes in. The members of the Council and of the Michigan and Wharton groups are all responsible, have reputations at stake, and must be presumed to have done their best.

But this committee and the Congress must act before the score is added up. The question this committee and the Congress must answer is: *Has the Council justified a gamble with the jobs of hundreds of thousands of workers, with the welfare of their families, with the tranquility of the Nation's cities, and with billions of dollars of potential GNP?*

The answer, in our opinion, is that the Council has not made a persuasive case for the surcharge—that recent and current developments in the economy as well as carefully prepared and soundly based forecasts by other reputable economists argue against the Council's position—and that it would be irresponsible to assume the risks that would be involved if the Council's advice were to be followed.

What of the risks on the other side? What if the Council should turn out to be correct that failure to enact the surcharge would lead to the generation of serious inflationary pressures? To these questions there are two answers. The first is that it is sounder to risk rising prices than to risk rising unemployment. The second is that, as will be shown, there are alternatives and better means than the surcharge to deal with the problem the Council anticipates, if that problem should materialize.

AN ALTERNATIVE APPROACH

In the statement submitted to this committee last year, we stressed that we were not opposed to tax increases as such but only to tax proposals that were designed to drain demand out of the economy and thereby to reduce employment opportunities while we were still far short of genuine full employment. We opposed cuts in total Government spending because they also would destroy employment opportunities and, in addition, would defer or prevent solution of urgent national problems. We emphasized that we would heartily support selective monetary and fiscal measures—including equitable tax increases—designed to reallocate resources so as to speed achievement of the Nation's high-priority social and economic goals. We pointed out also that selective measures can be used to minimize inflationary pressures and dangers, thus removing the inhibitions that stand in the way of an all-out drive toward full employment.

That is still our position. This year, the nature of the inflationary problem, as envisioned by the Council, argues all the more strongly for the application of selective measures rather than use of the blunt instrument of the surcharge advocated by the Council.

The Council's prognosis has been quoted above. What is foreseen is that, in the absence of the surcharge, rising consumer spending

would trigger a new boom in fixed business investment and in inventory accumulation—which may be translated as inventory speculation in anticipation of higher prices.

The Council can hardly argue that, with present unemployment and the present wide margin of unused capacity, the increase in consumer spending alone would put unbearable pressure upon resources. The danger, if there is any real danger, is that disproportionate spending on plant and equipment and on inventories would prove unsustainable. Distortions would thereby be created which could lead to a recession. As the Council says, "soaring profits" could generate a capital goods boom "in 1969, if not sooner [which] could sow the seeds of a subsequent collapse of investment in plant and equipment." Inventory speculation, similarly, could be replaced by disaccumulation putting additional downward pressure on the level of economic activity. A capital goods boom could also affect the balance of payments. As the Council pointed out in its 1967 report, a 50-percent increase in imports of capital goods occurred during the 1966 investment splurge which accounted for 20 percent of that year's total increase in imports. It is notworthy also that the rise in nonfarm wholesale prices, which began in late 1964 after 5 years of stability, and which has continued since, was touched off by the capital goods industries in response to inordinately high investment demand.

The problem as described above calls for preparation to head off an investment boom and inventory speculation if and when there should be signs that they are imminent. This can be done most effectively by standby, selective fiscal and monetary measures. Standby measures are appropriate since the Council apparently does not expect that absence of the proposed surcharge would lead to a business spending spree before late 1968 at the earliest.

If there is clear danger of an unsustainable investment boom, it would be utterly ridiculous to continue the investment tax credit which was designed to stimulate investment. Instead of stepping on the accelerator, the brakes should be applied. The situation would call for the reverse of the tax credit—for example, a special tax on investment spending. Similarly, inventory speculation could be deterred, for example, by a tax on inventories in excess of the individual firm's ratio of inventories to sales during an appropriate base period. Legislation authorizing such taxes could be enacted now with the proviso that they would not go into effect until a Presidential decision to impose them had been concurred in by a joint resolution adopted by both Houses of Congress. Thus, the Nation would be armed on the fiscal front to meet the danger the Council envisions.

Similarly, on the monetary front, the Federal Reserve Board could make it known now that it is prepared to make selective use of all the powers at its disposal to curb lending for investment and excessive inventory acumulation, if and when they threaten to get out of hand, while maintaining an adequate flow of credit for housing, for the needs of State and local governments, and for other high-priority purposes.

In the unlikely event that consumer spending should threaten to put undue pressure upon capacity, a progressive spending tax—along lines described above—which could also be enacted on a standby basis, could meet that problem.

Any or all of the above measures could and should be accompanied by implementation of the price-wage review procedure—also described above—which would prevent abuse of administered pricing power to pervert rising demand into inflation rather than full employment.

The above suggestions are not offered as definitive proposals. There may be better ways to serve the intended purposes. The measures described above are advanced solely in order to illustrate the point that the present state of economic knowledge makes available a large arsenal of selective weapons which can be aimed with precision at the specific problems the Council envisions and at other problems that may arise as we press on toward full employment.

We call, in short, for a rifle shot rather than a blunderbuss approach to those problems. If the danger is that pursuit of maximum profits will cause excessive business spending, it would be inexcusable, to say the least, to meet that danger by a measure such as the surcharge, which would inflict hardship and unemployment upon the most disadvantaged among us—upon families that are in no way to blame for creating the danger.

