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1970 JOINT ECONOMIC REPORT

REPORT

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ON THE

JANUARY 1970 ECONOMIC REPORT OF THE PRESIDENT

TOGETHER WITH

STATEMENT OF COMMITTEE AGREEMENT, MINORITY, SUPPLEMENTARY, AND DISSENTING VIEWS

MARCH 25, 1970

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[Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.]

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91st Congress } HOUSE OF REPRESENTATIVES { Report
2d Session } { No. 91–972

REPORT ON THE JANUARY 1970 ECONOMIC REPORT OF THE PRESIDENT

March 25, 1970.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. Patman, from the Joint Economic Committee, submitted the following

REPORT

together with

STATEMENT OF COMMITTEE AGREEMENT, MINORITY, SUPPLEMENTARY, AND DISSENTING VIEWS

[Pursuant to sec. 5(a) of Public Law 304 (79th Cong.)]

Note.—Due to pressure of other responsibilities, Senator Fulbright was unable to participate in the hearings and other committee deliberations pertaining to this report and reserves judgment on the specific recommendations made therein.

Note.—Representative Richard Bolling states: "Unusually heavy pressures of other responsibilities prevented me from fully participating this year in the hearings and Committee deliberations pertaining to the President's Economic Report. While I share the deep concern over the serious economic problems raised in this report, I do not find realistic and appropriate economic proposals to meet these difficult problems. Under the circumstances I cannot endorse this report."

STATEMENT OF AGREEMENT BY MAJORITY AND MINORITY MEMBERS OF THE JOINT ECONOMIC COMMITTEE

1. The year ahead will be a difficult one for the economy, and the administration should develop contingency programs to be implemented if anti-inflationary economic policies induce continuing unemployment or recession.

2. Fiscal policy must be prevented from being the destabilizing force in the year ahead that it has so often been in the past.

3. Government labor and manpower policies have a definite role to play in achieving price stability at high employment, and are especially important when unemployment rises. With determined efforts to improve the functioning of the economy, an unemployment goal of about 3 percent can be achieved over the long term.

4. The Government should identify and bring to public attention sectors of the economy, both public and private, where economic inefficiencies and resource shortages create inflationary pressures, and should promote responsible action to correct these conditions.

5. Housing and other sectors of high national priority should not continue to bear a disproportionate share of restrictive monetary policies, but instead must be more fully protected from tight monetary policies in the decade ahead. The administration should implement procedures to promote a flow of credit into these high priority needs.

6. There are serious disadvantages to direct wage and price controls, including the difficulty of effective enforcement, the suppression of price inflation rather than its elimination, and the production of distortions in resource allocation.[1]

7. The administration's strengthening of the role of the Bureau of the Budget in reviewing defense budget requests and the establishment of the Defense Program Review Committee to consider defense needs in the context of competing civilian priorities are significant steps toward more efficient defense spending.

8. The Executive should proceed to remove the present restrictions on American lending and investment abroad.

9. The foreign exchange costs to the United States of maintaining the defense posture of Europe must be borne by the Europeans themselves.

10. The United States should urge reform of the international exchange rate adjustment mechanism to permit more frequent and less disruptive rate changes.

11. The balance-of-payments data published by the Commerce Department should be put on a more sound conceptual basis.

12. Special drawing rights should be utilized for development assistance, and their use should be permitted for the payment of "gold" subscriptions to the International Monetary Fund.

[1] See supplementary statement of Chairman Patman and Representatives Reuss and Moorhead on page 58.

REPORT OF THE JOINT ECONOMIC COMMITTEE ON THE JANUARY 1970 ECONOMIC REPORT OF THE PRESIDENT

I. INTRODUCTION

During the past year the economy suffered the worst inflation in 19 years. Interest rates reached the highest level on record. Real growth slowed. The President's report projects virtually no increase in GNP in the first half of calendar 1970, with some pickup in the second half, producing a real growth of a little over 1 percent for 1970 as a whole.

A serious credit squeeze has produced devastating effects on homebuilding and the construction of necessary public facilities. These are the sectors that bear the brunt of tight money. As a result, needs for basic community facilities and for decent housing are going unmet. There is no assurance that the credit-starved sectors of our society will receive significantly more credit next year than they did last year.

Unemployment is rising. The February level of 4.2 percent approached the average of 4.3 percent which the Council of Economic Advisers has projected for the year. There is thus cause to fear that the average will be much higher than the Council's projection and that the peak may exceed 5 percent. Over the past year the number of unemployed has risen by 870,000.

Meanwhile, the rate of price rise continues high. For the fourth quarter of 1969, as measured by the most comprehensive index (GNP deflator), prices rose at an annual rate of 4.7 percent, far too rapidly for our economic health. During the most recent 3 months for which data are available, the period ending February 1970, the wholesale price index increased at an annual rate of 6 percent.

The administration projection shows the role of price rise as declining gradually but averaging over 4 percent for the year. The performance is unlikely to be any better than this, but it could be worse.

The policies espoused by the administration to counter inflationary pressures will result in a shortfall from our full growth potential of over $30 billion for the year ahead. The aggregate loss projected over the 4-year "slowdown" which began in mid-1969 will be approximately $80 billion (in today's prices), a tragic price to pay for fighting inflation in view of massive needs in our social sector.

We face a very real danger of higher unemployment, a stagnant economy, and an increasing shortage of homes and public facilities while inflation continues without substantial abatement.

We deem the program advanced by the President to be lacking in important respects.

We are deeply concerned at the absence of any policy to deal directly with excessive price and wage increases. Such failure, in our view, accentuates the dilemma of rising unemployment and simultaneously continuing price inflation.

We have strong doubts about the prospects for the budget surplus which the administration projects. These doubts rest on many bases. Just as an example, the statistical assumptions underlying the tax estimates are suspect. Revenue estimates depend in part on the contingency of future action by the Congress. Likewise the expenditure estimates assume a number of legislative enactments. The budget estimates also involve sale of financial assets of $3.6 billion. The uncertainty about fiscal prospects can only aggravate the unsettled conditions of the present. It leaves to the Congress the problem of evolving a realistic budget.

In spite of the selective credit control legislation passed by the Congress in 1969, the President's program contains no provision for channeling credit to the deprived sectors of the economy. We urge the President to act to correct the serious credit imbalance that is now destabilizing our economy.

There is regrettable lack of clarity about the effects on the budget of the Vietnam deescalation, particularly as to the relation between a cutback of $12 billion by the beginning of fiscal 1971 and a net reduction of only $6 billion in total military spending from fiscal 1970 to 1971.

There is an absence of any standby programs to be brought into effect if counterinflationary programs prove too severe and induce recession. Against such a contingency there should be a shelf of programs available for quick activation. We urge the President to undertake the preparation of such programs immediately.

The administration is to be commended for its projection of Federal expenditures through 1975. This is a helpful means of assessing the national capability for meeting additional needs. It accords with the recommendations of this committee. However, it does not go far enough. We urge the administration to increase the detail provided in the interest of producing a meaningful assessment of our long-range goals and their relations to future growth.

The administration's projection shows that existing Federal programs plus those proposed by the administration will probably absorb available revenues through 1973 and leave approximately $22 billion for significant additions by 1975. In the face of the great demands for increased expenditure on urban reconstruction, pollution control, education, income support, housing and public facilities, this amount is disturbingly small.

Moreover, it emphasizes the great need for reallocating our national resources in ways which reflect the high priority which should be given to our urgent social needs.

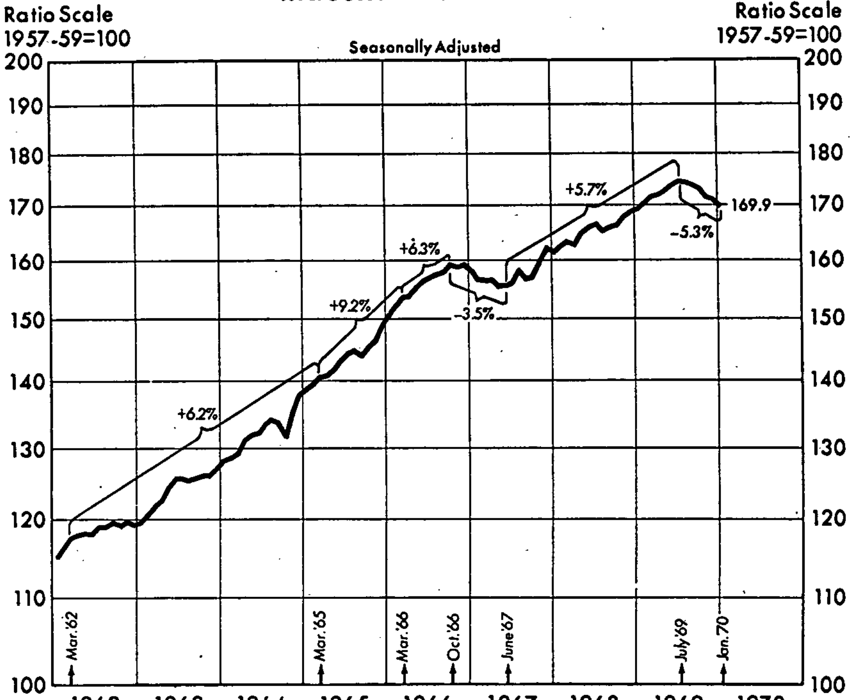
We repeat our recommendation to the administration that it focus attention on assessment of our national requirements and objectives and the development of means of determining priorities for public expenditure. We likewise urge the Congress to improve its procedures for making the same kind of determination. If this is not done, we will fail to direct our energies and our resources into the areas of greatest need.

These issues are more fully discussed in sections that follow.

II. THE ECONOMIC OUTLOOK

Seldom have we faced the year ahead with more uncertainties than appear at the present time. Unemployment is increasing—at what rate, and for how long, is unclear. Growth of total output was halted late in 1969 and there is no certain prospect of increased economic activity in the near term. Industrial production has declined month after month since mid-1969. The number of new housing starts has been declining for a year and currently is 30 to 40 percent below a year ago with no signs of recovery in sight.

CHART I



Percentages are annual rates of change between periods indicated. They are presented to aid in comparing most recent developments with past "trends."

Latest data plotted: January preliminary

Prepared by Federal Reserve Bank of St. Louis

Fixed capital spending by business, on the other hand, has continued upward despite increases in idle capacity. How long this trend will continue represents a basic question in the outlook. Many of the witnesses—official and private—at our hearings on the Economic Report emphasized that the projections by businessmen of further substantial fixed-investment spending might be too high.

On the other hand, the latest report officially compiled by the Securities and Exchange Commission and the Department of Commerce suggests that business executives, as late as February of this year, were planning an expansion of fixed-investment outlays of 10.5 percent in 1970. This expansion is not confined to the public utility sector where capacity is still inadequate, but extends to manufacturing facilities where excess capacity is already obvious.

At the same time there is growing evidence that business inventory investment is becoming subject to closer scrutiny and that in many lines unwanted inventories are accumulating—suggesting the prospect of reduced production rates to bring better balance in this important phase of investment.

A major element behind the stagnating situation in general economic activity has been the increasing weakness of consumer spending as the rise in real purchasing power has slowed. The sales of new automobiles have been particularly depressed and other durable goods purchases have also been reduced.

The Federal Government is continuing to expand its purchases in current prices, but in real terms they were on a gently downward path in 1969, and would appear to be on a more pronounced downward path through 1970 and into 1971. State and local purchases are continuing upward but mainly when expressed in terms of dollars of reduced purchasing power; in terms of the steadily growing needs at the local level, real demands are not being met in increasing degree.

Despite this slowdown of general economic activity the price inflation which has plagued the economy for the past several years shows no present sign of abatement. As 1970 began, prices were increasing at rates exceeding those of a year ago. Wage rates were also still advancing strongly. Significantly, dollar increases in wage rates brought virtually no advance in real purchasing power as consumer prices increased at an almost equal pace.

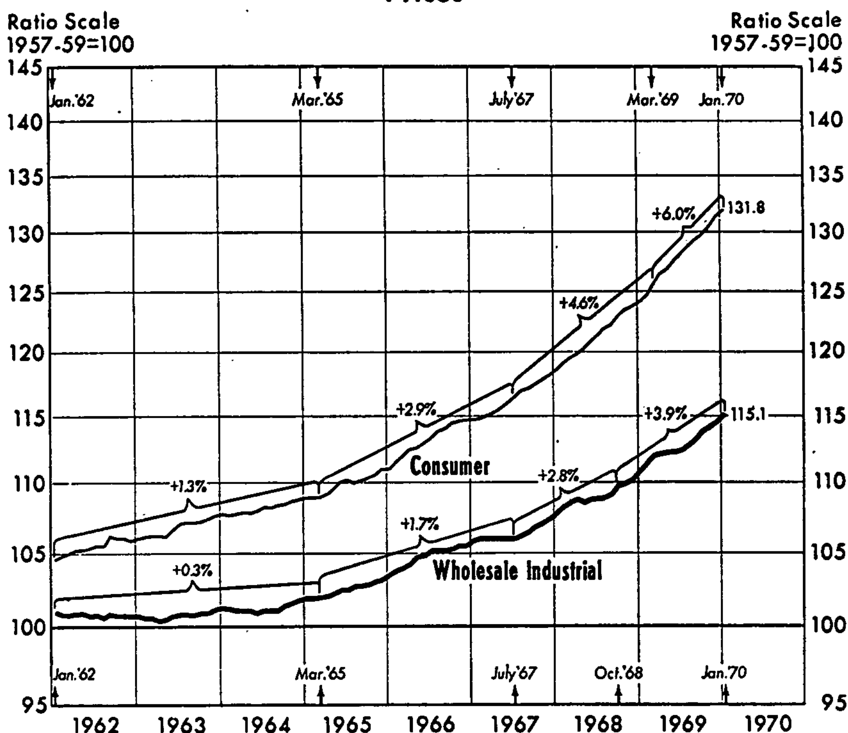
The one price area which showed the most remarkable strength was prices of money and credit—more particularly, long-term interest rates. This was part of the administration's policy to combat general price inflation. As we go to press, there is little, if any, sign that the policies which brought about these high interest rates are being changed. In the most recent few weeks, short-term interest rates have dropped somewhat, but there has been no assurance that this is part of official policy.

The analyses presented by the administration suggest a rise in GNP of about 5½ percent from $932 billion in 1969 to $985 billion in 1970—the latter conceived as the middle of a range from $980 to $990 billion. This outlook of the administration rests on the assumption that private business investment in fixed assets will increase

about 8 percent which is on the low side of the various surveys of business intentions—even by the most recent official estimates just released; that inventory investment will decline only slightly from last year; that residential construction expenditures will fall from $32.4 billion in 1969 to about $30 billion in 1970; that State and local purchases of goods and services will rise about $11 to $12 billion over last year; that Federal purchases will be down by about $4.5 billion between 1969 and 1970; and that consumer spending will rise by about $40 billion over the year despite a rise in the savings rate from 6 percent to 6½ percent.

CHART II

Prices



Source: U.S. Department of Labor

Percentages are annual rates of change between periods indicated. They are presented to aid in comparing most recent developments with past "trends."

Latest data plotted: January

Prepared by Federal Reserve Bank of St. Louis

Apparently this projected rise in GNP will involve an increase of about 1 percent in real terms, and about 4 percent or a little more in prices. The administration expects very little growth in real output in the first half of the year, renewed rise in output in the second half, and a slowdown in the rate of increase in prices, which apparently is expected to drop to about 3½ percent per year by the end of the year.

The administration's outlook for the economy this year rests in part on the expectation that under the assumed conditions there will be a surplus of $1.3 billion in the unified budget for fiscal 1971 and that

monetary policy will be eased somewhat from the degree of restriction pursued in the second half of 1969. It may be noted that private experts testifying before the committee did not, in general, vary greatly from the administration's estimate of GNP in 1970. Their forecasts, as well as those of other private forecasters, are generally in the $980 to $990 billion range. However, a high degree of uncertainty is attached to any forecast for the year.

This uncertainty stems in part from the fear that the excessively restrictive monetary policy of the past year, discussed in greater detail later, may have already sown the seeds of recession, given the lag between policy action and the resultant impact on the economy. There was indeed virtually unanimous expression of view that a loosening of monetary policy was necessary—and the sooner the better. There was not anywhere near the same unanimous sentiment that the framers of monetary policy would recognize this need. Indeed, the new Chairman of the Federal Reserve would give this committee no assurance that monetary policy would be eased in the near term, and at one point said easing depended on "responsible" congressional action on the budget. On the other hand, fear was also expressed that events might lead to too massive a swing to monetary ease to shore up an economy showing signs of recession—in other words, the authorities might revert to the policy of 1967–68 during and after the "minirecession" of early 1968. Such a development would once again set in motion an intensification of inflationary forces.

This committee feels that even if monetary policy is quickly eased, there is in the present prospect no assurance that the high-priority demands which have been held back by the high-interest policy of the past year will be met. As discussed in section IV the private economy is, at the present time, in an illiquid position and thus demands for long-term credit may continue to gravitate toward the business sector. Thus, there is a pressing need to implement immediately the credit rationing proposed to assure that a more adequate flow of credit is made available for housing, public facilities, and other priority needs in the year ahead.

It should be pointed out that in the area of fiscal policy, discussed in the following section, careful attention must be continuously paid to ongoing developments in the tax and expenditure process. The Tax Reform Act of 1969 provides for a series of changes occurring in steps over the course of the next several years. Moreover, as we propose below, some further tax reforms are still vital to see that the tax system is more equitable. In other words, as detailed in the next section, the tax-expenditure outlook must be considered as still in a formative state, and further changes should be such as to assure that fiscal policy does not once again become the destabilizing force it has so often been in the past.

This committee views with concern the very disturbing prospect that present policies imply continuing excessive unemployment and continuing inflation. We cannot be satisfied with a policy which presumes it will take almost 4 years to regain steady full employment growth without inflation. We must get back on course much sooner.

III. FISCAL POLICY

Current doubts about the economic outlook can be traced in part to uncertainties as to Government economic policies, particularly the economic impact of proposed budget policies. The President's budget calls for a surplus for fiscal year 1971 of $1.3 billion. Even this thin margin rests on a number of proposals that could easily fall by the wayside, producing a substantial deficit. Two proposals in the budget are monetary rather than fiscal measures: That is, the speedup in the collection of withheld income and excise taxes and the net sale of financial assets, which together add up to a shift of liquidity from the private to the public sector in the amount of $4.8 billion. These tend to tighten financial markets at a time when the administration is calling for an easier monetary policy. This is obviously inconsistent.

A number of other items may be classed as uncertain because they require congressional action that may not be forthcoming. Though the administration is against wage and price guidelines or controls the budget proposes to save at least $1 billion by postponing government military and civilian pay raises from July 1 of this year to January 1, 1971. About $2.2 billion of additional reduction in expenditures assumes adoption of proposals that terminate, restructure, or reduce various civilian programs such as the special milk program, agricultural conservation payments, certain hospital construction grants, sale of stockpiled commodities, and reduction of school assistance to federally impacted areas. On the revenue side of the budget there are estimates of $653 million from increased user charges, about $560 million from extension of excise taxes, over $200 million from an increase in the taxable income base for social security taxes, and something close to $700 million for increased postal rates, or a total of $1.5 to $2 billion.

Without forecasting congressional action on these items, it is apparent that in the absence of favorable money market conditions and affirmative action by Congress to enact these changes, the budget would shift from a thin $1.3 billion surplus to a deficit of somewhere between $4 and $7 billion.

It is important to note that the $1.3 billion surplus rests on the assumption that the economy will be operating at well below its potential with excess unemployment and hence a reduction of private incomes subject to taxes.

The assumed economic conditions underlying the fiscal 1971 budget are significantly more bearish than those used in putting together the numbers for the fiscal 1970 budget and even more so than the excess demand conditions which generated the budget for fiscal 1969. This is a familiar situation which led this committee to recommend

years ago that an alternate calculation be provided showing how the budget would look if the economy operated each year at its full employment potential. This calculation would remove, as far as practicable, the effects of changing economic conditions on the budget, thus assisting Congress to understand the effects of changing budget policies.

If we reestimated the budget on the theoretical assumption that the economy continues at its full employment potential from fiscal 1969 through fiscal 1971, then the budget would look quite different. Expenditures would be lower because of lower unemployment compensation required at high employment levels. Revenues would be higher because of higher incomes. Thus, adding these amounts to the estimated surplus in the President's budget the high employment budget for fiscal 1971 could, under the administration's proposals, show a surplus larger than the $8 to $10 billion high employment surplus recommended last November by our Subcommittee on Fiscal Policy, a recommendation with which we concur.

The problem Congress is faced with in the next few months is to achieve the recommended full employment surplus of $8 to $10 billion in a realistic and socially desirable manner. In doing this, we recommend that the Congress avoid measures like tax collection speedups, sale of financial assets, and the postponement of comparability pay increases for government workers called for both by law and economic justice.

Congress also should move as rapidly as practicable toward reducing the Government's dependence on surpluses in the trust accounts—particularly social security—to cover deficits in the remainder of the budget, for the present practice produces the undesirable consequence of substituting essentially regressive payroll taxes that fall heaviest on middle and lower income groups for a far more progressive and equitable income tax. The present practice unfairly taxes lower income groups to pay for benefits that often flow to those in higher income brackets.

There are two principal avenues by which to achieve the desired high employment surplus in the budget in the next few months.

1. Congress should reorder the national priorities as expressed in the budget by:

> **a. Combing both military and nonmilitary programs to reduce Government expenditures for programs where costs are high relative to benefits. Reassessment of priorities could result in further reductions in military spending and in such areas as space, the SST program, highway construction, and similar items that have no place in an austerity budget.**
>
> **b. Increasing funds for social and human resource programs such as education, environmental improvement, income support, housing, and particularly manpower programs vitally needed to cushion the transition from inflation to stable economic growth.**

2. Congress should continue full speed ahead with tax reform begun in the Tax Reform Act of 1969. Large amounts can be added to revenue enabling us to sustain a suitable $8 to $10 billion high employment surplus even

though Congress provides for the high priority programs suggested immediately above. Tax reform can also promote the basic objectives of the Employment Act.

In carrying out these recommendations, Congress should pay particular attention to two further aspects of budget policy to which this administration, like its predecessors, has given too little consideration: (1) the stability of fiscal policy, and (2) the economic impact arising from changes in the mix of expenditure and tax policies.

Stability of Fiscal Policy

The notorious instability of monetary policy has been matched over the post-World War II decades by equally unstable fiscal policies. Nor has this changed in recent years.

The high employment budget exhibits substantial shifts over recent years. According to most estimates, the full employment budget shifted from a deficit of about $12 to $15 billion in the spring of 1968 to a surplus of about $10 billion one year later. During the fall of 1969 the surplus began drifting down again. In the last half of 1970 it would rise again, under the administration's plans, probably reaching excessive levels in the first half of 1971 calendar year—perhaps as high as $20 to $25 billion.

Another way of illustrating the instability of fiscal policies is to examine movements of the actual budget surplus on a seasonally adjusted annual rate basis for periods shorter than a year, such as quarterly. Unfortunately the now standard form of the budget—the so-called unified budget—is not available quarterly on a seasonally adjusted basis. The budget figures, however, enter into the national income accounts (NIA) which are available on a quarterly basis. These accounts differ somewhat from the concepts underlying the unified budget but the differences are not important for present purposes.

The NIA budget showed a deficit of $9.5 billion per year in the second quarter of calendar 1968. As the effects of the Revenue and Expenditure Control Act of 1968 became effective, the NIA budget shifted to a surplus which reached $13.5 billion per year in the second quarter of 1969. The NIA surplus dropped sharply in the third quarter to $7.7 billion per year and the administration's budget estimate suggests a deficit of less than a billion dollars per year for the first 6 months of the current calendar year. If quarterly estimates were available for the budget, it seems likely that both the second and third quarters of this calendar year would show somewhat larger deficits. The budget plans then suggest a sharp rise to an average annual rate of surplus of $5.6 billion for the first half of calendar 1971. These fiscal gyrations are just as wide and as unacceptable as the variations in monetary policy that have been so widely condemned. They violate a cardinal principle of economic policymaking, reiterated by the President on page 10 of his 1970 Economic Report:

> Third, we must achieve a steadier and more evenhanded management of our economic policies. Business and labor cannot plan and consumers and homebuyers cannot effectively manage their affairs, when Government alternates between keeping first the accelerator and then the brake pedal to the floor.

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Effects of Changes in the Budget Mix

Increased attention should be paid to the effect of changes in the composition of revenues and expenditures in the budget. For example, receipts are estimated to rise by $2.7 billion from fiscal 1970 to fiscal 1971, but extension of excises, increases in social security tax rates and tax base, and an increase in railroad retirement revenues account together for a rise of $3.1 billion in revenues. Furthermore, the surplus in the trust accounts in fiscal 1971 will be about $8.7 billion. Thus, essentially regressive types of taxes (excises and employment taxes) are being substituted for the more progressive income taxes.

On the expenditure side of the budget, purchases of goods and services decline about $4 billion from the current fiscal year to fiscal year 1971. Within this category, defense purchases decline by $5.8 billion. On the other hand, transfer payments rise by $8.1 billion and grants-in-aid by $2.4 billion. The effect of these shifts in outlays within the budget is to reduce spending with high-powered characteristics such as defense purchases and to increase the less stimulative expenditures such as transfers and grants-in-aid.

We conclude that the budget for fiscal 1971 is substantially more restrictive of private economic activity than the published surplus might suggest. In overall terms, Congress should aim at a full employment surplus in fiscal 1971 of $8 to $10 billion, with changes in expenditures and receipts along the lines indicated earlier in this report.

Longer Term Perspectives

For many years the Joint Economic Committee has pointed out that the Economic Report and the budget must provide a framework of long-term projections of the economy and the budget in order to provide Congress and the public with an adequate perspective on the decisions to be made each year. For example, our report "The Federal Budget as an Economic Document," submitted to Congress in 1963, recommended "the budget for each year should be presented in the context of a broader, longer run set of budgetary projections. These projections should probably cover a 5-year period." [1] These recommendations were reiterated in our report of last year.

In view of this longstanding opinion of the committee, we are pleased that the Economic Report and the budget submitted this year contained projections of the economy and the budget through 1975. This continues the initial efforts of last year when the projection of the Cabinet Coordinating Committee on Economic Planning for the End of Vietnam Hostilities was submitted along with the President's Economic Report.

The administration's initial excursion into longer term projections illustrates, however, the danger of not going far enough once the decision is made to try a new initiative. The projections provide

[1] 88th Congress, 1st sess., Senate Rept. 396.

overall magnitudes without spelling out either the specific assumptions that went into the projections or on the other hand, quantitative estimates for selected alternatives. As the administration's own spokesman, Director of the Bureau of the Budget, Mr. Mayo, said, "We constructed the 1975 figures in terms, obviously, of extension of some specific assumptions, all of which should have disappeared into the background when we indeed finished cooking the pie. We can't give a measurement at this point as to how much of this versus how much of that. You could have an infinite combination within reason, an infinite combination of health programs versus MIRV versus manned bombers versus lunar exploration and so forth. * * * Our job was to bake the pie as best we saw it, not to do the allocation of the pie."

We conclude, therefore:

In the future the budget and Economic Report should continue to contain long-term projections but in sufficient detail as to the quantitative outcome of alternate program packages to facilitate worthwhile and reasoned debate of the Nation's policies.

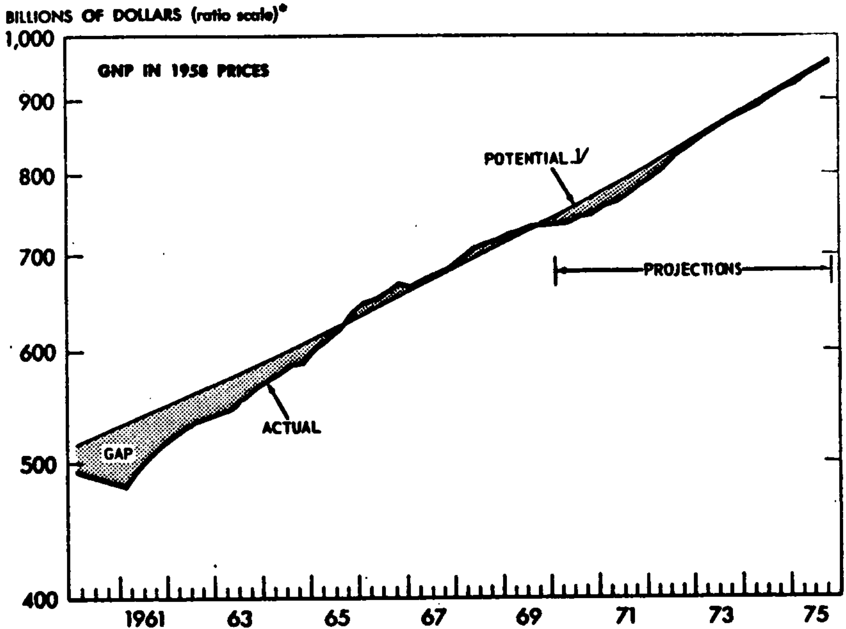
In particular, we deplore the administration's unwillingness to spell out the defense-nondefense character of the projections. This is a minimum requirement. Much more detail is necessary.

Though we are disappointed that these projections were not as detailed and specific as we would like, we are very much interested in some of the implications that can be drawn from even this limited exercise. The broad framework the administration developed is summed up in chart 8 on page 85 of the Economic Report showing gross national product actual and potential in 1958 prices (reproduced below). It will be noted that actual output ran above the potential from the end of 1965 through the middle of 1969. By the end of last year, actual real GNP output was about 1 percent below the potential, whereas the actual was about 1 percent above the potential in the fourth quarter of 1968. This chart reveals that the administration's policy does not envisage actual gross national product catching up with the full employment potential again until the second quarter of 1973. This implies a period of almost 4 years from mid-1969 to the second quarter of 1973 during which output could be below potential and unemployment of labor and capital is expected to be excessively high.

In the aggregate over the 4 years from mid-1969 to mid-1973, the projections imply a loss of output of about $80–$90 billion valued at first quarter 1970 prices. The loss will be even higher in terms of the price levels likely to prevail if prices follow the pattern assumed by the Council in its Economic Report. It may be that economics is a dismal science, but we find it impossible to believe that reasonable men cannot find a better path to a healthy economy than this distressing combination of high unemployment and continuing, though slowing, inflation.

Chart III

Gross National Product, Actual and Potential



*SEASONALLY ADJUSTED ANNUAL RATES.

1/ TREND LINE OF 3.5 PERCENT FROM MIDDLE OF 1955 TO 1962 IV, 3.75 PERCENT FROM 1962 IV TO 1965 IV, 4 PERCENT FROM 1965 IV TO 1969 IV, 4.3 PERCENT FROM 1969 IV TO 1970 IV, 4.4 PERCENT FROM 1970 IV TO 1971 IV, AND 4.3 PERCENT FROM 1971 IV TO 1975 IV.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

It is interesting also that the budget projections which are a part of this exercise imply that in the absence of any rise in prices over the level of 1969, the cost of present programs, called Base Line in the projections, would be only $3 billion higher in 1975 than in 1970, or a bare 1½ percent. New initiatives proposed by the administration could rise from about $1 billion in the current year to about $15 billion in 1975 if prices remain at 1969 levels. While the administration failed to separate these budget projections into defense and civilian components, it is readily apparent that our growing population will require larger nondefense spending over the period from now to 1975. The projections thus imply a fall in defense spending, possibly a reduction in the defense program, in real terms, to the level prevailing before the Vietnam buildup. We believe that the cuts in defense spending apparently implied in these projections should be achievable. As we discuss more fully in the section on Federal spending priorities, the adequacy and achievability of these projected cuts in defense outlays cannot be fully evaluated in the absence of more complete information on defense spending plans, including the anticipated future costs of specific weapons systems.

IV. MONETARY AND FINANCIAL DEVELOPMENTS

The money supply has been held virtually constant during the last 8 months at a level of slightly under $200 billion. This stability contrasts with an annual rate of increase of 4 percent in the first half of 1969 and a better than 7-percent rate through 1967 and 1968. Not since the crunch of 1966 have we had such "stability" as we have had since mid-1969.

The demand deposit component of the money supply at $153.5 billion, has been held down over this period. When time deposits are added, total private deposits and currency were reduced $6 billion, or 1.5 percent over 1969 as a whole. Total reserves of member banks were off over this period by almost 2 percent.