Selective measures can be applied equitably to avoid needless hardship and unstabilizing distortions in the economy and to advance us toward our national goals. Gross fiscal and monetary measures are inequitable in their impact, victimize the innocent, do not prevent distortions, and allow for no distinction between high-priority national purposes and matters of lesser importance.

The proposed surcharge is afflicted with all the defects that apply in general to gross measures. In addition, its enactment now would create grave risks. On those grounds we oppose it and urge consideration of standby selective measures.

The War on Poverty

The war on poverty is a casualty of failure to keep our national priorities in order. As we in the UAW have emphasized repeatedly, victory in that war requires:

Jobs for all who can work;

Decent wages for those at work; and

Decent incomes for those unable or denied the opportunity to work.

Because we have failed to move with sufficient vigor on all of these three fronts, we are not winning but losing the war on poverty. When poverty is measured in relative terms, as it should be, *there were as of 1966 and probably are now actually more families who should be considered poor than when the Nation first committed itself to make war on poverty.*

On the job front, acceptance of the Council's goal of 3.8 percent unemployment for 1968 would mean to condemn to continued poverty those who are capable of earning their own way but for whom there are no jobs.

Yet there is no lack of work to be done in America. We can provide more jobs than there are able-bodied poor to fill by doing the work that most needs doing in our society—remodeling our cities, building the homes and schools and hospitals and other facilities we so desperately

need, cleaning up our air and water, and the other myriad of necessary tasks that must rank high on our list of national priorities.

So long as, and to the extent that, private industry fails to provide the needed jobs, government should provide them by acting as employer of last resort.

The crucial actions required on the wage front are to broaden the coverage and to increase the minimum wages provided for under the Fair Labor Standards Act. According to the Social Security Administration, 1.9 million families with 9.5 million members in all, including 5.4 million children under age 18, were poor in 1966, even though the family head worked full time throughout the year. By the most recent estimate available, another 600,000 persons not attached to families were in the same plight in 1964.

The minimum wage for those covered by the Fair Labor Standards Act prior to 1966 went to $1.60 per hour as of February 1968. A worker fully employed 52 weeks a year at that wage earns slightly less than the Council's 1966 minimum consumption standard of $3,335 for a nonfarm family of four, and with prices continuing to rise the gap will grow. For workers first brought under coverage of the act in 1966, the current minimum wage is only $1.15 per hour. Altogether, approximately two-fifths of all persons in families classified by the Council as poor in 1966 either worked full time themselves or were members of families headed by full-time workers. Yet, although the Council concedes that minimum wage legislation contributes to the elimination of poverty, it fails to call for further improvement of that legislation.

On the income maintenance front, the war on poverty has only begun to nibble at the flanks of the enemy. The last session of Congress enacted a disgracefully inadequate increase in social security benefits. When the new benefit levels become effective, those whose entire incomes consist of benefits at the bottom of the scale will receive roughly two-fifths—if they are single—to one-half—if they have eligible spouses—of what they need to lift them out of poverty, in accordance with the standard applied by the Council.

As the Council's report says, if Congress had accepted the minimum $70 social security benefit and other improvements proposed by the administration, an additional 500,000 aged people would have been freed from poverty. But $70 a month for a single person, or $105 for a couple, is still a poverty income. Canada, with a substantially lower per capita income than ours, is able to pay a minimum benefit of $210 per month as a matter of right to every retired couple without other income.

The pitifully small increases in social security benefits enacted last year were coupled with punitive measures against welfare recipients reminiscent of the Elizabethan poor laws. Welfare payments, unemployment insurance, workmen's compensation benefits and other income maintenance programs, as well as social security, still provide only poverty incomes to large numbers and, in some cases, to the great majority, of those dependent upon them. Many more are denied even the grossly inadequate payments provided under existing programs.

The glaring gaps and inadequacies in the Nation's income maintenance programs must be filled without delay. If we mean what we say about waging war on poverty, we will proceed with all possible speed

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both to *provide above-poverty minimum benefits under all social insurance programs and to establish a soundly designed program providing an adequate guaranteed minimum income for all.* We hope the Commission on Income Maintenance Programs recently appointed by the President will recommend bold and swift action in both areas.

HOW MUCH PROGRESS?

Given the Nation's failures to mount effective attacks on the three fronts where the war on poverty must be won, it is not surprising that we are making only slow progress when measured by the Council's absolute and frozen standard for defining poverty and no progress at all when measured by a more rational and more humane relative standard.

Even by the most commonly used standard, which the Council has adopted as its own, we are making progress at a rate which will not result in the elimination of poverty before about 1980 or 1985. The Council of Economic Advisers describes this standard as follows:

> For statistical purposes, households are defined as poor if their income falls below the cost of a certain minimum consumption standard—$2,185 in current prices for a nonfarm couple under 65 years of age, $3,335 for a nonfarm family of four, and so on.

In other words, although the standard varies by size of family, age, and location, and the dollar amounts are adjusted for changes in living costs, the actual buying power below which a family in a given category is considered poor does not change. The present standard was adopted on the basis of 1962 living standards, and it represents the same standard today as it did in that year.