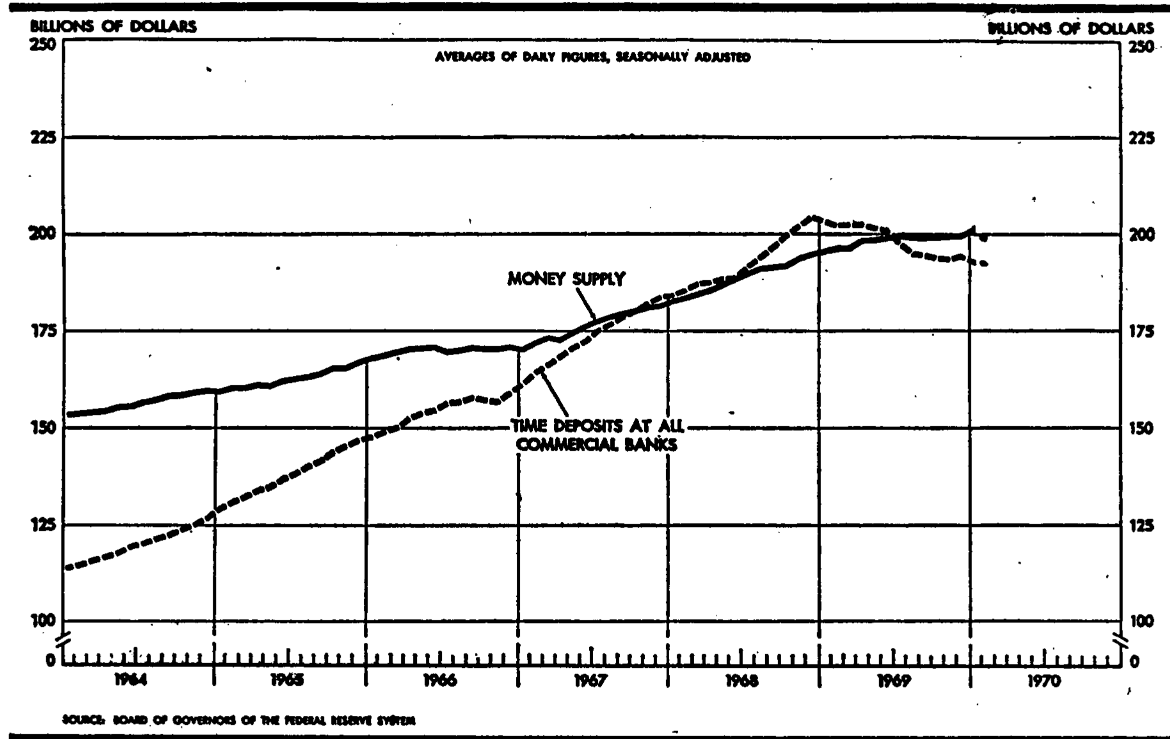
The actual figures on the course of monetary developments during 1969 are, in effect, not fully revealing as to the intent of the monetary authorities when they met at various times during the year to consider the question of changing the degree of restrictiveness of monetary policy. It will be recalled that in the first part of last year, when the authorities were calling for substantial restraint, the figures on the money supply showed expansion at an annual rate substantially lower than the revised 4-percent rate which is now published. However, even taking this fact into account, Chairman Burns' characterization of the Federal Reserve position remains true: "Monetary policy moved progressively, in the course of the past year to a posture of severe restraint—virtually halting the growth of the money supply and putting an extremely tight rein on the ability of banks and other financial intermediaries to finance the Nation's economic needs."

To implement its increasingly restrictive policy, the Federal Reserve raised the discount rate from 5¼ percent to 5½ percent in December 1968 and to 6 percent in April of last year. At that later date required reserves of member banks were raised by one-half of 1 percentage point. It was also becoming increasingly clear that the large commercial banks were searching out alternative sources of funds in Euro-dollar markets, through nonbank affiliates and other channels which helped the banks escape the full brunt of monetary policy. In September, the monetary authorities imposed new regulations bringing such funds under regular reserve requirements or making it more costly to use such channels.

The extremely high demand for credit combined with restrictive monetary policy pushed interest rates to the highest point in recorded history. It may be noted that in the last 12 months, the prime interest rate was raised six times. The rate on new 3-month Treasury bills averaged more than 7.7 percent in December, almost 2 percentage points above the rate 12 months earlier and almost 4 percentage points above the level prevailing in 1965. Rates on 9–12 month issues reached an even more astronomical level of 8.3 percent in December, almost as high as the yields on Baa corporate bonds. Yields on FHA new home mortgages soared to 8½ percent at yearend, more than a full percentage point higher than a year earlier and 3 full percentage points higher than in 1965. High grade tax-exempt municipals fared no better. By yearend, yields were up to nearly 7 percent from 4.9 percent in December 1968.

CHART IV

MONEY SUPPLY



There is some suggestion in recent weeks that pressures on interest rates—particularly short-term rates—may be easing. The Treasury bill rates on new issues are down a point or so.

As was to be expected, the extremely tight monetary policy of 1969 hit hardest those least protected yet highly important segments of the economy—homebuilding, local public facilities construction and small businessmen—whose principal source of credit is the local bank.

While private nonfarm housing starts for 1969 as a whole were about as high as in 1968 and total home mortgage lending was also relatively well maintained, these annual figures conceal the great deterioration during the course of the year which has truly become a depression in home building. By January and February of this year housing starts averaged only 1.26 million (on a seasonally adjusted annual rate basis) down about 30 percent from 12 months earlier.

The two increases in FHA-VA rates in the past year have raised monthly mortgage payments by 20 percent on, say, a $20,000 mortgage.

> **The extreme disruption of the housing market must be attributed directly to the excessively restrictive monetary policy. In a more basic sense, it represents a failure of Government policy framers to come to grips with fundamental structural deficiencies which place a disproportional burden on housing. This committee completely rejects as fallacious the argument that housing and similar high priority needs must repeatedly bear the brunt of monetary tightening.**

The Council's Report makes this a major point in describing the economic process needed to return to noninflationary growth. The first step, it states, is "A Slowdown in the Growth of Total Spending."

> Monetary restraint and the resulting scarcity and high cost of credit would slow down spending in various ways. Expenditures financed by borrowing—for new houses, for State and local construction projects, for business investment, and for consumers' durables—would be most directly affected.

Later in its analysis describing housing demand it states:

> During the year, private housing outlays declined 6.7 percent (annual rate) from the first to the fourth quarter, and this decline was a major reason for the dampening in the rise of aggregate demand.

Thus the Council recognizes that the dampening of aggregate demand was achieved by forcing a high priority major industry into a depression. But there seems to be little recognition of the social costs of this policy. The report later cites a variety of steps taken to ameliorate this depression, but these steps were at best indirect, and indicated little feeling or urgency with regard to the housing situation.

While the administration's steps were in general in the right direction, they were almost totally inadequate to meet the immediate needs of the home buyer and to soften the impact of excessive monetary tightness. Fortunately, existing federally supported financial institutions did step up financial aid to institutions directly involved in home mortgage lending, thus preventing a major debacle in the home building market, but again there was no assurance that

basic institutional change is underway to assure that the housing market will not again become a major scapegoat in the future anti-inflationary policy.

The committee feels very strongly that the Federal Reserve discount window should be opened to federally supported housing agencies just as it is now open to commercial paper for investment purposes having a lower social priority. Only by greatly expanding home construction rates (as brought out in the priority section) can we meet our housing goals. It is essential that we now establish an institutional framework which will insure housing against the discriminatory impact of tight monetary policy. There are a number of such proposals now before Congress. It behooves the present administration to act now in supporting basic changes in institutional arrangements.

For the immedate future we repeat the recommendation made in our report last year that the Federal Reserve should exercise, *when appropriate*, its authority to purchase the obligations of Federally supported agencies whose primary policies involve aid to the housing markets. The *appropriate* time is already past but it is still not too late. The Federal Reserve should now abandon its "Treasury securities only" policy just as it was earlier forced to abandon its equally inappropriate "bills only" policy.

This committee feels that the failure of Government policy in the housing area applies also with respect to the discriminatory impact of monetary policy on State and local credit needs and on the financing needs of small business. In the decade ahead, all three of these segments of high priority demand must be much more equitably protected against the ravages of extreme monetary policy actions.

This committee has conducted a detailed study of the State and local borrowing needed to insure that public facilities are adequate to meet the needs of our growing population. Instead of expansion of credit availability to meet these needs, the net expansion of State and local debt fell off in 1969, and there is no reason to believe that this trend can be reversed in 1970 unless the disruption in the markets for State and local issues can be overcome.

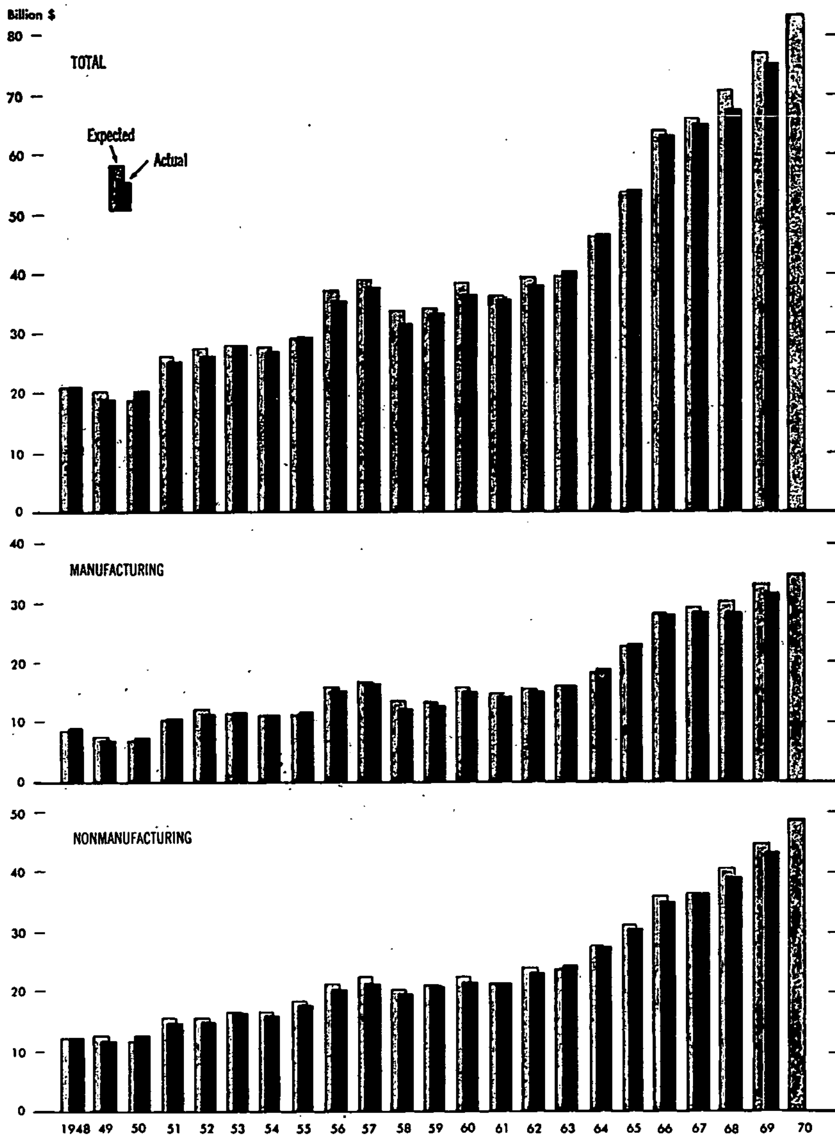
Hopefully a quick easing of monetary policy may be expected to bring interest rates on municipal bonds down somewhat. However, there is need for the development of new financial arrangements to assure an adequate flow of capital funds for States and municipalities.

As cited earlier, the present administration's policy to disinflate the economy is stated to be based on restricting borrowing for housing, State and local construction, business investment and consumer durables. We have just indicated the extreme impact of tight money on housing and State and local facilities needs. What happened to its impact on business investment and consumer durables?

With respect to the latter, there is reason to believe that consumers are cutting back on their expenditures for durables, notably automobiles. It is, however, a far cry from recognizing this development to the proposition that tight money has been responsible. The evidence available to this committee suggests that it is not tight money which is inhibiting purchases of consumer durables but rather the sluggish advance in real after-tax consumer income—primarily the result of

largely uncontrolled inflation. We have seen little evidence that high interest rates or lack of availability of consumer credit were serious factors limiting purchases of consumer durables. Few persons with adequate income are turned down for an auto loan; interest rates on such loans have for years been the highest charged by banks and there is little evidence that banks have instituted more restrictive lending terms on such loans.

CHART V



In sharp contrast to the credit scarcity in housing and the public sector, tight money has not been effective in restricting business spending on plant and equipment. We have seen one of the longest, most sustained expansions in such spending on record. Since 1961, when the last cutback appeared, the record is as follows (in billions of dollars):

Year	Amount	Year	Amount
1961	35. 9	1966	63. 5
1962	38. 4	1967	65. 5
1963	40. 8	1968	67. 8
1964	47. 0	1969	75. 3
1965	54. 4	1970 (anticipated)	83. 5

In only 2 of these years—1965 and 1966—has the dollar expansion equaled or exceeded that which took place in the 1968–69 period, a period which witnessed the tightest money policy on record.

Moreover, business representatives are still saying the expansion in 1970 will be at least as great as last year. It may be, as the administration spokesmen appearing before the committee testified, that here also there is a lagged response—an expression receiving increasing currency as expected results fail to appear—but it is noteworthy these same business representatives have also been telling us that the repeal of the investment tax credit—which, before repeal, was supposed to be such a stimulant to investment—would have little impact on their planned investment. It is, of course, also possible—as we were told in the hearings—that businessmen are now becoming more convinced of the efficacy of the anti-inflation fight. If so, the business community will soon cut back its spending, particularly as it sees the steadily expanding gap between capacity and utilization. However, so far the record as just revealed does not substantiate such a cutback.

Summing up to this point. Tight money has restricted total demand; but its current and future impact is and will be at the expense of high priority items in our overall national budget; restrictive developments have failed to attack the major causes of continuing inflationary developments and may indeed be sowing the seeds of a disruptive recession or depression in 1971 when—as indicated earlier—the budgetary position will move from less to more restrictiveness.

Business Financing

One of the really disturbing aspects of recent financial developments is the growing illiquidity of the business community.

The effect on the nonfinancial business community is made clear from table 1, below. Nonfinancial corporate business had total uses of funds of $113.5 billion in 1969, $10 billion more than in 1968. The usual demands for such funds take the form of liquid assets to cope with growing business and, more importantly, capital expenditures. The latter accounted for almost all of the increase between 1968 and 1969—mainly reflecting higher spending on fixed capital. But it is significant to note that demand for financial assets was at a record rate in 1969 far above any year except 1968.

TABLE 1.—USES AND SOURCES OF FUNDS, NONFARM NONFINANCIAL CORPORATE BUSINESS, 1959 TO 1969

[In billions of dollars]

Uses or sources of funds	1959	1964	1967	1968	1969
Uses, total	53.1	64.9	85.9	103.5	113.5
Purchases of physical assets	36.9	52.1	72.5	76.9	86.5
Nonresidential fixed investment	31.1	44.1	63.8	68.0	77.1
Residential structures	1.7	2.1	2.2	2.3	2.7
Change in business inventories	4.1	5.9	6.4	6.5	6.7
Increase in financial assets	16.2	12.8	13.5	26.6	26.9
Liquid assets	5.6	1.2	.6	10.1	4.1
Demand deposits and currency	−1.0	−2.3	−2.2	1.3	2.6
Time deposits	−.4	3.2	4.1	2.2	−8.0
U.S. Government securities	6.6	−1.5	−2.5	1.8	−1.1
Open-market paper	−.2	1.6	1.5	4.5	8.3
State and local obligations	.7	.2	−.4	.4	2.3
Consumer credit	.8	1.3	.9	1.7	.9
Trade credit	7.7	8.1	8.8	14.8	17.7
Other financial assets	2.0	2.2	3.2	.1	4.2
Sources, total	57.9	71.8	94.2	110.4	118.8
Internal sources	35.0	50.5	61.2	63.1	63.0
Undistributed profits	12.6	18.3	21.2	22.0	21.3
Corporate inventory valuation adjustment	−.5	−.5	−1.1	−3.2	−5.6
Capital consumption allowances	22.9	32.8	41.2	44.3	47.4
External sources	22.9	21.3	33.0	47.3	55.8
Stocks	2.2	1.4	2.3	−.8	2.6
Bonds	3.0	4.0	14.7	12.9	12.7
Mortgages	3.0	3.6	4.5	5.8	4.3
Bank loans, not elsewhere classified	3.5	3.8	6.4	9.6	8.5
Other loans	−.3	.9	1.4	3.6	9.1
Trade debt	5.5	3.6	2.6	5.7	9.9
Profits tax liability	2.4	.5	−4.1	3.7	1.5
Other liabilities	3.6	3.5	5.2	6.9	7.1
Discrepancy (sources less uses)	4.8	6.9	8.2	6.9	5.4

Source: Board of Governors of the Federal Reserve System.

More important, however, is the changed composition of demand for "liquid" assets. Corporations reduced their holdings of deposits and currency—a reversal of trends in most previous years. They also reduced holdings of short-term Governments. These are most liquid assets.

On the other hand they increased, very greatly, holdings of what is categorized as "open market paper"—doubling their net acquisitions—and also increased sharply their holdings of other financial assets. However, it should be noted that these so-called liquid assets in large degree reflect short-term "liquid" liabilities of other corporations.