By this standard, the Council reports considerable progress. It states:

> Between 1959 and 1966, the number of poor declined sharply from 38.9 to 29.7 million, or from 22.1 to 15.4 percent of the population.

But, is this an acceptable way to fix a standard for measuring poverty? Its implication is that the standard of living below which we consider families to be poor is not to be permitted to rise with the improvement in living standards of the rest of society. It would mean that once those now considered poor have seen their incomes raised to a level fixed 6 years ago, the rest of us will be free, in all good conscience, to turn our attention elsewhere. We would be relieved of all obligation to assure them even a minimum share in the fruits of society's growing productivity—since 1962 and forever into the future. Yet, as the standards of the whole Nation rise and they are left behind, they will still be considered poor both by their neighbors and in their own eyes.

The lack of realism in such a frozen standard is easily appreciated if the same process is traced backward in time. Tables attached to the Council's report give us data on living costs and earnings as far back as 1929. In that year the Consumer Price Index, at 59.7, was just about one-half of today's level. To be precise—$3,335 per year, which marks the poverty line for a family of four at average 1967 prices, is the equivalent of an income of $1,711 a year at 1929 prices, or just under $33 per week.

A family of four with an income of $33 a week would not have been considered poor in 1929. Average gross weekly earnings in manufacturing industries were only $24.76 in 1929, and the average factory worker who had a steady job, though he undoubtedly would have like to be better off, certainly did not consider himself to be poor.

By comparison, average weekly earnings in manufacturing in 1967 were $114.90 per week, or $5,975 a year for a fully employed worker. The poverty level for a family of four, at $3,335, is just 56 percent of this. Thus, a family of four is considered poor, by the Council's standard, if it has less than 56 percent of the income of an average factory worker. That does not seem unreasonable. But an income of $33 per week which provided the same standard of living in 1929 was one-third higher than that of the average factory worker. To consider $33 an appropriate "poverty line" for that time is entirely unreasonable.

Part of the difference, of course, is that it was in fact impossible for anyone in 1929 to enjoy the same standard of living as we do today. Many of the conveniences which we take for granted, frequently to the extent of considering them necessities, did not exist for anyone in 1929. Advancing technology has given us a multiplicity of new things—new household equipment, new textiles, new foods, the list could be extended indefinitely—that have revolutionized our way of life in less than 40 years.

To adopt a rigid, unchanging standard of consumption to represent the poverty level for any given family would be to deny the poor any share in the benefits of the technological revolution.

One of the major causes of trouble in our central cities has been the alienation of large sections of our people who, by reason of poverty, discrimination, and neglect, have felt themselves denied the right to participate in the mainstream of America's progress. The concept of a fixed poverty consumption standard carries with it the implication that the poor must continue to be cut off from that progress. It proclaims that if we bring the poor up to a level of consumption that was barely tolerable 6 years ago, we will have done enough. But the poor will not consider it enough—nor should we.

POVERTY IS RELATIVE

Poverty is a relative matter. It can have no absolute standard. It might conceivably be possible to draw up and price a consumption standard that was just barely sufficient to maintain human existence—just enough calories and vitamins to sustain the spark of life, just enough clothing to cover nakedness, just enough shelter to prevent death by exposure. Such a standard is conceivable. In fact, it must be admitted to our everlasting shame that there are still sections of our country where people are living at such a standard—and dying when they fall below it. But to adopt such a standard, to say that only below such a level is anyone poor, would be intolerable to the conscience of America.

Yet, the moment a higher standard is accepted, the moment it is admitted that even the poor should have something beyond the bare necessities, there must be admitted also the necessity to raise that standard along with the living standards of all the rest of the people. As

those standards rise, what were once luxuries become comforts, comforts become common conveniences, conveniences become necessities. And so it is for the poor as well as for the more affluent.

People are considered poor, and consider themselves poor, not by any arbitrary measure of what they have, but by how far what they have falls below the commonly accepted standard of the society in which they live. This does not mean that everyone is poor who falls below the average. It means that the standard of poverty is: How far does he fall below the average?

An ingenious and entirely reasonable method for establishing such a standard was proposed by Victor R. Fuchs in the Summer 1967 issue of "The Public Interest." He wrote:

> I propose that we define as poor *any family whose income is less than one-half the median family income.* No special claim is made for the precise figure of one-half; but the advantages of using a poverty standard that changes with the growth of real national income are considerable.
>
> First, it explicitly recognizes that all so-called 'minimum' or 'subsistence' budgets are based on contemporary standards which will soon be out of date.
>
> Second, it focuses attention on what seems to be a fundamental factor underlying the present concern about poverty—i.e., it represents a tentative groping toward a national policy with respect to the distribution of income.
>
> Finally, it provides a more realistic basis for appraising the success or failure of anti-poverty programs. [Emphasis in original.]

The median income is that level which places exactly half the families above it and half below it. For some purposes it represents a more satisfactory concept of what we consider the average family than does the arithmetic mean, because, unlike the latter, the median is not affected by how wealthy the very wealthy are, or how poor the very poor.