The committee believes the usual measures of liquidity may indeed conceal a growing illiquidity of non-financial business. Excessively tight money contributed to this predicament. We fail to find an adequate awareness of this in the statements of the administration.

In view of the highly discriminatory manner in which restrictive monetary policy has affected top priority sectors of the economy, this committee strongly recommends that the President instruct the Federal Reserve authorities to institute a system of credit controls in the banking area

and establish a Capital Markets Committee to oversee the borrowing operations of business in the capital markets. Legislation to authorize machinery for more effective distribution of available credit funds was overwhelmingly voted in the last session of Congress. The aim of this policy of selective credit controls should be to bring about greater availability of credit for housing, municipal facilities and small business and to restrict the availability of funds for such highly inflationary purposes—under present circumstances—as industrial spending on fixed capital expenditures.

V. IMPROVING THE STRUCTURE OF THE ECONOMY

If the Nation is to achieve and maintain both full employment and price stability, it must avail itself of a wider range of policies than are presently being employed. For the past 14 months, the administration has relied almost exclusively on fiscal and monetary policy to bring inflation under control. Sound fiscal and monetary policies are essential, but failure to also make full use of policies to improve the structure of the economy, including price and incomes policy, imposes an unnecessary cost on the Nation in terms of unemployment and of output forgone. The private witnesses who appeared before the annual hearings of this committee were very nearly unanimous in emphasizing that inflation could be conquered more rapidly, and at smaller cost in terms of jobs and output, if fiscal and monetary policy were supplemented by specific standards for price and incomes behavior and by a more vigorous attack on structural inefficiencies in the economy. A consciously enunciated price and incomes policy must become a standard part of the policy mix. The familiar litany of structural inefficiencies must be effectively acted upon and not merely reiterated. Only by supplementing fiscal and monetary policy with incomes policy, manpower policy, vigorous antitrust policy, and a wide range of other structural policies can we fully and effectively employ all of our resources and produce in sufficient quantities the goods and services our people require.

PRICE AND INCOMES POLICIES

As indicated earlier, there is little evidence as yet of the long-predicted slowdown in the rate of price increase, and so long as prices continue to advance sharply, there is little reason to suppose that demands for large wage and salary increases will abate. Unless specific standards for appropriate price and income changes are developed, we fear that the economy faces a difficult period marked by labor disputes, work stoppages, and an unnecessarily prolonged continuation of inflation.

The Council of Economic Advisers should at once initiate consultations with labor and business regarding appropriate price and incomes behavior. Following such consultations, the Council should publish promptly a set of specific quantitative standards for price and income changes. The standards should be such that voluntary compliance by business and labor will contribute to the restoration of greater price stability.

The number of workers who will be involved in collective bargaining negotiations during 1970 is unusually large. Approximately 5 million workers are covered by agreements either terminating or scheduled to be reopened during 1970. This compares to only 2.7 million workers involved in such negotiations in 1969.

The rate of money-wage increase agreed to under collective bargaining decisions has accelerated rapidly during the past 2 years. Negotiated first-year wage-rate increases reached in major collective bargaining agreements averaged 5.7 percent in 1967, 7.2 percent in 1968, and 8.3 percent in 1969. Only the fact that relatively few workers were involved in 1969 decisions has kept wage settlements from being even more disastrously inflationary than they were. In order to slow inflation and protect the real wages of all workers, it is essential that this trend of accelerating settlements be reversed in 1970. At the same time, workers who received relatively small wage increases in 1969 under contracts negotiated in earlier years lost ground in real terms due to the rapid price rise. Their legitimate demands to "catch up" should not be ignored.

The Council of Economic Advisers has expressed the hope that slower growth of consumer demand, softer product markets, lower profit margins, and higher unemployment will lead to smaller wage demands by labor unions and to greater resistance to large wage increases on the part of businesses. We believe that this method of conquering inflation will be far too costly in human terms, and we have little confidence that it will be uniformly effective. The average wage settlement has been increasing rapidly and the dispersion of individual settlements around the average is very wide. It is, therefore, extremely difficult for individual unions to determine what an appropriate wage demand should be and equally difficult for businessmen to determine whether union wage demands are excessive in the present situation. Thus market forces during 1970 are likely to work in an extremely erratic fashion and to produce acrimonious disputes and protracted work stoppages.

The unsatisfactory pattern of price and wage changes which are resulting from the administration's "hands off" policy is becoming increasingly widely recognized. Serious and thoughtful suggestions for a wage-price "freeze" or for other forms of direct control have been heard with increasing frequency recently. Such compulsory approaches have serious disadvantages; enforcement is difficult, inflation is suppressed rather than eliminated, and distortions in resource allocation are introduced.[1] The 6 months' postponement of pay increases for Federal workers which the administration has requested is, in essence, a wage freeze for one sector of the economy. A wage freeze for only one sector has the disadvantages of a general freeze. In addition, it raises a serious question of equity. It is true that postponing Federal pay raises will strengthen the budget position for fiscal 1971, but it will also force one sector of the economy to bear an unduly large share of the costs of fighting inflation. If the administration means the postponement of Federal pay increases to be an example to the private economy, the proposal should be accompanied by specific standards for private wage and price behavior.

It is most regrettable that the Council did not see fit to publish standards for price and incomes behavior in its annual report. Indeed, the problem of the large number of wage settlements scheduled for

[1] See supplementary views of Chairman Patman and Representatives Reuss and Moorhead, p. 58.

1970 was almost totally ignored by the Council. The development of specific standards for price and incomes behavior in an inflationary period is, of course, difficult. We do believe, however, that it is possible. The needed discussion of this difficult problem should not be postponed any longer.

Maintaining price stability in the years ahead.—Our immediate task is to halt inflation. Once we have succeeded in this, the challenge will be to maintain reasonable price stability while regaining and maintaining high employment. In order to restore the economy to a full employment level from the reduced levels prevailing during the transition, actual output for a period will have to rise faster than the rate of growth of our productive potential. The Council anticipates that this "catching up" will take place during 1972 and 1973. We hope that we will not have to wait that long. Whatever the calendar period is in which this rapid catching up to potential takes place, it will be important to avoid introducing new inflationary pressures into the economy. We have already stressed the fundamental role of sound fiscal and monetary policy. We believe that fiscal and monetary policy can and should be assisted by the regular publication of specific quantitative standards for price and incomes behavior. This should be a regular function of the Council of Economic Advisers.

The Council of Economic Advisers should be given statutory authority and responsibility for the annual recommendation of specific voluntary standards for price and incomes behavior. Business and labor should be consulted in the formulation of these standards, and the recommended standards should be transmitted to Congress as part of the President's Economic Report.

If the responsibility of the Council for recommending price and incomes standards were clearly founded in statute, performance of this responsibility would cease to be a controversial political question, and we would not again suffer from the abandonment of policy just at the time it is most needed. The abandonment of the guidelines in 1967 had a detrimental effect on the economy. It is true that the administration continued a policy of persuasion or "jawboning" in certain specific prices and wage decisions during 1967 and 1968, but this effort was less equitable and probably less effective than a published, explicit, uniform standard. The present administration has chosen to abandon all public attempts to intervene in price and incomes decisions. A stop-go or erratic price and incomes policy is completely unsatisfactory. The economy will be better served if the development of price and incomes standards becomes an accepted and continuing function of the Council under explicit statutory authority and responsibility.

If voluntary standards are to be effective, the public must be able to judge the quality of the price and incomes decisions made by business and labor. This will require not only the setting of price and incomes standards, but also the gathering and publication of the productivity, price, and income data required to measure compliance with these standards.

There should be established outside the Executive Office of the President a Federal Productivity, Price, and Incomes Office which would have the following responsibilities:

(1) to collect, analyze, and publish the information on productivity, prices and incomes needed to evaluate the extent of compliance with the price and incomes standards set by the Council of Economic Advisers;

(2) to identify and bring to public attention actual and potential economic inefficiencies in both the public and private sectors of the economy which keep prices and incomes in particular markets at artificially high levels. This function should include, but should not be limited to, reviews of Government procurement policies, regulatory policies, restrictions on international trade, stockpile policy, and both Govment and private policies which create artificial barriers to entry into particular occupations;

(3) to identify and bring to public attention potential shortages either of specific materials or of specific labor skills which can be expected to create inflationary pressures.

The need for the first of these three functions has already been discussed. The second, the identification of economic inefficiencies which keep prices unnecessarily high, is equally as important. In theory, no one is in favor of economic inefficiency. In practice, of course, particular vested interests may oppose the removal of particular inefficiencies which redound to their particular benefit. Thus there is the need to establish an office which will survey these questions independently, objectively, and on a regular basis.

This year, as in the past, the Council of Economic Advisers has singled out in its annual report numerous areas in which public policy actions could improve the efficiency of the economy. The problems mentioned in this year's report include resale price maintenance, agricultural price supports, regulation of transportation and communication, and the need for better consumer information. We recognize that, within the executive branch, the Council is a dependable and persuasive voice against Federal policies which interfere with economic efficiency. In this connection, it is interesting to recall the following quotation from the Council's first report in December 1946:

> It [the Government] must review, as part of a total program, the legal aids and financial subsidies that it has always given to particular branches or phases of transportation, manufacture, trade, and finance and, more recently, to agriculture and labor. It must gage carefully the amount and character of public informational, regulatory, and service work the Government needs to perform as a means of preventing fraud, discrimination, or waste, and securing maximum advance in efficiency of operation. * * *

We are not suggesting that the Council diminish its efforts in this area. Indeed, they should be strengthened. However, the very familiarity of the list of economic inefficiencies which we continue to tolerate points up our failure to develop a fully effective mechanism for dealing with them. There is a need for an office outside the Executive Office of the President which could independently analyze questions of economic efficiency and report publicly on a systematic basis.

The third suggested function of the Productivity, Price, and Incomes Board, the timely identification of potential shortages, could do much to prevent the introduction of new inflationary pressures into the economy. The economy will be undergoing some major shifts in the next few years. Resources are being shifted from the defense and aerospace sectors into the production of civilian goods and services. Restraint on the total level of resource use will not prevent new inflationary pressures if shortages of particular skills or particular raw materials are allowed to develop during this transition. Many of the most serious inflationary pressures in the economy today can be traced to our past failure to fully anticipate resource requirements and to take the necessary policy steps to encourage the appropriate shifting of resources. Obvious examples can be found in the health care industry and in the construction trades. Where changing Government policies will create the need for substantial resource shifts or where the private economy is not responding adequately to growing or shifting demands for particular goods or services, public policies need to be more systematically directed toward facilitating the necessary reallocation of resources.

Labor and Manpower

In his statement submitted to this committee, the Secretary of Labor described manpower policy as "a junior partner to fiscal and monetary policy." We agree that greater efficiency of labor market operation can make a vital contribution to the attainment of price stability at high employment. However, an even more fundamental objective of policies designed to improve the functioning of our labor markets is the need to assure the availability of productive and well-paid employment for all who desire to work. The prospect of rising unemployment and the need to shift resources from the defense sector to high-priority civilian uses make labor and manpower policies a particularly crucial element in economic policy at the present time, not simply a "junior partner." Aspects of labor policy to which we would like to call particular attention include manpower training, job placement, employment and job vacancy statistics, and unemployment compensation.

Manpower training.—Elimination of high rates of unemployment in particular geographical areas and among particular segments of the population has long been a goal of public policy. During the 1960's a number of new efforts to combat these structural defects in the economy were initiated, efforts ranging from the Job Corps to the adjustment assistance provisions of the Trade Expansion Act. Since these efforts were new, it was natural and desirable that a number of approaches should be explored. It is also natural that some of these

approaches have proved more successful than others and that some confusion and duplication of effort have at times resulted. After nearly a decade of experience, it is now appropriate to undertake a systematic consolidation of manpower programs.

Legislation proposed by the administration last year recognizes this need, but the failure to treat the need for assistance in adjusting to increased import competition within the context of overall manpower policy is a serious defect. A worker displaced by import competition needs help in finding a job producing a good or service for which there is sufficient total demand, just as does a worker displaced by technological change or the migration of industry between regions, or a worker who has never had the opportunity to acquire the occupational skills required in a modern economy.

This Nation should have a comprehensive program to combat unemployment and underemployment whether the cause is technological change, increased import competition, or inequality of individual opportunity.

As this committee has reiterated for the past several years, the long-term unemployment goal should not exceed 3 percent.

The manpower program should be funded and staffed at a level adequate to serve every citizen who has a legitimate need for job-training or job-placement assistance.

The Nation appears to be moving toward adoption of a comprehensive Federal income support system. As discussed elsewhere in this report, we support such a program. We also support the access of every citizen to full opportunity for productive employment. In many cases full employment opportunity implies job-training and placement assistance. Despite its rapid expansion in recent years, the manpower program is not yet funded and staffed at a level adequate to the need.

The requirement contained in the administration's family assistance plan for registration of recipients with the Employment Service will be meaningful only if the required manpower and placement services are available. We recognize that expansion of the manpower program to the level necessary to fully accommodate the need may not be immediately achievable because of limitations on the shortrun supply of competent staff personnel. However, it is important to recognize the need and to move as quickly as possible to fill it.

Since we believe that the manpower training programs should at all times be adequate to fill legitimate needs, we see no need for any automatic expansion tied to an arbitrary statistical indicator, such as some particular level of the unemployment rate. At any time when unemployment can be reduced and economic efficiency improved through job training, the program should be expanded. The administration should explore with Congress the possibilities of alternative arrangements for moving quickly to change program levels in response to changing needs, but such arrangements should be regarded as part of a total national commitment to human resource development, not merely as a countercyclical device.

Full opportunity for productive employment should be equally available to all citizens. Discrimination based on sex is no more acceptable than is discrimination based on race, religion, age, or national origin.

Much attention has been given recently to the question of whether mothers with sole responsibility for the care of minor children should be required to work. The more significant question is whether those women who wish to work can be given the opportunity to do so. It must be recognized that in this context opportunity means not only admission to training programs, but also the availability of adequate day care facilities for children. The present supply of day care facilities remains far from adequate.

We heartily support expanded and improved job-training efforts, but emphasis on job training does not remove the need for a vigorous attack on other structural weaknesses in the economy.

The longrun potential of job-training programs is very great. However, it must be recognized that they are unlikely to have any massive aggregate economic impact in the immediate future. To imply otherwise could lead to disillusionment with what is basically a worthwhile and essential effort.

As we have indicated earlier in this chapter, the problem of inflation is not merely a temporary one. We will continue for the foreseeable future to be faced with the problem of preventing inflation without resort to unemployment. Job training accomplished this year can have a significant anti-inflationary impact in the years ahead, but it should not be relied upon as the solution to our immediate stabilization problem. Some of the other structural changes which we discuss throughout this report—such as the removal of import restrictions—could have an immediate anti-inflationary impact. One structural improvement does not substitute for another. A concerted effort to correct many different structural weaknesses is required.

Job placement services.—Our ability to match jobseekers with job vacancies continues to need improvement. We should no longer tolerate either the cost to the individual or the loss of output which results when the individual seeking work is not brought together with a job which makes full use of his abilities. The "job banks" which have recently been introduced in a number of cities should contribute to a more efficient job-placement process. It is important to recognize, however, that these job banks are essentially an improved administrative procedure, through which lists of job openings are made more rapidly and more widely available. While they may represent a significant technical improvement, they are not a major substantive policy innovation. Experimentation with a more complete computerized matching of jobs to individuals is currently underway, but the potential of this approach remains to be evaluated.

Employment and job vacancy statistics.—A number of measures of the employment situation are regularly available. Two series of data are used to develop these measures. One series is obtained through monthly interviews with a sample of individual households. The other is collected from business establishments. In addition to the familiar overall unemployment rate, the household data also provide

figures on the extent of labor force participation of different groups in the population, the extent of part-time employment, and various measures of unemployment for particular groups and by duration of unemployment. The business establishment data provide information on employment in different industries, hours worked per week, labor turnover, and hourly and weekly earnings. When the job vacancy statistics currently being developed by the Bureau of Labor Statistics become available, our knowledge of the demand for and supply of labor will be quite extensive.

Further refinements of our statistics will, of course, remain necessary and desirable. No doubt the job vacancy data will need to be revised and improved as more experience with them is acquired. Seasonal adjustment of the employment series remains a difficult problem. An even greater need than additional statistical refinements, however, is more complete public understanding of the statistics already available.

Public attention tends to focus primarily on the overall rate of unemployment. This particular statistic has shown itself to be somewhat erratic at times, and far from a complete and reliable guide to labor-market conditions. The unemployment rate is a ratio between two numbers—the number of persons unable to find work, and the total civilian labor force of which these persons are a part. The unemployment rate therefore varies not only as the number of unemployed persons changes but also as the size of the civilian labor force changes. The size of the civilian labor force is partly determined by growth of the adult population, but it is also affected by the number of people entering or leaving the Armed Forces, by the number of women and young people wishing to work at a particular time, and by the number of people who enter or leave the labor force in response to the degree of availability of suitable employment opportunities.

Thus, the unemployment rate in 1970 may be influenced by the number of returning veterans who choose work rather than school and by the number of women who may leave the labor force because their husbands have been discharged from the armed services and have returned to civilian jobs. These factors are difficult to predict and may be only loosely related to changes in the total demand for labor. However, if, as is expected, the demand for labor continues to slacken during the year, a number of potential workers may find job opportunities insufficiently attractive or too difficult to locate and may cease looking for work—thereby ceasing to qualify as labor force participants. In this sense, the unemployment rate fails to show the true extent of unemployment, and the understatement is apt to be greater in periods of slackening labor demand than at other times. In judging the seriousness of unemployment, it is thus essential to make full use of all the available statistical data, not merely the overall unemployment rate.

Unemployment compensation.—The fact that unemployment is already rising and may be expected to rise further during the current year lends urgency to the need to improve our system of unemployment compensation.

The coverage provided by the unemployment compensation system should be broadened to include more workers, provision should be made for extended benefit payments in periods of excessive unemployment, and the level of

benefits should be increased. Benefit increases should be accomplished in such a way as to reduce existing disparities among the States with respect to the ratio of benefits to average earnings.

Legislation which has already passed the House and is now before the Senate would partially achieve the above objectives. The coverage of the system would be broadened, and a Federal contribution to the cost of extended benefits would become available automatically when the insured unemployment rate reached 4½ percent nationally for 3 consecutive months or when the employment situation in a particular State reached a certain level of severity, regardless of the national unemployment average. Because the problem of rising unemployment is an immediate one, action on this legislation should be completed promptly, even if the resultant legislation must to some extent fall short of the full need for improvement of the system. The provisions of legislation adopted this year should be designed to be put into effect quickly.

While the problem of higher unemployment is an immediate one, it may not be a problem which will be quickly overcome. The administration's economic projections imply that unemployment will remain above 4 percent until sometime in mid-1973. If unemployment compensation legislation enacted in this session of Congress falls short of our recommendations, particularly with respect to raising the level of benefit payments and fully expanding the coverage, further legislative consideration will remain desirable at the earliest opportunity. The possibility of establishing benefits as a percentage of average weekly wages, rather than in terms of fixed dollar amounts, is among the possible improvements which should receive early and careful consideration. Such proposals are not a new idea. Legislation proposed by the Johnson Administration in 1965 would have had the effect of requiring all States to raise weekly benefit maximums to a level equivalent to two-thirds of the average weekly wage. More recently the present administration has called on the States to act voluntarily to achieve a similar goal. A standard based on two-thirds of average wages would raise benefits in all States and would place workers in all States on an equal footing with respect to the relationship of benefits to average earnings.

A Positive Program To Avoid Further Idling of Resources

Given the present uncertainty of the economic outlook, policymakers would be derelict if they were not prepared to move quickly should it become necessary to take positive steps to reverse a major economic downturn. Improvements in the unemployment compensation system will strengthen the automatic stabilizers which act to cushion the economy in a recession, and manpower programs can ease the transfer of labor resources among sectors of the economy, but additional discretionary programs should be available which can be activated quickly should the need arise.

Administration spokesmen were unable to give this committee assurance that such programs were at hand. We were told that the administration stood ready to act promptly to halt a further down-

turn, but aside from the relatively minor step of lifting the partial freeze on Federal construction programs, we could obtain no information as to what specific actions might be taken.

If it has not already done so, the administration should prepare immediately a coordinated program of specific discretionary actions which could be taken quickly in the event that the magnitude of the current economic downturn exceeds present expectations. This coordinated program should include measures to quickly channel additional funds into low- and moderate-cost housing and State and local public facility construction.

There is no doubt about the strength of the underlying demand for low- and moderate-priced housing or for municipal facilities. The scarcity and high cost of credit is currently preventing this demand from being fully expressed in the market, but many municipal projects have proceeded through the planning stage, so that construction could begin quickly if funds became available. Should the economic situation develop in such ways that substantial additional resources become idled, systematic procedures should be available to channel these resources into sectors where needs are great and where expanded activity can begin quickly.

Strengthening the Role of the Consumer

There is increasing recognition today that proper functioning of our economy requires articulate and well-informed consumers. Several measures designed to strengthen the consumer's position in the marketplace have been enacted in recent years. These include the 1966 Truth-in-Packaging Act and the 1968 Truth-in-Lending Act. A number of additional proposals are presently before Congress. Several of these, such as the proposals to make permanent the Office of Consumer Affairs and to establish an Independent Consumer Council and an Office of Intergovernmental Utility Consumers' Counsel, are designed to improve the organizational machinery of Government for dealing with consumer affairs. Similarly, legislation to permit consumer class actions before the Federal Courts would improve the ability of the Judicial Branch to protect the consumer interest. We regard such organizational improvements as highly desirable.

Other legislation currently under consideration would strengthen consumers' relationships with credit agencies. Legislation prohibiting the distribution of unsolicited credit cards and legislation giving the consumer the right to inspect his credit bureau file on request would fill important gaps in the present structure of legal safeguards against unscrupulous credit practices.

Worthy as these legislative items are, their objectives cannot be realized if there is failure of implementation because of inadequate budget, appropriation, or administrative decisions. The purpose of government in this Nation is to serve and protect the interests of all the people. Subordination of this responsibility to misplaced obligations to the private business sector corrupts our representational government. The failure to carry out the full purpose of much of the

consumer legislation passed in recent years and the failure to fully utilize existing government machinery and authority must be corrected.

PRESERVING COMPETITION

In recent years there have been very significant changes in the structure of the American economy which affect the decisionmaking process. In a merger movement of unprecedented dimensions, conglomerate corporations are spreading their influence over a wide array of industries and markets and across major sectors of the economy. At the same time, hundreds of one-bank holding companies have been formed for the purpose of breaking the traditional wall of separation between banking and industry. Corporate decisionmaking is being further centralized not only in a relatively few corporations, but in command centers in major financial centers of the Nation. This development raises fundamental social and political questions, as well as economic problems for our free enterprise system. It also brings to center stage the question of whether traditional antitrust enforcement is adequate to meet the challenges of this centralization of economic power in American society.

In its report two years ago, this Committee questioned whether the antitrust agencies were "applying sufficient enforcement vigor in an imaginative application" to their enforcement responsibilities. We also asked whether our tax system and other governmental programs may be encouraging mergers, and urged the Federal Trade Commission to "probe deeply into the ramifications of the growing concentration of economic power flowing from the increasing conglomerate mergers."

The Federal Trade Commission initiated such an in-depth investigation and recently issued a 750 page "Economic Report on Corporate Mergers" which points out that:

> By the end of 1968, the 200 largest industrial corporations controlled over 60 percent of the total assets held by all manufacturing corporations. This concentration of economic resources represents a substantial increase over previous levels that have earlier prompted major concern on the part of the U.S. Congress. Specifically, the share of manufacturing assets held by the 100 largest corporations in 1968 was greater than the share of manufacturing assets held by the 200 largest corporations in 1950, the year Congress enacted the Celler-Kefauver amendment to section 7 of the Clayton Act. The 200 largest manufacturing corporations in 1968 controlled a share of assets equal to that held by the 1,000 largest in 1941, when the Temporary National Economic Committee submitted to Congress its final report and recommendations on an *Investigation of Concentration of Economic Power.*

The Federal Trade Commission has testified that:

> * * * the present merger movement, which increasingly involves mergers of the conglomerate type, is raising the overall level of concentration in the economy. Irrespective of how one chooses to measure aggregate concentration, the

> results are essentially uniform: there has been a sharp increase during the postwar period in the concentration of economic resources in the hands of the 100 or 200 largest firms. * * *
> Mergers in general, and lately conglomerate mergers in particular, have played a major role in this trend toward increased overall concentration.

The testimony pointed out that:

> * * * a significant trend has developed in the quality of firms which are being acquired: a substantial proportion of the middle range of corporations are disappearing. Between 1948 and 1968 a total of over 1,200 manufacturing companies with assets of $10 million or more were acquired. Overwhelming, these acquired companies have been well established, healthy firms making good profits. These are precisely the kinds of companies—the viable medium tier—which we would expect to grow in the normal way and thereafter present a real competitive challenge to the top companies.

The Department of Justice has stepped up its anti-merger enforcement program by filing a number of significant conglomerate merger cases. The Attorney General has set forth the policy of the Department of Justice. It "may well oppose any merger among the top 200 manufacturing firms or firms of comparable size in other industries," and "will probably oppose any merger by one of the top 200 manufacturing firms with any leading producer in any concentrated industry."

We think there is no substitute for bringing of important merger cases in the face of such a wave of merger activity. At the same time, however, this Committee recognizes that the pro-merger biases, particularly in governmental policies, should be rectified in order to lessen the pressures of the merger movement. Specifically:

(1) The Securities and Exchange Commission should increase its efforts to eliminate false and misleading corporate reporting, and the accounting profession should be urged to take firmer steps to eliminate such practices.

(2) The Bureau of the Budget should immediately undertake to coordinate the efforts of the SEC to protect investors and the FTC to protect competition through the development of meaningful product line reporting in published financial statements of large multi-market corporations.

(3) Tax biases encouraging mergers should be eliminated. The Tax Reform Act of 1969 removed one source of tax bias favoring growth through acquisition. However, most large acquisitions have been accorded "tax free" treatment under Section 368 of the Internal Revenue Code. While the sale of most business assets which generate capital gains is subject to taxation at the time of the transaction, the sale of whole enterprises when accomplished through an exchange of stock is not.

Bank Holding Companies*

In addition to the continued movement toward concentration of economic power in the hands of relatively few corporations, a threat of economic concentration of perhaps even greater magnitude has emerged with the tremendous growth of unregulated bank holding companies.

One-third of all the commercial bank deposits in the United States are now held by banking institutions which are part of a one bank holding company scheme. These one bank holding companies, unlike either banking institutions or regulated bank holding companies, can enter any kind of business activity they desire. Already many of these one bank holding companies are engaged in a wide variety of commercial and industrial enterprises having little or no relationship to banking.

Congress over the last 35 years has severely restricted the nonbanking activities in which banks and multibank holding companies may engage because of the abuses that can occur as the result of mixing the commercial bank function with other activities. Congress originally established this principle of separating banking and nonbanking activities largely as a result of the adverse experiences with the financial community which occurred in the 1920's and helped bring about the stock market crash of 1929 and the great depression.

Banks and bank holding companies should not be permitted to use the power of credit to dominate the economy and to carry on unfair business practices which threaten the economic health of all other businesses which use credit. If left unchecked, unregulated bank holding companies would be able to use the power of credit to force customers to take nonbanking services in order to obtain loans. These bank holding companies could also cut off credit from business customers of the bank competing with their own nonbank activities. Moreover, bank holding companies are in a position to extend large

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*Senator Sparkman makes the following statement in lieu of subscribing to the provisions in the report related to bank holding companies:

"I strongly believe that Congress should enact timely, equitable and effective legislation to bring one bank holding companies under appropriate Federal regulation. The possible problems alluded to in the body of the report certainly deserve serious consideration. Indeed, there are many serious and delicate issues which will have to be resolved by the legislation.

"In order to do this, it will be necessary to hold thorough, comprehensive hearings on the matter. The House of Representatives did not complete its consideration of the legislation until late in the last session of Congress. This fact, business already pending before the Senate Banking and Currency Committee, and the necessity for prompt action on expiring Acts have made it impossible for hearings of the nature required to be scheduled to date.

"There has been no request by the Administration that legislation on the matter be delayed. To the contrary, Administration spokesmen have reiterated their desire that appropriate legislation be enacted promptly. In addition, the affected industries agree that one bank holding companies should not be exempt from Federal regulation.

"As soon as the pending Committee business makes it feasible—probably within the next few weeks—I shall discuss the matter of hearings on one bank holding company legislation with the members of the Committee, with the purpose of assuring that the judicious and timely action that is required will be taken on this subject."

amounts of credit to other holding company subsidiaries, thus creating unsound financial conditions for the bank to the detriment of a bank's depositors, stockholders, and the public at large.

If such an economic pattern should develop in the United States, no business enterprise of any consequence could continue to compete and remain healthy without associating itself with one of these giant financial conglomerates. Therefore, this most serious threat to our free enterprise system as we know it today must be brought under prompt and effective government regulation.

The most immediate and effective means of dealing with the threat to competition created by one bank holding companies is through completing passage of amendments to the Bank Holding Company Act which have already been approved by the House and are now pending before the Senate.

VI. NATIONAL PRIORITIES

Last year this Committee urged a major concentration on national goals and priorities as a central requirement of public economic policymaking. Specifically, we called for a determination of the dollar costs required to attain primary social goals; an evaluation of the resources which could be called upon to reach social objectives; and specific focus on the allocation of Federal revenues between the military and civilian programs.

During the course of 1969 this Committee, through its Subcommittees, has given much attention to these problems. The need to undertake major shifts in the use of our national economic resources and the role which the Federal Government plays in resource allocation have also received a great deal of attention in the other Committees of Congress, elsewhere in the Federal Government and among the public at large. We are encouraged to observe this growing national consensus in favor of a searching reevaluation of the uses to which we put our national wealth.

The Joint Economic Committee plans to continue during the current year its studies of our national priorities and of the role of the Federal Government in influencing resource use. On the basis of our Subcommittee studies conducted during the past year and of our annual hearings on the Economic Report, we see a need to stress in this report three important considerations relative to further evaluation of our national priorities. The first is the need for fuller understanding of the pervasive influence of the Federal Government on total resource use in the economy, the second is the need for Congress to question searchingly the adequacy of the 1971 budget with respect to the share of budgetary resources allocated to social programs, and the third is the need for similar searching inquiry into the adequacy of the proposed cuts in defense spending and of the information made available by the executive branch concerning the defense budget.

The Role of the Federal Government in Resource Allocation

The extent of the influence of Federal policies and activities on our total national resource use is not always fully recognized. The $200 billion of budget expenditures has a tremendous effect on production, growth, employment, income distribution, and regional development but this is only one aspect of the total Federal impact. Tax policies that relate to an equal amount of Federal revenues likewise have fundamental effects on investment, consumption, income distribution, growth, and the very structure of our economy.

Less obvious but also of vast importance are the regulatory decisions made at the Federal level. These have pervasive implications for resource allocation. Moreover, Federal credit programs have grown to the point where they exercise extensive influence on the flow and direction of economic resources. At the present time, the Federal

Government is not able to carry out sufficient or adequate evaluation either for program formulation or for operation.

The Joint Economic Committee, through its Subcommittee on Economy in Government, has devoted considerable effort to these questions in the past year, and it is the committee's expectation that this valuable work will continue. Meanwhile we would cite the following information and evaluation needs as already well established by the committee's work.

The following recommendations of the Subcommittee on Economy in Government are based upon the more detailed analyses, which appear in two of their reports entitled, *The Military Budget and National Economic Priorities* and *Economic Analysis and the Efficiency in Government*, both of which we fully endorse.

1. The Federal budget document contains little of the kind of economic information required for efficient decisions. There are no budget projections of individual programs and components of programs, no comprehensive program budgets, and no indication of the regional impacts of programs. Although a competent "tax expenditure" budget has been prepared by the Department of the Treasury, the Executive budget document makes no reference to it. Nor does it provide any data on the effects of subsidies on income distribution and other important aspects of the economy.

2. The Planning-Programing-Budgeting System which was designed to stimulate the analysis and evaluation of public expenditures has not yet achieved the results originally expected. It has not been effective in eliminating inefficient and inequitable programs which are often protected by powerful vested interests. Moreover, the analysis and studies which it has produced have been retained in the executive branch, often buried, and almost never made available to the Congress.

3. The Congress lacks a staff capability to apply economic analysis such as cost-benefit appraisal to the programs for which it annually appropriates funds. This is most needed in spending and taxing policies. The policy initiatives once held by the legislative branch have seriously eroded in recent years. In this increasingly complex and technical economy, the Congress must have access to the evaluations of skilled program analysis. Correction of this problem warrants high priority.