If we accept the concept of the median income as that of the average family, then Mr. Fuchs' formula means, in essence, that *any family is considered poor if it has less than half the income of the average family at any given time.*

As Mr. Fuchs himself admits, it would be desirable to refine his formula somewhat before implementing its use. He points out that there is nothing sacred, for example, about the precise figure of one-half. It is useful, however, in that one-half the median income in 1962 was only slightly over $3,000, the family poverty level accepted at that time.

Obviously, also, the same poverty figure cannot be applied to families of all sizes, ages, and locations. This was a deficiency of the official poverty concept when it was first established, and it was corrected by careful research on the part of Social Security Administration technicians. We now have different poverty levels for different types of families, based on number and ages of children, ages of adults, farm or nonfarm location, and so on. The same research could be applied to Mr. Fuchs' formula, except that instead of expressing the poverty level in different dollar amounts for different types of families, it would be expressed in different percentages of the median family income.

The startling fact about Fuchs' definition of poverty, however, is that if we accept it *we find that we have made virtually no progress at all in eliminating poverty.* He published with his article the attached table (to which UAW technicians have added one more year of data)

showing since 1947 the percentage of families each year with incomes below half the median, as well as the percentages with incomes below $3,000 and $2,000 (in constant 1965 dollars), respectively. The table shows that, between 1947 and 1966, families with less than $3,000 of 1965 buying power fell from 30 percent of the total to 15.1 percent. *But the proportion of families with less than one-half the median income showed no significant change*, fluctuating between 18.9 and 20.9 percent of the total.

PERCENTAGE OF U.S. FAMILIES CLASSIFIED "POOR" BY CHANGING AND FIXED STANDARDS, 1947-66

[In 1965 dollars]

Year	Median income	Percentage of families with income—		
		Less than ½ the median [1]	Less than $3,000	Less than $2,000
(1)	(2)	(3)	(4)	(5)
1947	$4,275	18.9	30.0	17.2
1948	4,178	19.1	31.2	18.1
1949	4,116	20.2	32.3	19.5
1950	4,351	20.0	29.9	18.1
1951	4,507	18.9	27.8	16.3
1952	4,625	18.9	26.3	15.8
1953	5,002	19.8	24.6	15.4
1954	4,889	20.9	26.2	16.7
1955	5,223	20.0	23.6	14.6
1956	5,561	19.6	21.5	13.0
1957	5,554	19.7	21.7	13.0
1958	5,543	19.8	21.8	12.8
1959	5,856	20.0	20.6	12.1
1960	5,991	20.3	20.3	12.1
1961	6,054	20.3	20.1	11.9
1962	6,220	19.8	18.9	10.9
1963	6,444	19.9	18.0	10.2
1964	6,676	19.9	17.1	9.2
1965	6,882	20.0	16.5	9.1
1966 [2]	7,231	19.2	15.1	[3]

[1] Estimated by interpolation.
[2] UAW estimates.
[3] Not available.

Source: U.S. Bureau of the Census, Current Population Reports series P-60, No. 51, "Income in 1965 of Families and Persons in the United States," January 1967. (From the Public Interest, summer 1967.)

In other words, the proportion of families who are poor because they enjoy less than half the income of the average family is no smaller today than it was 20 years ago, and *in absolute numbers of poor families we are actually losing ground.* In percentage terms, the improvement since we began talking about a war on poverty has been minuscule. In fact, the percentage of poor families has been higher in recent years than in some years of the late forties and early fifties.

It is true that a closer study of family income distribution does show one encouraging sign. There has been some upward movement within the ranks of the poor, for the proportion with incomes between one-quarter and one-half of the median has increased somewhat, with a corresponding decrease in the proportion having less than one-quarter of the median. But we have a long way still to go.

SENSE OF URGENCY NEEDED

We know what actions are needed. The present administration and its predecessor have called again and again for them to be done. Unfortunately, they have not always called for as much to be done as

was needed, and they have not been able to obtain from reluctant Congresses even the full amount that they have asked for. This has been especially true in the most recent years, when our national priorities have been getting more and more seriously out of order.

It is a sense of urgency that is essential—a sense of urgency in the administration, a sense of urgency in the Congress, a sense of urgency in State and local governments, a sense of urgency in the people. Lieut. Gen. James M. Gavin, USA (ret.), felt it when, with Arthur Hadley, he wrote in *Saturday Review* February 24, 1968:

> In the urban ghetto, migrants slowly begin to leave—if they have not already—what we like to think of as "our America". They become among those uncounted by the census. Denied participation in the American dream, they become 'they' and 'them'. So the cities—and, through them, the nation—tragically divide into "we" and "they". And inflaming this division to the raw edge of violence is the fact that overwhelmingly "we" are white and "they" are black. This underculture of poverty has now gone on for so long that the Negro poor are already practically a separate society. They are not yet a separate nation with aspirations different from our own. But unless we both work together—"we" and "they"—America will in fact divide more fatally than at any time in our history.
>
> I wish there were some eloquence I could use, some fact I could cite, some verbal Pearl Harbor I could deploy, so that all Americans would rise and say: "That is true, I personally must do something about it." The riots in Watts and Detroit are there for all to look at. A recent report to President Johnson by a White House-appointed board of experts opened with the words: "You are the last President to have the option of governing one nation." I would not be that definite. But I do not believe that the report—at this writing, unreleased—exaggerates by much.