A major effort is required if these problems are to be corrected. We reiterate the recommendations of the Subcommittee on Economy in Government which recommended as follows in their February 1970 report on *Economic Analysis and The Efficiency of Government:*

> **An Office of Economic Evaluation and Analysis should be established as an autonomous nonpartisan staff unit within the Joint Economic Committee. This Office would be responsive to all congressional offices and would assist them in obtaining analytical studies, data, and information on policy and program alternatives.**
>
> **Additional funds for procuring specific analyses of Federal programs and policy areas should be appropriated and allocated to the committees with substantive program responsibilities. These studies would provide Congress with independent appraisals of programs and decisions and would reduce congressional reliance on the executive branch for such information.**

At the same time, the Bureau of the Budget should reshape the budget document so that the information in it would be of much more assistance to decisionmakers and the public. It must become an economic document.

THE PROPOSED DOMESTIC COUNCIL

We note that the President has just sent to the Congress a major reorganization plan which implicitly, if not explicitly, vitally affects the objectives and procedures contained in the Employment Act of 1946. The proposed Reorganization Plan No. 2 of 1970 would establish a new Domestic Council, with a supporting new layer of professional staff, which will "be charged with integrating the various aspects of domestic policy into a consistent whole."

Included in its express assignments are the following:

> Assessing national needs, collecting information and developing forecasts, for the purpose of defining national goals and objectives.
>
> Identifying alternative ways of achieving these objectives, and recommending consistent, integrated sets of policy choices.
>
> Providing rapid response to Presidential needs for policy advice on pressing domestic issues.
>
> Coordinating the establishment of national priorities for the allocation of available resources.
>
> Maintaining a continuous review of the conduct of ongoing programs from a policy standpoint, and proposing reforms as needed.

The aforementioned responsibilities are clearly within the duties of the Council of Economic Advisers. Section 2 of the Employment Act of 1946 sets forth this Declaration of National Policy:

> SEC. 2. The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power. (15 U.S.C. 1021.)

Section 4 of the Act establishes the Council of Economic Advisers and sets forth its duty and function as follows:

> (1) to assist and advise the President in the preparation of the Economic Report;
>
> (2) to gather timely and authoritative information concerning economic developments and economic trends, both current and prospective, to analyze and interpret such infor-

mation in the light of the policy declared in section 2 for the purpose of determining whether such developments and trends are interfering, or are likely to interfere, with the achievement of such policy, and to compile and submit to the President studies relating to such developments and trends;

(3) to appraise the various programs and activities of the Federal Government in the light of the policy declared in section 2 for the purpose of determining the extent to which such programs and activities are contributing, and the extent to which they are not contributing, to the achievement of such policy and to make recommendations to the President with respect thereto;

(4) to develop and recommend to the President national economic policies to foster and promote free competitive enterprise, to avoid economic fluctuations or to diminish the effects thereof, and to maintain employment, production, and purchasing power;

(5) to make and furnish such studies, reports thereon, and recommendations with respect to matters of Federal economic policy and legislation as the President may request.

It is clear that, at best, there is decided overlap of responsibilities here. Under the circumstances it is incomprehensible why the Chairman of the Council of Economic Advisers and the Director of the Bureau of the Budget are not included on the Council. The new proposal does not even mention the activities of the Council of Economic Advisers, and, perhaps even more significant, does not propose that the Chairman of the Council, or his representative, be a member of the new proposed Council.

This Committee strongly urges the President to amend this proposal to include the Chairman of the Council of Economic Advisers and the Director of the Bureau of the Budget on the proposed Domestic Council. We deem it especially important that this new proposal not be construed as a de facto downgrading of the Council of Economic Advisers. Indeed the President should make unmistakably clear that the CEA perform its traditional function as his chief economic adviser and have ready access to the President.

Social Programs in the 1971 Budget

In his budget message the President stated:

> This anti-inflationary budget begins the necessary process of reordering our national priorities. For the first time in two full decades, the Federal Government will spend more on human resource programs than on national defense.

This committee is very aware of the difficulties of allocating an adequate share of budgetary resources to important social uses, given the limitations on total expenditure and the proportion of expenditure which is not subject to direct Presidential control in the short run. We commend the administration for their concern that the budget should reflect a shift in our national spending priorities. Nevertheless, we feel obliged to question whether the comparison between defense

expenditure and "human resource programs," as defined in the budget document, is particularly helpful to an effort to evaluate any shift in budget priorities.

The budgetary category of "human resource programs" includes education and manpower, health, income security, and veterans' benefits and services. For fiscal year 1971 these programs total $82 billion, of which $51.5 billion is trust fund expenditure, including $42.4 billion of Social Security funds and $5.0 billion of Railroad and Civil Service Retirement funds, and at least $15.2 billion is other expenditures classified by the Budget Bureau as "relatively uncontrollable" because these items are fixed by law and their growth from year to year is governed by legislative formula rather than by budgetary discretion. Thus considerably less than 20 percent of the expenditures in the human resource budget category can in any sense reflect the desire of the Administration to shift spending priorities. In any case, a budgetary category which includes such items as civil service retirement but excludes housing, community development, and environmental control is not an appropriate measure of the shift of budgetary resources into those social programs which are in greatest need of increased funding.

This report is not the place in which to outline a detailed program of budgetary reallocation, but it is both possible and appropriate to point to the areas to which we think Congress should give particular attention in its deliberations on the 1971 budget.

We urge prompt action to meet: (1) the need for substantially increased Federal effort in the areas of housing and community development, education and manpower, health, antipoverty and income support, environmental control, and the administration of justice; (2) the need to reduce or eliminate expenditures for space, the supersonic transport and highways; and (3) the need to further reduce defense expenditures.

Housing and community development is an area to which we devoted particular attention in last year's report. The situation is clearly more acute today than it was a year ago. The place of human resource programs—health, education, manpower, and income support—in the budget has been a source of protracted debate in recent months. Environmental control and the administration of justice are two program areas which have been stressed in Administration statements. Thus each of these functional areas of the budget seems to us in need of particular review with respect to the adequacy of its share of the total budget. Because housing is an area to which this committee has devoted particular attention, the need for greater Federal effort in this area is discussed in greater detail in the next section. The following sections present this Committee's views with respect to income support and environmental control programs—two areas in which Congress is currently evaluating the need for new initiatives.

Housing.—Housing is an outstanding example of a longstanding problem with the most serious social consequences for low- and moderate-income families which the Federal Government has so far failed to solve. Yet it is not a "human resource" program under the definition contained in the budget. In the Housing and Urban Devel-

opment Act of 1968, Congress set a goal of 26 million new housing units to be constructed, including 6 million for low- and moderate-income families, in the 10-year period from fiscal year 1969 to fiscal year 1978. Construction averaging 2.6 million units per year was, in 1968, considered to be the minimum requirement for catching up and fulfilling the national housing commitment undertaken in the Housing Act of 1949 and reaffirmed in 1968; namely, to provide a decent home and a suitable living environment for every American family. In calendar year 1969, total private and public housing starts were a disappointing 1.5 million, 50,000 less than the year before. Further, vacancies declined in 1969. At this rate, the Nation will continue to fall behind as older homes fall into the substandard category and as the population expands. The Federal Government must share a large part of the blame for not meeting the goals set out in the 1968 act. While it is true that the administration is increasing overall expenditures for community development and housing, it is not fulfilling the commitment which it undertook 2 years ago in the public housing, rental assistance, and homeownership programs.

The administration believes that controlling inflation is the key to solving the housing shortage. It assumes that a reduced rate of price and income increases will bring about a reduction in interest rates and this will greatly stimulate the housing industry. The administration admits that its program will fail by its projection of only 1.4 million housing starts in 1970. This is even below 1969's poor record. It is generally forecast that housing starts will sink even lower in 1970 unless prompt action is taken by the Congress. The committee is persuaded that the administration's policy, together with the still modest Federal housing program, will not meet our goals in this area, and that it will not bring the immediate relief which low-income families are entitled to expect. It will not assist the housing industry out of its depression without additional budgetary or other assistance.

Congress should not allow a default on the promises contained in the Housing Act of 1968. Federal assistance for home construction for low- and moderate-income families will have to be greatly expanded to meet the national housing goals. The fact that we have already fallen behind the low- and moderate-income housing construction objectives adopted in 1968 makes it imperative that additional Federal resources be allocated to this area.

Income support.—The Nation and the Congress have had placed before them during the past year a number of proposals for a comprehensive Federal system of income support. While these proposals differ in important respects, most particularly with respect to the level of support and the scope of coverage, certain fundamental principles are common to several proposals currently under consideration.

This Commitee favors the adoption of a comprehensive Federal system of income support. Such a system should adhere to the following principles:

Equal treatment should be provided for every needy citizen regardless of location, work status, or family status.

The level of support should be adequate to provide a decent standard of living.

Opportunities for employment and incentives to work should be protected.

The Family Assistance Plan proposed by the Administration and currently under consideration by the Congress could be a first step toward full realization of the fundamental principles cited above. It would be a uniform Federal system and would make assistance available to those who are working to provide their own support, as well as to those unable to work. It falls short of a comprehensive system in that income support would be made available to families but not to single individuals or childless couples, except for those in special categories of disability.

The minimum level of support proposed in the Administration's proposal is $1,600 a year for a family of four. Even though this cash support would be supplemented by food stamps worth $800 more, the total income support would not be adequate. Again, however, it can serve as a first step toward an adequate system. The President's Commission on Income Maintenance, in its recent report, recommended a basic cash support of $2,400 a year for a family of four. The Commission did not regard this level as adequate. Rather it was chosen because it might be realistically achievable as a beginning level. Another proposal before the Congress would tie the basic level of support to the poverty definitions of the Social Security Administration. While the initial level of support which might be included in a plan adopted by the Congress may fall short of full adequacy, the need to achieve a level providing for a decent standard of living must remain an important national objective.

The Family Assistance Plan, as well as other income support proposals, contains a financial incentive to work. Whether the precise amounts of the work incentives have been properly chosen can only be determined by experience with the operation of the system. The Family Assistance Plan also contains requirements that certain categories of recipients must register for job training or employment. As we discuss in the manpower section of this report, this somewhat arbitrary work requirement seems to us less important than the question of whether we can provide the jobs and training needed to insure employment for all those wishing to work. Adequacy of manpower services and of day care provisions for children must be considered together with adequacy of an income support program.

Pollution control.—Yet another area where Federal resources are urgently needed is that of environmental quality control. A major attack on combating air pollution and water pollution is urgently needed *now* if future generations of Americans are to enjoy a hospitable environment. The Administration is to be commended for carrying forward the previously enacted program to clean up the environment. But much more is needed and time is short if we are to preserve the Nation's natural beauty and resources.

A comprehensive pollution control program should include provision for solid waste management, and a park and recreation program, as well as air and water pollu-

tion control, and should incorporate measures based on user charges so that the financial burden of combating pollution is placed on those who do the polluting rather than the general public.

While the urgency of our need to protect and improve our physical environment would be difficult to overstate, we must not allow pre-occupation with this one problem to lead to neglect of our other human and social needs. One of the witnesses at our annual hearings assessed the Administration's allocation of budget resources to social programs in this way, "The new Federal Budget does not reflect in any sense the urgency of the situation we will face very soon." And, "The President's budget . . . does little to relieve the acute and dangerous pressure on local governments. Its new initiatives would in fact provide less new money than the amounts we are now losing by virtue of the Federally-generated inflation resulting largely from the expansion of military expenditures during the past five years."

National Defense

A major obstruction in the way of analyzing Federal spending priorities arises from the fact that the category "national defense," as used in the budget, does not contain all of the items that should be incorporated in that category. The budget does include military assistance to foreign governments, part of atomic energy, stockpiling of strategic materials, expansion of defense production, selective service, and emergency preparedness activities. It does not include such defense-related activities as interest paid on the national debt, coast guard, maritime subsidies, and economic assistance to Vietnam. In a sense, too, veterans programs can be considered as a cost of past wars and military programs. If these outlays were incorporated into the defense program, costs would be considerably higher than indicated. In our view, a meaningful evaluation of the allocation of budgetary resources requires such inclusion.

We recommend that the Bureau of the Budget include in the category of defense programs the full costs of past and current defense-related activities.

In respect to national defense expenditures, the 1971 budget figure is $73.6 billion, a decline of $7.6 billion from the $81.2 billion in fiscal 1969. The Committee is very encouraged by the willingness of the Administration to recommend this reduction. The Subcommittee on Economy in Government in its December 1969 Report on the *Military Budget and National Economic Priorities* formally recommended that expenditures by the Department of Defense for fiscal year 1971 be reduced by no less than $10 billion below the level of actual expenditures during fiscal year 1969. The current request represents a reduction of more than $7 billion below actual outlays by the Department of Defense for fiscal year 1969. The decision to cut this part of the budget was made, according to Secretary of Defense Laird's Posture Statement for fiscal year 1971, because of "The clear intent of Congress to make major reductions in defense spending," as well as the President's determination to reorder our allocation of resources and the need to bring inflation under control.

The committee is deeply disturbed, however, over the decision of the Administration to withhold from the Congress and the public the current costs of the war in Vietnam. The costs of Vietnam have in the past been regularly included in the budget documents and the economic reports of the President. They have been used to justify great increases in military expenditures as well as to demonstrate the need for the surtax imposed in 1968. The Administration states that the costs of Vietnam have gone down sharply. Yet it chooses to conceal the costs and the amounts by which the costs have been reduced.

The actual costs of Vietnam have a direct bearing on the question of national priorities. The greater portion, if not all, of the savings from the reduced costs of the war should result in a reallocation of resources from military to civilian objectives. Other reductions in the costs of the defense program should have the same result. As recently as October 1969, Secretary Laird stated that Vietnam costs should fall to an annual rate of $17 billion by the end of the current fiscal year. Last year's budget document estimated that military outlays for Vietnam would be almost $29 billion in fiscal year 1969. This would indicate a decrease of $12 billion, as compared with the total; however, the total reduction in the military budget for fiscal year 1971 is only $7.6 billion below that for 1969. Unless the current costs of Vietnam are made public, Congress and the taxpayer have no way of judging to what extent the funds saved due to reduced outlays for Vietnam are being diverted back into other defense expenditures.

The Administration should make full public disclosure of the costs of the war in Vietnam, the amount by which Vietnam costs have been reduced from the previous year, and estimates for future expenditures.

Last year this Committee called attention to the substantial evidence that greater effectiveness and efficiency in defense spending could free resources badly needed for civilian programs. Hearings during 1969 substantiated further the existence of great waste and sloppy management practices which involve billions of dollars of unnecessary costs. Moreover, it is noted that the real and personal property holdings of the Department of Defense have increased by $7.6 billion, reaching a total of over $200 billion and involving a total of 29.5 million acres of land not including 10 million acres under the jurisdiction of the Civil Works Division.

We urge reform and improvement of weapons procurement and immediate review of defense real estate holdings in the interest of a more efficient and effective military program as well as a better utilization of our scarce national resources. Experience with the C-5A cargo plane, the Deep Submersible Rescue Vehicle, the SRAM missile, the DE-1052 destroyer, and other military programs inquired into by the Subcommittee on Economy in Government are dramatic examples of the unnecessary cost overruns and waste that pervade the procurement system.

Although the sums already earmarked for human resource and other civilian programs are not insignificant, it should be recalled that the lion's share of the Federal budget is still consumed by military, space and related programs. As the Eisenhower Commission on the Causes and Prevention of Violence pointed out in its December 1969 final report: "For the past three decades, the primary concerns of the Federal government have been the national defense, the conduct of wars and foreign affairs, the growth of the economy, and, more recently, the conquest of space . . . They currently devour more than two-thirds of Federal expenditures and approximately 50 percent of Federal, State, and local expenditures combined." The Eisenhower Commission is only the most recent of an impressive number of blue ribbon panels established by the government in the past several years which have recommended that new directions be taken in Federal budgetary allocations. We cannot afford to wait on this urgent commitment.

The Committee notes with approval the apparent strengthening of the role of the Bureau of the Budget in the review of defense budget requests. Last year we pointed out that the Bureau of the Budget does not attend to defense spending matters with anything like the thoroughness given to civilian programs, and we recommended that the Bureau increase substantially its scrutiny over the defense budget. According to the Budget Director, the budget review procedures for the Department of Defense have been changed from past practices and are now the same at the "decisionmaking level" for DOD and the civilian Agencies.

The Committee was also pleased to learn of the establishment within the Executive Branch of the Defense Program Review Committee (DPRC) as an arm of the National Security Council, on which serve the Director of the Bureau of the Budget and the Chairman of the Council of Economic Advisers. Hopefully, this Committee will play an important part in the consideration of defense needs within the context of competing civilian priorities.

On the other hand, the Committee discerns little, if any, progress on the part of the Council of Economic Advisers in the analysis and evaluation of issues related to military spending. In last year's Economic Report of the President, only two pages were devoted to the defense budget. This year's Report fails to address the defense budget altogether. The Report offers no guidance on the impact of defense outlays on wages and prices and the extent to which they contribute to inflation, or the influence of defense expenditures on industrial concentration, or of the steps being taken or planned by the Government to minimize the effects of defense reductions on unemployment and community distress.

VII. INTERNATIONAL ECONOMIC ISSUES

In 1969 the external reserve assets of this country grew by more than $1.2 billion, an increase significantly larger than the 1968 gain of $880 million, the special drawing rights (SDR) amendment to the International Monetary Fund (IMF) Articles of Agreement was ratified, and a $9.5 billion distribution of SDRs was approved over an initial three-year period. The emergence of a British trade surplus combined with devaluation of the French franc and upward revaluation of the German mark reduced speculative pressures in European exchange markets, and the dollar remained firm on the exchanges throughout the year. Although a number of international economic problems persist, all of these developments are evidence of progress.

Perhaps the chief external economic concern of the United States is the continuing small size of the U.S. trade surplus, which improved only marginally in 1969. In addition, last year U.S. banks and corporations borrowed a substantial quantity of short-term funds in the Euro-dollar market. Any sudden drop in dollar interest rates relative to those in other countries might induce a volume of capital outflows from the United States that could once again place the dollar under severe pressure.

The outstanding retrogressive step taken during the past year was the agreement within the IMF to purchase South African gold. Although the members of the Fund had already agreed on a schedule for distributing special drawing rights in amounts presumably sufficient to assure an adequate supply of international liquidity, the recently concluded agreement is introducing newly mined South African gold into the international monetary system at an unspecified, loosely controlled rate, and at a signficant cost to the industrial nations.

Also during 1969 the Administration submitted an interim trade bill for Congressional consideration. This bill will shortly come under the examination of the the House Ways and Means Committee. The bill submitted includes a number of provisions endorsed in the 1969 Annual Report of the Joint Economic Committee. In particular, we advocated easing of the requirements that must be fulfilled before adjustment assistance can be extended to firms and workers injured by the expansion of imports. We also urged Congressional endorsement of the supplementary agreement on trade in chemicals negotiated during the Kennedy Round. This agreement would terminate the U.S. practice of valuing certain imports, primarily benzenoid chemicals, at the American rather than the foreign selling price.

The Administration trade bill does not attempt to define long-run goals for U.S. external commercial policy. The policy objectives of the United States in trading with other countries must be related to our goals in promoting a mutually acceptable pattern of international investment and in fostering the economic development of less advanced countries. The Subcommittee on Foreign Economic Policy of the

Joint Economic Committee is currently undertaking a review of U.S. trade, investment, and aid policies with the intention of formulating an appropriately integrated set of long-run objectives. The Subcommittee expects to complete its deliberations and publish a report by the end of 1970.

Removing Import Quotas

Limits on the absolute quantity of goods that can be imported into a country, unless set so high as to be meaningless, invariably result in higher prices to domestic purchasers and encourage arrangements among domestic producers to restrict competition. While arguments for quotas are usually formulated in terms of national security or the need to protect certain groups of producers within the economy, it is always questionable whether the indirect subsidy consumers are forced to pay is worth the resultant benefit.

During periods of inflation, it is especially important that the continued need for quotas be questioned. In addition to simple abolition, the alternatives of tariff protection or direct cash payments to domestic producers must also be considered. The elimination of quotas or the substitution of other measures that do less violence to the market mechanism can effectively combat inflation in at least two ways. First, the threat of foreign competition can break up market sharing arrangements domestic producers have devised or have implicitly accepted over the years. Second, when foreign producers are prepared to increase their output without substantially raising prices, the abolition of quotas can make imports available to domestic users at far lower prices than those charged by domestic producers. Even the substitution of tariffs for quotas would permit an expansion of competitive imports when inflation drives up the prices of similar domestically produced goods.

All existing statutory quotas and "voluntary" quantitative limitations on imports should be reviewed in terms of the benefits that consumers might derive from abolition or the substitution of less disruptive measures. The limitations on imports of steel, oil, and beef are particularly appropriate for reconsideration in this light. Similarly, the Long-Term Cotton Textile Agreement should be re-examined to determine the magnitude of savings that consumers might realize from unimpeded imports. The average consumer spends about 10 percent of his income on apparel, and the percentage for lower income individuals is probably considerably higher. Given the current inflationary environment, failure to seriously re-examine quantitative import limitations must necessarily impair the credibility of any effort to reduce or stabilize prices.

Quantitative import restrictions are inconsistent with any economically rational and effective attack on inflation. All quantitative limits on imports should be reviewed, not only because these restrictions misallocate resources, but especially because their removal could have a significant anti-inflationary impact.

Measuring the Balance of Payments

In 1969 the United States accrued a balance-of-payments *surplus* of $2.8 billion according to the official settlements calculation, a substantial improvement over the $1.6 billion surplus achieved the previous

year. By contrast, when computed on the liquidity basis, this country suffered a $7 billion *deficit* in 1969, after a $168 million surplus in 1968. But the 1968 liquidity balance surplus was merely a statistical gimmick, since it was achieved through the benefit of $2.3 billion of "special transactions."

Although the balance-of-payments data published by the Commerce Department have become more understandable in the past year as the result of decreased reliance on "special transactions," continued use of the liquidity balance exaggerates the balance-of-payments problem of the United States. The current liquidity balance measure should be replaced by an alternative with a more valid conceptual foundation.

If the United States had net sales of goods and services abroad just sufficient to balance our net payments to foreigners resulting from international long-term investment and from government military and economic development assistance, this country would still tend to show persistent external deficits according to the liquidity calculation. These deficits would result primarily from the normal year-to-year increase in the demand of foreign international traders, banks, and corporations for additional dollar balances. Such assets in foreign hands can be expected to increase gradually because of the growing need abroad for dollars as transactions or working balances. The component of the total increase in U.S. short-term liabilities to foreigners that results from this demand for additional working balances is an indication of the desirability of dollar assets. But the consequent liquidity balance deficit erroneously gives the opposite impression.

The liquidity measure of the flow of receipts from and payments to foreigners fails to set against increases in U.S. short-term liabilities to foreigners any associated rise in U.S. short-term claims on foreigners. Such claims arise largely from the international banking activities of the United States, which have expanded manyfold since World War II. Of course, net purchases of goods and services from non-residents and net long-term investment abroad do not generate such liquid claims against foreigners; it is primarily lending by banks and short-term investment abroad by corporations that create these claims. Thus, by not deducting short-term claims against foreigners from similar liabilities to foreigners, the liquidity balance tends to confuse the international banking activities of U.S. institutions with the non-bank-related activities of American traders and investors.

In addition to the creation of widespread misunderstanding, exaggeration of U.S. payments deficits through use of the liquidity balance fallaciously argues for the maintenance of restrictions limiting U.S. capital exports and intensifies protectionist sentiments.

No single statistic can faithfully summarize the United States balance of payments. Nevertheless, some indicators are clearly superior to others. In this regard, the liquidity definition has clearly outlived its usefulness. It should be replaced by an alternative definition that will help emphasize the distinction between bank-related and non-bank international transactions and that balances U.S. short-term claims on foreigners against liabilities to them.

Military Expenditures

Last year, we asserted that the wealth and economic stability of the EEC countries—to a significant degree attained through U.S. assistance and encouragement—warranted that these countries pay the local cost of maintaining U.S. troops within their borders.

The Common Market nations must pay the full foreign exchange cost of United States troop commitments in the European Economic Community.

This country is making a major continuing contribution to the security of Western Europe by stationing over 300,000 troops in the area and by paying the budgetary costs of training and equipping these forces. The Common Market countries should therefore pay on a current basis the local costs of maintaining U.S. troops stationed in and around continental Europe.

In his February 18 Report on "United States Foreign Policy for the 1970s," President Nixon asserted, "A more balanced association and a more genuine partnership are in America's interest. As this process advances, the balance of burdens and responsibilities must gradually be adjusted to reflect the economic and political realities of European progress."

Loans to the United States are not adequate compensation; nor are military purchases above and beyond what would otherwise have been obtained from this country on a competitive basis. We are not investing in a productive enterprise that will yield larger expected returns in the future; instead, we are participating in a continuing long-term mutual security effort. Loans are therefore inappropriate as an offset for our expenditures. Moreover, when we accept non-competitive military sales to foreigners as an offset, we are making a contribution of real resources that subsidizes the cost of raising foreign armies. Payment by the United States for the cost of maintaining troops in and around continental Western Europe only swells the dollar reserves of recipient nations. We are making our friends rich in exchange for the privilege of helping to defend them.

In his testimony, Under Secretary of the Treasury for Monetary Affairs Paul A. Volcker estimated that U.S. gross military expenditures abroad had risen in 1969 to $4.8 billion, up from $4.5 billion during the previous year. Although U.S. military activities abroad continue to contribute more to our balance-of-payments deficit than any other single activity—be it trade, travel, or international investment—these costs have not even stopped growing, much less begun to decline. Since 1964, U.S. military expenditures abroad have consistently risen year by year, and in 1969 the rise continued despite the advertised curtailment of our involvement in Southeast Asia. If the U.S. balance-of-payments problem is to be solved, our military expenditures abroad must be brought under control.

Capital Flows

In February 1965, President Johnson announced a comprehensive program to reduce U.S. balance-of-payments deficits. This program included limitations on short-term lending to foreigners by banks and other financial institutions administered by the Federal Reserve and a voluntary program administered by the Commerce Department

to curtail corporate direct investment abroad. In January 1968 both measures were tightened, and the direct investment control program was made compulsory. Thus, lending to foreigners and direct investment abroad have now been restricted for over 5 years.

The continued limitation of lending to foreigners by financial institutions and the restriction of corporate direct investment abroad is undermining the future strength of the U.S. balance of payments.

Curtailing the short- and medium-term lending of banks and other financial institutions tends to limit the credit available for financing U.S. exports. Once export markets are lost due to inadequate financing, recapturing the same market position is difficult—far more difficult than just maintaining a given share of a foreign market. This relationship is apparently recognized by the Administration. A special category of export financing loans has recently been exempted from the credit restraint program administered by the Federal Reserve System. Moreover, the Export-Import Bank expanded its activities last year, and this initiative is expected to continue.

Restriction of U.S. direct investment abroad must eventually undermine this country's balance-of-payments position through a decline in profits and dividends from abroad, through a drop in earnings from the sale of technology and managerial services, and through a loss of exports to subsidiaries and to foreigners making purchases through U.S. dealer-subsidiaries. The debate about the value of direct foreign investment has centered on how soon these losses would begin to accrue and on how much damage they would inflict upon the U.S. balance of payments.

The effect to date of the direct investment controls has apparently been not so much to retard additional U.S. direct investment abroad as to shift its financing to foreign capital markets. As the period since the controls were first introduced lengthens, the likelihood increases that these restrictions will cause U.S. direct investment to be actually forgone rather than merely financed abroad. The long queue of borrowers in the Euro-bond market and the nearly $1 billion decline in U.S. issues abroad last year may indicate that some U.S. companies have or will abandon plans for foreign direct investment.

Several experts have attempted to estimate the period that elapses before an initial foreign direct investment capital outflow is recouped in terms of repatriated profits, dividends, other earnings from sales of services, and additional exports. These estimates have ranged from two to twelve years. But restricting U.S. direct investment abroad starts to curtail external earnings long before the entire initial balance-of-payments cost of an investment would be recouped. Losses become significant towards the middle of the recoupment period. Thus, taking even the longest estimated recoupment period, these losses would shortly begin to assume substantial proportions and can only grow in the future.

Possible flows of short-term capital should not be allowed to dominate the fundamental balance-of-payments policies of the United States.

Short-term capital can move quickly from one country to another and, as 1969 demonstrated, such flows at times assume massive proportions. Differences between countries in interest rates or anticipated

exchange-rate changes are usually the incentive to move liquid funds across national boundaries. When these incentives persist for several months or even years, more and more people become aware of the possible benefits from transferring their assets to another country. Consequently, the volume of funds transferred internationally grows as the incentives to do so endure. Strong incentives to move funds continued from 1968 into last year. The impact of these inducements is evident in U.S. balance-of-payments data for 1969.

United States liquid liabilities to foreigners increased by $8.2 billion last year; of this increase approximately $6 billion represented additional liabilities of U.S. banks to their overseas branches. Much of the rise in liabilities to branches was apparently made possible by the transfer of corporate funds from the United States to other countries in order to take advantage of the higher yields available abroad.

Regulation Q, which prevents U.S. commercial banks from offering yields as high as those available in Europe, does not extend to the foreign branches of U.S. banks. Moreover, until September 1969, the head offices of U.S. commercial banks were not required to hold reserves against deposits accepted from foreigners. Such foreigners included the overseas branches of American banks.

Head offices in this country consequently directed their overseas branches to bid aggressively for deposits as a means of avoiding the domestic squeeze on available funds. To the extent that dollars flowing out of the United States in search of higher yields abroad are redeposited with the foreign branches of U.S. banks, this round-about flow of funds does not necessarily represent a weakening in the underlying balance-of-payments position of the United States, despite a marked jump in the liquidity deficit.

In September 1969 the Federal Reserve imposed a 10 percent reserve requirement on the deposit liabilities of U.S. banks to foreigners. The imposition of this reserve requirement halted the growth of foreign-owned deposits in U.S. banks.

As another example of the size and volatility of short-term capital movements, outflows from Germany since revaluation of the mark have exceeded $6 billion. Thus much of the capital inflow which took place prior to the revaluation has been reversed. The magnitude of these transfers illustrates how a nation tends to attract liquid capital when it is unwilling to revalue its exchange rate in line with increases in its competitive ability and its capacity to attract foreign direct investment. Such short-term capital flows can exert severe pressures on the reserve positions of countries from which the funds are drawn. Apparently a significant part of German reserve gains from early 1968 through November 1969 resulted from correct foreign expectations that the mark should and would eventually be revalued.

The pattern of short-term capital flows during the past year suggests at least three lessons for policymakers.

First, revaluations or other fundamental adjustments by nations in strong competitive positions and enjoying persistent external surpluses must be more prompt if short-term capital flows are not to be a more disruptive factor in international economic relations.

Second, political and other disturbances will undoubtedly occur from time to time that will stimulate substantial short-term capital flows but not require a change in exchange rates. Since the horizons

of investors will probably continue to expand, additions to the stock of international liquidity in the form of SDRs and the expansion of contingent lending arrangements will probably be necessary to counter these temporary crises. Persistent resistance by surplus nations to revaluation and inadequate facilities to deal with speculative short-term capital flows would force monetary authorities to depend increasingly on direct controls and regulations.

Third, the rise in domestic short-term interest rates above the yields that banks are permitted to pay under regulation Q created an incentive for American institutions to bid aggressively for funds abroad. Overseas branches served as the agents of U.S. banks in this search for funds. The consequent rise in Euro-dollar rates produced a massive round-about flow of short-term capital from the United States and then back. High Euro-dollar rates also induced foreigners to convert assets denominated in other currencies into dollars for placement in the Euro-dollar market. This sequence of events illustrates the concern for possible international implications that must be included in the formulation of policies regulating the domestic activities of U.S. banks.

To summarize, international short-term capital flows will continue to pose difficult management problems for monetary authorities in the United States and abroad. Keeping the above conclusions in mind may help ease such difficulties. New policy tools and consultive procedures should probably also be considered to help regulate these flows. But the temporary disruptions caused by short-term capital flows should not be allowed to obscure more basic international payments issues or to become an excuse for the maintenance of capital export controls.

Because of the prominent position of the United States in international trade and investment, this country has a special responsibility in working for the elimination of tariff and nontariff trade barriers and for the removal of restrictions impeding capital movements. Therefore, the Executive should publish a program for the phased elimination of all "temporary" capital export limitations. These restrictions should be removed as soon as possible, and under any circumstances, they should be abolished during the current Administration. Capital export restrictions should be eliminated within this period regardless of future developments in the U.S. balance of payments. An intensified effort to improve the international payments adjustment mechanism and to persuade surplus nations to accept their responsibilities in the adjustment process should accompany the abolition of U.S. capital export limitations.

In his April 4, 1969, balance-of-payments statement, President Nixon stated, "Fundamental economics call for . . . ultimate dismantling of the network of direct controls which may seem useful in the short run but are self-defeating in the long run."

In practice, however, the liberalization of capital export restrictions tends to be postponed if the United States balance of payments appears to be anything but strong. For example, Bureau of the Budget Director

Robert P. Mayo recently asserted, "Too small a trade surplus prevents us from removing the restrictions that now limit the free flow of capital abroad." But the limitations over U.S. lending and investment abroad—now in their sixth year—are themselves producing a deterioration in our balance of payments. This induced deterioration is now being used as part of the excuse for maintaining the controls. The longer these restrictions remain in place the more they will tend to intensify the disease they were designed to cure. Thus a serious commitment must be made to the removal of all controls over capital exports if the U.S. balance of payments is not to be progressively undermined.