Time is, indeed, running out. History will judge our generation of Americans by what we do in human terms with the vast wealth at our command. Its judgment will be deservedly harsh if we, who are closer than any people ever were to the possibility of creating a paradise on earth, permit our country, instead, to become a social jungle.

Planning the Democratic Future

To cope with the distress and injustice in our midst—with poverty, our deteriorating cities, our sick, our unemployed, the disaffection of our young, the insecurity of our aged—we must lift these problems to the center of our concern.

We must appreciate the fact that not gold or the dollar or our balance of payments, but the people of this country, constitute our fundamental security, our fundamental investment, our fundamental hope. Their education, skills, discipline, commitment, well-being, aspiration are the bedrock of our economy and the wellspring of our way of life.

We must, secondly, see in their true magnitude and full dimensions the wealth and economic capabilities of this Nation. There exists no historical or contemporary parallel to the human and technological resources we command. To paraphrase the poet, the fault lies not in our resources but in ourselves, if we fail to realize our promise.

So great is our present productivity that, despite all the inefficiencies of our economy, our current Gross National Product stands at $4,000 per person, or $16,000 for a family of four. Yet the GNP, thus evenly parceled out, is a statistical abstraction that hides the mocking realities of poverty, deprivation, unemployment, frivolous luxury, and senseless waste.

We have, thirdly, an overriding responsibility to use the unparalleled resources at our disposal more wisely, more sensibly, more justly. We must turn our attention from our aggregate wealth and its aggregate accretion year by year to its more effective use. Our thoughts must go to what a better and happier America we can build, not in some remote future but now and in the very next tomorrows, by consciously diverting resources from unessential or foolish purposes to the challenging tasks of social and human renewal.

Yet, thinking won't make it so. Thought, unless quickly followed by appropriate actions, will be only a sentimental and even a dangerous evasion. It is too late in the date for leisurely study. We must lose no time in putting our house in order. We shall continue to invest the democratic future badly until we move from wishful thinking to deliberate planning in applying our vast resources to the areas of critical human need.

We are still trusting too much to the random forces of the private market. It is our peculiar delusion that the private sector of our economy can buy and sell us into a better tomorrow. Yet the evidence under our feet and before our eyes testifies that we cannot manage the expansion, distribute the abundance, and solve the growing problems of a late 20th century postindustrial society according to the simple notions of laissez faire economic activity handed down to us from the 18th century.

We must accept the plain fact that the private sector is not so constituted that it can plan as a sector in the national interest. Corporations plan ingeniously for their own ends, but there is no easy correspondence between what separate employers may regard as their particular advantage and the larger needs and interests of the Nation.

Government, therefore, must assume the ultimate responsibility for developing and conducting a democratic form of planning to assure that investment and resources are shared between and within the private and public sectors to meet priority needs and achieve national goals.

The terrible summer of 1967 demonstrated beyond any doubt our urgent need to plan as a nation to meet national needs. Until that summer, employers of the private sector had gone blithely on their way, decentralizing their operations, building new plants in the segregated suburbs, ignoring the unemployed of the ghettos. In the light of last summer's fires, the businessmen saw, and many of the most enlightened among them acknowledged, the error of their ways. They have begun to face two basic facts: their need to involve themselves directly in the reconstruction of American cities, both in the physical and the human sense; and their need to cooperate with labor and Government in attacking the social and economic ills that beset the Nation.

Many of these businessmen have entered the urban coalition and have endorsed the coalition's statements of intention, which include the following passages:

> We believe the American people and the Congress must reorder national priorities, with a commitment of resources equal to the magnitude of the problems we face. The crisis requires a new dimension of effort in both the public and private sectors, working together to provide jobs, housing, education, and the other needs of the cities.

* * * * * *

> Government and business must accept responsibility to provide all Americans with opportunity to earn an adequate income. Private industry must greatly accelerate its efforts to recruit, train and hire the hard-core unemployed.
>
> When the private sector is unable to provide employment to those who are both able and willing to work, then in a free society the Government must of necessity assume the responsibility and act as the employer of last resort or must assure adequate income levels for those who are unable to work.

The clear implication of these statements is that we must develop a national planning mechanism to insure the necessary coordination of efforts in the two sectors. For the ends sought cannot be realized unless we possess the institutional means to assess our national needs, to establish priorities for meeting those needs within the limitations of our resources, and then to allocate the resources between and within the private and public sectors to accomplish our defined purposes. Since the planning must be democratic, not merely business but all the functioning groups of the society must be heard in the process of establishing priorities and achieving goals.

We are not proposing here, it should be understood, any system of coercion. Rather we propose use of the democratic process to arrive at a censensus with respect to goals, priorities, and time schedule for their achievement. Out of this consensual process there would emerge, as a byproduct, a common framework of assumptions as to the future course of the economy. Within such a framework, both Government decisions and decisions in the private sector could be made with greater confidence and would be more effective because they would reinforce each other rather than work, as they now frequently do, at cross purposes. The net effect of such democratic planning would be not restraint but liberation. Our great resources could be deployed much more effectively in meeting private and public needs.

The plan would provide the basis for determination of the selective measures, monetary and fiscal among others, needed to assure the availability at the right time of the resources needed to achieve the plan's goals. Since the plan will have evolved from democratic censensus, the selective measures required to carry it out should obtain ready and widespread acceptance. There should therefore be little difficulty in enlisting the cooperation of the political authorities in enacting and applying such selective measures as may be needed to facilitate implementation of the plan.

Nothing has happened since the summer of 1967 to diminish the urgency of the challenges the urban coalition asks us to face. On the contrary. President Johnson in his February 22 message on urban problems stressed, "There is no time to lose." He declared:

> Today, America's cities are in crisis. This clear and urgent warning rises from the decay of decades—and is amplified by the harsh realities of the present.

There is no time to lose, but we are losing it. The UAW seriously urges upon the Congress as a body, and upon each Congressman and Senator, a more sober consideration of the real dangers and opportunities implicit in our domestic situation, not so much in terms of what might be regarded as opportune in an election year but rather in a dispassionate effort to clear away the cobwebs of fashionable assumption and get to the bone and marrow of our predicament.

Whether we look abroad to the cities of the struggling and developing nations or steadily confront the crises of our own communities,

we are bound to understand that the ultimate questions of social and economic justice underlying all prospects for world or local peace cannot be answered by firepower. American values and American hopes depend ultimately not on the answers that come out of the barrel of a gun but out of a steady commitment to demonstrate their worth and their relevance in the daily lives of people.

We have temporarily forgotten that invaluable truism. Let us come back to its saving truth. Let us do what has to be done to make our Nation and our people whole. Our prime concern is not our balance of payments but the balance between our capabilities as a democratic society and our efforts to realize those capabilities within the Nation, where our writ runs without hindrance and our responsibility is therefore absolute.

UNITED MINE WORKERS OF AMERICA

By W. A. Boyle, President

We appreciate the opportunity to present our views on the Economic Report of the President and the Report of the Council of Economic Advisers.

This year we would like to confine our remarks to four general areas:

1. Wage-price restraints.
2. Governmental fiscal policy.
3. International trade.
4. Research and development.

Wage-Price Restraints

Over the past several years the question of wage-price control measures has appeared in much of the economic literature. The President himself has added to this literature in his periodic messages on the subject and through the Council of Economic Advisers.

The thrust of the concept as advocated by the President and the CEA is that restraint on the part of business and labor is necessary if we are to avoid a wage-price spiral. Following this line, a strong suggestion is made that national productivity should be the guiding limit on wage increases and that companies should refrain from unnecessary price increases.

There are, of course, several inconsistencies in this policy.

1. We do not believe it to be necessary. In fact, wage-price control has historically proven to be ineffective short of wartime conditions and even then of only marginal benefit. We suggest that there are several very stringent avenues to prevent runaway inflation, avenues which inspire a far greater discipline than any conceived under either voluntary or mandatory controls. These are the disciplines of:

(*a*) The marketplace—where consumers may choose not to buy if price and quality are not to their liking.

(*b*) Competition—where a new and better way imposes ceilings on the price levels in the private sector.

(*c*) Commonsense—which leads reasonable men to consider the well-being of the Nation, as well as their own in any action which they take.

We in the coal industry are prima facie evidence of the effectiveness of such disciplines. Since 1948 the price of coal has declined. During this period wage levels of coal miners have increased and the general price level has skyrocketed. But the chilling impact of stringent competition, the presence of alternate fuels, and the statesmanlike realization on the part of industry leaders that the future security of the industry was at stake held down coal prices.

2. Wage-price restraints fall unevenly on the population. It is all too easy to single out a union which is asking for a long overdue wage increase. But, very often much larger increases in fees by the service industries and the professions go unnoticed because they are accomplished quietly and without the fanfare associated with collective bargaining. Yet, as most wage earners are acutely aware, such increases bite deeply into the pocketbook of the average American.

3. Wage restraints are burdensome upon the wage earner without an equal burden being placed upon profits. If such restraints are necessary, then the man who works for wages and the man who collects the profits should share such a burden equally. This is especially pertinent in those industries with higher than average productivity, but with relatively rigid price structures. History has shown that in these instances there has been developed a growing disparity between the income of workers measured in wage payments and the income of managers and owners measured in dividends, profits, bonuses, and so forth.

But, short of a declared war emergency and short of a fair and equitable sharing of the burden, we feel that we should pursue the interests of our members through the medium of free collective bargaining. This method has served us and the Nation well in the past. We would be ill advised to deviate from it now without an overwhelming reason to do so.

Governmental Fiscal Policy

If one examines the dilemma facing the country today in the economic area, one fact is obvious—the fiscal policy of the Government is the major engine of inflation. The needs of national defense, especially the conflict in Vietnam, are the major causes of the distortion in our fiscal framework.

Therefore, it is incumbent on the administration to cut its fiscal cloth to match available resources. In short, we have come to a time for priorities, for choosing those programs of greatest significance and postponing those of lesser value.

To some this would mean a retrenchment in many of the programs of the Great Society—the war on poverty, the Federal aid to education program, and so forth.

We reject this as false economics because we believe that such efforts will return much to our Nation and, in fact, are vital to the continued viability of our social, political, and economic institutions. Indeed, if the unfortunate struggle in Vietnam has taught us any lesson at all, it has taught us the importance of a population dedicated to a system of government as basic to their own individual welfare. If this is lacking, if our ghetto residents, or our rural poor, look to other systems for a hope in life, our national well-being is in serious jeopardy.

On the other hand, there are programs which can be curtailed or postponed without undue damage to the economy. I refer especially to the civilian nuclear power program, which consumes hundreds of millions of dollars each year. Much of the work being done in this program can be postponed or even canceled.

We are sure that there are other similar areas throughout the Federal budget. We hope that the Members of Congress will diligently seek them out and prune wherever possible.

International Trade

A large part of the President's message dealt with the subject of international finance. This concern is obvious because of the recent devaluation of the British pound and the precarious position of the dollar.

Much has been written and spoken on this subject and we can add but little to the overall picture.

This much, however, we do know. So long as American political and military commitments remain at their present levels, the dollar will continue under sharp attack. In order for it to survive intact, two things are required:

1. Public policy which will insure the continued viability of the U.S. economy and which will protect it from the unfair importation of cheap foreign goods.
2. An aggressive, export-minded American industry with the ability and the determination to compete successfully in foreign markets.

The recent trade agreements concluded under the Kennedy Round will intensify the competitive pressures under which American industry will have to operate.

American coal is in a unique position to help in the balance of payments in two ways.

First, U.S. coal is more than competitive abroad. Our coal, because of the efficiency of the American coal miner, adds $500 million to the U.S. balance of payments each year. America ships coal to Japan, Western Europe, Canada, and most of the coal-using nations of the free world.

It does this on the bases of quality and price.

The fact that we do not send more coal abroad rests in the political and not the economic sphere. Most of the nations of the world erect barriers to the entry of U.S. coal. Frequently, such barriers are non-tariff in nature, but extremely effective nonetheless.

Space does not permit me to catalog such barriers. Nevertheless, they do exist and as such tend to minimize the value of coal exports to the economy. They do so in two ways:

1. By reducing the market potential for U.S. coal.
2. By helping to create an atmosphere in which the export market is regarded as an undependable market outlet, an outlet to be exploited for the short run, but not to be developed for the long pull.

Second, the large reserves of U.S. coal and the modern technology to mine it should render us nearly self-sufficient insofar as fuels are concerned.

Unfortunately, just the opposite is true. Energy sources are imported into our markets in a flood, driving coal from its normal outlets. Often such flooding is done by unfair means, by dumping tactics.

Currently, coal faces a competitive battle from South American residual fuel oil, from Canadian naatural gas, and from Middle Eastern oil. Last year there was an attempt to dump German coal into the U.S. market.

In the face of such competitive pressures, the American coal industry has stood virtually alone. Government officials, ignoring our pro-

tests, permitted and are even now permitting large blocs of foreign energy to enter our shores. Residual fuel oil, for example, is decontrolled, for all practical purposes. So, too, is the importation of Canadian natural gas.

In allowing U.S. coal to face such an unrestricted attack, the U.S. Government is acquiescing in the weakening of an industry vital to domestic security and important in world trade. It would seem obvious that the present course is both illogical and self-defeating.

Many other industries and other trade unions are coming to the same conclusions. As a result, our entire concept of international commerce is being reevaluated in many quarters, including the Congress of the United States.

Hopefully, this inquiry will continue. For, even though we subscribe to the ideal of freer international trade, we also know that such trade should be on a truly reciprocal basis, with adequate protection for essential domestic industries.

Research and Development

Our final section is perhaps the most important of all. We look to research and development to assure the future in coal, just as America must look to it for the continued prosperity and security of our Republic.

The real frontier to be explored today is the border of science, the effort to push ahead to new scientific breakthroughs. Only in this way will further significant material and social progress be possible for all Americans.

Any discussion of research and development inevitably leads one to probe the role of the Federal Government. This is so because of the dominant position occupied by the Federal Establishment in research and development activity. For example, almost $17 billion is budgeted for this purpose in the Presidential budget for fiscal year 1969.

This money and the scientific know-how which it commands can and should have deep significance for all Americans. Its proper use should permit our Nation to move ahead to solutions to some of our pressing problems and to permit a fuller maximization of our human and material resources.

But, instead, such full benefit is not accruing because in our opinion:

1. Most of the research effort is expended in three major fields—space, defense, and atomic energy.
2. Little overall coordination is being done to permit a rational view of the entire spectrum of research work.
3. Priorities dealing with the best possible alternative among a great many desirable courses have not been drawn up.

The validity of our contention is quite evident in the energy industry. For decades atomic energy has received the bulk of research attention, while coal, our most plentiful energy resource, has received a pitiful portion. This is not to infer that those charged with coal research in Government have not done all that could be expected of them. Rather, the resources committed to coal research have been infinitesimal compared with the potential benefit of such research.

Coal, as is well known, is a storehouse of chemical products, liquid fuels, and energy. From coal can come many of the products necessary

in our industrial economy—oil, gas, chemicals, and energy itself. Upon coal can be built industrial complexes employing hundreds of thousands of men and women and pouring billions of dollars into the national economy.

The bridge to such a happy situation is research, research which today is both possible and practical—if—if sufficient resources are made available to it.

We hope that this will be done in the years ahead.

In conclusion, we look forward to another year of prosperity and progress for the United States in the economic sphere. We recognize problems but, we believe that with intelligent action on the part of all segments of our national life, we may move ahead to eliminate whatever barriers are impeding our national progress.

STATEMENT OF JERRY VOORHIS

I shall confine this statement to brief comments on three subjects: health, education, and interest rates.

First, a sentence appears on page 160 of the report which reads in part: "There appear to be significant efficiency gains from group practice." I wish that the committee report had added the word "prepayment" after "group practice." A number of studies as well as conferences conducted by the Health, Education, and Welfare Department, have recently demonstrated what some of us in the group health movement have known for a long time, namely, that subscribers to group practice-prepayment health plans have significantly lower rates of hospital utilization than do other insured groups in the population. Hospital costs are the most rapidly rising and by far the most expensive item in the health cost of the American people. If health can be maintained among large groups in the population with a lesser use of hospitalization, clear gains will have been made. I believe I am correct that it has now become Government policy to encourage group practice and prepayment for health care. Not only will this result in lower costs in connection with medicare and other Government programs as well as less drain on seriously overtaxed hospital facilities, but it will also provide a better quality of care for the people who have the benefits of group practice-prepayment health plans.

Serious consideration should be given toward applying on a much wider scale a plan in effect in New York City. In that city some 15,000 to 20,000 welfare recipients are now given comprehensive high-quality health care through Health Insurance Plan in Greater New York. The welfare department of that city has had the wisdom to pool the funds fomerly paid on a hit-and-miss emergency basis for spasmodic medical care for its clients and to make direct per capita payments to Health Insurance Plan. In return HIP contracts to provide all necessary health care to this group of welfare clients. The net total cost is not appreciably more than was formerly spent. The difference is these people's health is now regularly maintained by carefully chosen groups of doctors. The money is spent for health, not for sickness.

I can imagine no one measure which would contribute more toward improving the chances of our poor people to work their way out of poverty than for a plan of this kind to be more widely used.

Another measure that would make possible expansion of services by group practice-prepayment health plans would be passage of legislation already introduced, to provide Government guarantee of private loans for the construction of needed hospital facilities by nonprofit, cooperative, community, labor and other types of group practice-prepayment plans.

My second comment has to do with education. While the present program of federal aid to education, coupled with the Headstart pro-

gram, marked by far the best advance yet made toward improvement of our educational system, they constitute only the beginning of what the present generation owes to our beleaguered young people. In my opinion, the Federal aid program should be expanded even more than has now been done, particularly in assisting local school districts with the cost of more adequate physical facilities so that their own resources may be used toward payment of better salaries to more and better qualified teachers. I also recommend careful study of the so-called new careers movement as an element in the war on poverty and the development of an extensive program for the training of educational aids among the low-income people who, with such training, could make a significant contribution toward the enrichment and increased practicability of the education provided to children in low-income areas of both our cities and our rural areas.

The third subject which I wish to discuss is the rate of interest. Every item in the consumer price index is affected by the rate of interest. The higher the rate of interest, the more the cost of living is forced upward, the greater inflationary pressures become, and the more difficult it is to produce an adequate supply of the things most needed by our people—housing, in particular. It needs no proof on my part to show that low-cost housing especially expands and contracts in inverse proportion to the rate of interest. If interest rates are low, housing starts can be and are expanded closer to the number which our country so desperately needs. If interest rates go up, as they have been so disastrously doing recently, it shuts off the supply of new low-cost housing more surely than any other single factor can do.

Furthermore, interest rates at the high level at which they have now been pushed quite literally, price out of the market for decent homes millions of people who might be able to afford good housing and even to own their own homes if the interest rate were lower. At 6¼ percent interest on a 30-year mortgage a $16,000 house costs $16,000 for the house but $20,000 for interest on the debt.

The present high level of interest rate has already pushed our bill for interest on the Federal Government debt to the astronomical figure of $14,200,000,000. Next only to expenditures on war, this is the largest single item in the whole national budget. If interest rates had been held at levels where they were held even under the terrific pressures of World War II, the bill for interest on our Federal Government debt would today be only about half it is!

High interest rates bear most heavily on those elements in the population which are least able to bear additional burdens: namely, the poor, the farmers, and small business. High interest rates penalize every productive agency and institution in the economy. And the point must somewhere be reached where the sheer weight of interest payments becomes so great that the whole productive process in a free economic order is slowed down. Admittedly, we have not yet quite reached that point in the United States. But if present trends are allowed to continue, we certainly shall reach it before long. The time is now when measures should be instituted to reverse the trend toward higher and higher interest rates and to bring them back into line with national needs and elemental economic justice.

It simply is not true that higher interest rates act as a curb upon inflation. Quite the contrary, as stated above, they add to the price of practically every item in the economy. The only real reason for increasing interest rates is because the Federal Reserve System and the lending institutions have the power to increase them. Higher rates are not needed for the sake of economic prosperity of banks or other lending institutions. Their rate of return to investors was higher than the return to most investors when interest rates were much lower than they are now.

There is probably no single economic influence which can encourage the high level of productive activity which our country so critically needs as much as a low interest rate can do. It is earnestly to be hoped that the Joint Economic Commitee will urge upon all agencies of our Government as well as the Federal Reserve System a prompt reversal of the present high interest policy.

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