A greater effort to persuade surplus countries to accept their responsibilities in the functioning of the international adjustment mechanism must accompany the removal of our capital export controls. Among the most important of these responsibilities is a willingness either to revalue currencies upwards when confronted with continuing substantial surpluses or to implement other measures to reduce these surpluses. Appropriate alternative measures would include the unilateral removal of tariff or nontariff import barriers, the relaxation of capital export limitations, or an increase in foreign economic development assistance.

More prompt adjustment by surplus nations, continued expansion of contingent lending arrangements between monetary authorities, and further additions to the global stock of reserves can all help eliminate restrictions over the movement of goods and capital and prevent the reintroduction of controls. In some instances, however, temporary restraints will be necessary—particularly over international flows of short-term capital. When restrictions are unavoidable, market adjustments via special taxes or reserve requirements are generally preferable to administrative quotas or ceilings. Transforming existing ceilings and quotas into price adjustments in the market place also deserves consideration as a means of working towards the elimination of all capital export limitations.

Use of SDR's for Development Financing

The special drawing rights facility will help finance a continued expansion of international trade and will avoid the need to invest real resources in the acquisition of a comparable amount of monetary gold reserves. The process of creating SDR's is virtually costless, and while the developing countries will share in the benefits derived from this new facility, the greater proportion of these gains will undoubtedly go to industrial nations.

The SDR mechanism can also be used to increase financial assistance to developing nations without in any way impairing its international monetary function. A portion of each SDR distribution could be allocated to the International Development Association for subsequent distribution to poor countries. These SDR's would eventually be spent by the needy recipients for imports from industrialized nations. Thus, the SDR's would ultimately supplement the reserve stocks of the wealthy states, but in the process of acquiring these assets, the rich would make real transfers to the poor. Programs to raise the standards of living of the less fortunate could therefore be expanded.

A reform of this type should not be permitted to affect the total amount of special drawing rights distributed; it should merely alter the pattern in which a given allocation of SDR's is distributed. Since only 15 percent of the voting power in the IMF can veto a suggested distribution of SDR's, this reform can hardly endanger the acceptability of special drawing rights by threatening excessive distributions.

The new capability of the International Monetary Fund to create special drawing rights should be utilized to increase financial assistance to developing nations.

Gold

The recently concluded agreement among members of the IMF to resume purchases of gold from South Africa and to introduce such gold into the international monetary system constitutes a major revision of the March 1968 agreement separating the private and official gold markets. The importance of gold as a monetary reserve asset is virtually certain to be eclipsed during the next decade as additional SDR's are distributed. But since the United States is the only nation in the world committed to buy and sell gold at $35 per ounce, the United States under the new arrangement has technically become the purchaser of last resort for additional South African gold entering the system.

Given the existence of the SDR facility for providing additional reserves, it is economically wasteful for the United States to be supporting the price of gold. Moreover, the new arrangement discriminates in favor of South Africa to the disadvantage of other countries that obtain the major part of their export earnings from the sale of commodities other than gold.

To help make SDR's fully comparable to gold in the settlement of international obligations, nations should be permitted to pay their "gold subscription" obligations under IMF quota increases in special drawing rights. This reform, which has been endorsed by Under Secretary of the Treasury Paul A. Volcker, would further decrease the dependence of the international monetary system on gold and would permit additional real savings from the decreased use of commodity money.

The unlimited obligation of the United States to purchase gold at $35 per ounce should be eliminated, and the IMF Articles of Agreement should be modified to permit the payment of "gold" subscriptions in special drawing rights.

SUPPLEMENTARY VIEWS OF CHAIRMAN WRIGHT PATMAN

In an overall sense, this is one of the finest reports ever produced by the Committee and its staff. However, there are certain points developed in the Majority views which I feel should be emphasized.

The Majority rightfully criticizes the Administration for failure to implement policies to bring interest rates down. The most glaring example of this failure is the total absence of effort to halt and roll back the prime interest rate during the eight-month period ending last June.

During that period, the prime rate rose from 6¼ percent to 8½ percent, a record climb of 36 percent. Not once during the period following his election did President Nixon or any member of his Cabinet attempt to exercise moral suasion and achieve a halt to this steadily worsening situation.

In fact, Nixon's election was looked on as a signal for higher interest rates. The last prime rate increase which brought the rate from 7½ to 8½ percent, a record single increase, was known by the Nixon Administration four days before it was announced, yet not a single word of protest was heard from the White House. That 1 percent increase in the prime rate means that the people of the nation will be paying an additional $15 billion a year on private and public debt. Last year, the people of the nation paid a total of $120 billion on interest on all debts.

Indeed, Secretary of the Treasury, David Kennedy, during his appearance at the House Banking and Currency Committee investigation of the prime rate increases, unhesitatingly admitted that he did not discuss the situation with the large bankers of the nation because he was convinced there was nothing he could do about the problem. He was, however, moved to meet with the representatives of the largest banks of the nation following the last prime rate increase on June 9, 1969.

The *American Banker*, in reporting the meeting, quoted one of the bankers who attended it, as saying: "I told him (Kennedy) afterward it was a damn good show." Another banker was quoted as saying: "We all know Dave and like him and are in entire sympathy with his views." The impression of comradeship was very strongly conveyed in numerous press reports of the meeting. Later in the year it was revealed that the large banks of the nation enjoyed enormous profits during the first half of 1969—profits ranging 20 to 30 percent higher than the same period in 1968.

It goes without saying that the prime rate establishes a floor for all other types of bank loans. When it goes up, interest rates on higher risk loans are bound to increase. The most painful example of this is the two interest rate increases for FHA–VA mortgages approved by the Nixon Administration after it took office. The last increase—a full one percent—brings the current rate to 8½ percent. When the one-half percent insurance premium is added to that, the FHA mortgage effective rate for such loans is 9 percent. The impact

of this exorbitant interest rate can be more fully realized when it has recognized that a one percent increase on a $20,000 30-year mortgage raises interest payments by more than $5,000 and that a 9 percent interest rate means total interest payments of $38,000 on a $20,000 mortgage. Total interest and principal payments amount to $58,000.

This increase in mortgage interest rates is largely responsible for the present situation in which virtually all moderate income families in the nation have been priced out of the housing market. As it now stands, only half the people of the country are able to purchase homes. Housing for the most part is being provided only for the affluent. Minimum monthly payments of $226 are now required for a $20,000 30-year FHA mortgage. When the monthly payment includes not only the principal and interest, but also insurance, maintenance, utilities and taxes, which must be considered fixed costs, a family must have a net income of $10,800 or a gross income of at least $13,000 to be able to afford a mortgage of this size, if it is not to spend more than 25 percent of its net income for housing.

Additional funds needed to meet the nation's low- and moderate-income housing goals can be provided from any one of the following sources: (1) Federal Reserve purchase of housing paper; (2) establishment of a National Development Bank, capitalized at a level of $1 billion and with an authorization for a maximum indebtedness of $20 billion to provide direct loans or to guarantee the loans of conventional lending institutions for low- and moderate-income housing at interest rates not to exceed the discount rate or 6 percent whichever is lowest, or (3) requiring investment of private pension plan funds in low- and moderate-income mortgages in return for the tax exemption which applies to the earnings of pension plan assets which now total some $140 billion.

The larger banks of the nation have made it clear that they want to handle all the important loan money the way they wish and they object to the use of funds from any one of these three sources to meet the nation's housing goals for low- and moderate-income families. So far, it has been impossible for Congress to override the obstacles created by the big commercial bankers.

In effect, the nation is confronted with a housing disaster. This is largely attributable to the alarming, intolerable increase in interest rates.

The Secretary of Housing and Urban Development himself admitted that the interest rate increases that he authorized have raised monthly payments by 20 percent on a $20,000 30-year mortgage.

The report observes that not only housing, but the ability of State and municipal governments to finance their needs is drastically affected by the economic climate that prevails. An illustration of this point is the fact that local governments time after time have extreme difficulty in marketing their bonds, and that bonds sold in today's market required crippling yields. A 25-year $16 million bond issue, carrying a 5 percent interest rate, required interest payments totalling more than $12 million. That same bond issue at an 8 percent rate required total interest payments of more than $21 million.

There are but three examples of Administrative failure to control interest rates by policy decisions. Moreover, these examples point up the senselessness of trying to fight inflation by raising interest rates.

Throwing gasoline on fire to put out the flames would be as logical. The history of the nation from 1939 to 1953 is undeniable proof that interest rates can be held at reasonable levels by Government if it so chooses. This was a time when extremely inflationary pressures were being exerted on the nation's economy vis-a-vis World War II, the post-war period and the Korean conflict. Yet, during all of this time, interest rates remained at reasonable levels because the Government insisted that a low interest rate level be maintained on its long-term obligations, which, then as now, occupy a major portion of securities marketed. As a matter of fact, President Truman, following the policy of President Roosevelt, not only managed to keep interest rates down but also succeeded in reducing the national debt by $29 billion before he went out of office in 1953. He succeeded in doing this despite the widely accepted concept that this nation like all others would not be able to escape rampant inflation following World War II. The average yield on long-term Government bonds from 1939 to 1953 was 2.36 percent. Decisions to reverse this policy, beginning in 1953, have resulted in raising the yield on long-term Government bonds to a high of 6.12 percent last year.

Indeed, this deliberate policy of allowing interest rates to increase on Government bonds, and the resulting effect on the entire market, has burdened the American public with excessive interest totaling $231.3 billion during the 14-year period beginning in 1963. Moreover, when excess interest paid during the last 3 years is added to this the result is an incredible total of $396.2 billion.

Excess payments of interest caused by addition over the rate that prevailed in the Roosevelt-Truman administration have cost the American people approximately $396 billion in the past 20 years. When we consider that $57 billion of the total Federal debt of $375 billion represents U.S. bonds held by the Federal Reserve which have been purchased from holders and paid for with American currency, it is obvious that the alleged total debt of the United States is overstated by this amount. Putting all these figures together, it becomes clear that the excess interest payments are far in excess of the outstanding Federal debt held by the public.

If you subtract the excess interest and the bonds in the Fed portfolio, which should have been canceled long ago, as it would have been under business practice, it would be more than enough to pay off the debt.

In addition, I feel that the recommendation calling on the Executive to proceed with removal of present restrictions on American lending at home and abroad should be accompanied by provisions requiring that records of international financial transactions be kept.

A major problem confronting this nation is the transferral of funds through American banks to secret numbered accounts in foreign banks. Such transactions are frequently used to hide income earned from subsequent investments and to "purity" money obtained from criminal practices, which is later used for the purchase of stocks in the American market or for investments in American business and industry. It is of the utmost importance that this practice be halted. To do so requires legislation which makes record keeping of such transactions mandatory. To this end, legislation is under consideration in the Congress at this time.

YIELDS ON LONG-TERM GOVERNMENT BONDS, PUBLIC AND PRIVATE DEBT, AND TOTAL INTEREST PAID; INTEREST COSTS FIGURED AT 14-YEAR AVERAGE RATE (1939-52), AND EXCESS INTEREST PAID, 1953 THROUGH 1969

Years	Yields on long-term Government bonds (percent per annum) (1)	Public and private debt (billions) (2)	Interest paid (billions) (3)	Interest costs figured at weighted average rate, 1939-52 (3.21%) (billions) (4)	Interest paid in excess (billions) (5)
1939	2.36	$183.3	$8.3		
1940	2.21	189.8	8.4		
1941	1.95	211.4	8.5		
1942	2.46	258.6	8.4		
1943	2.47	313.2	8.6		
1944	2.48	370.6	9.2		
1945	2.37	405.9	10.2		
1946	2.19	396.6	11.4		
1947	2.25	415.7	12.3		
1948	2.44	431.3	13.4		
1949	2.31	445.8	14.6		
1950	2.32	486.2	16.1		
1951	2.57	519.2	17.7		
1952	2.68	550.2	19.5		
Average per year, 1939-52	2.36				
1953	2.94	581.6	21.7	18.6	3.1
1954	2.55	605.9	23.5	19.4	4.1
1955	2.84	664.9	25.8	21.3	4.5
1956	3.08	698.3	29.5	22.4	7.1
1957	3.47	728.3	33.6	23.3	10.3
1958	3.43	769.1	35.5	24.6	10.9
1959	4.08	831.4	40.3	26.6	13.7
1960	4.02	872.4	44.2	28.0	16.2
1961	3.90	929.8	46.8	29.8	17.0
1962	3.95	997.1	52.5	32.0	20.5
1963	4.00	1,071.7	58.7	34.4	24.3
1964	4.15	1,153.7	65.2	37.0	28.2
1965	4.21	1,245.6	72.4	39.9	32.5
1966	4.65	1,340.8	81.9	43.0	38.9
Annual average or total for period, 1953-66	3.66		631.6	400.3	231.3
1967	4.85	1,436.4	89.9	46.1	43.8
1968	5.26	1,568.5	104.4	50.3	54.1
1969	6.12	[1] 1,650.0	120.0	52.9	67.0
Annual average or total for period, 1953-69	3.97		945.9	549.6	2.36

[1] Estimated.

Sources:
Col. 1: Treasury Bulletin, Feb. 1970, table AY-1.
Col. 2: Survey of Current Business, U.S. Dept. of Commerce, May 1969.
Col. 3: Office of Business Economics, Department of Commerce.

U.S. BILL YIELDS

Year	Percent per year	Year	Percent per year
1939	.023	1953	1.931
		1954	.953
1940	.014	1955	1.753
1941	.103	1956	2.658
1942	.326	1957	3.267
1943	.373	1958	1.839
1944	.375	1959	3.405
		1960	2.928
1945	.375	1961	2.378
1946	.375	1962	2.778
1947	.594	1963	3.157
1948	1.040	1964	3.549
1949	1.102	1965	3.954
		1966	4.881
1950	1.218	1967	4.321
1951	1.552	1968	5.339
1952	1.766	1969	6.677

Source: U.S. Treasury Department.

SUPPLEMENTARY VIEWS OF CHAIRMAN PATMAN AND REPRESENTATIVES REUSS AND MOORHEAD

We fully support the recommendations of this report with respect to the importance of immediate development of price and incomes standards. We would like to point out, however, that time will be required to develop these standards. Full consultation among labor, business, and the Government will require several months. Inflation should not be allowed to continue unabated during this period.

It is our belief that the President should immediately call on all sellers of goods and services to observe a temporary moratorium on all price increases for a period sufficient to allow for the cooperative development by business, labor, and the Government of adequate and equitable price and incomes standards. During this moratorium period, wage increases should be held to amounts which business can reasonably be expected to absorb through productivity gains.

We are not unaware of the serious disadvantages of a price or wage "freeze" as listed in this report. Because the moratorium we are suggesting will be quite temporary and because some income adjustment will be permitted, the disadvantages of the "freeze" approach are minimized. Even so, we recommend this approach only because of the urgent need to halt inflation—and to do so without sinking further into recession. We believe business and labor would cooperate in an appeal by the President to observe a voluntary moratorium. However, if a need is felt for legislative authority, we believe the Congress would not hesitate to act.

DISSENTING VIEWS OF SENATOR TALMADGE

(Relative to Committee Position on Income Support)

While I agree with the need to do something to improve our system of welfare payments, I cannot agree with the majority's thesis that we should adopt a comprehensive federal system of income support which would insure to every citizen a decent standard of living, whether the individual works or not. Moreover, I am concerned that the Administration's welfare reform bill will do little to provide an incentive to work while adding millions more to our welfare rolls.

Although the Administration has emphasized the work incentive features of the Family Assistance Plan, the work incentive provisions are almost identical to the work incentive plan adopted by the Congress as a part of the Social Security Amendments of 1967. This work incentive program called WIN was enacted in an attempt to provide an effective program of work and training for people in the Aid to Families with Dependent Children program (AFDC). Unfortunately, this program has been a miserable failure. Very few welfare recipients have been trained under the program, and even fewer have been placed in productive jobs. At the end of 1969, there were only about 50,000 people who were actually in a WIN training program.

In my view, the Congress should take a long look at the present WIN program before enacting the President's Family Assistance Plan, a plan which would result in adding at least 10 million individuals to the welfare rolls. We must determine why the WIN program has not worked satisfactorily, and attempt to make such changes as are necessary in the Administration's bill.

One of the most promising approaches to encourage training and placement of welfare recipients is a tax incentive. Last year I introduced a bill which would provide a tax credit to employers who provide on the job training, and a tax credit to employers who hire individuals off a WIN program. If we are to get welfare recipients into productive employment, we must give the employer an incentive to hire them.

No work incentive program has any chance of success if we do not have the full cooperation of the business community. The end product of any such program is to get the unemployed individual a job.

I concur wholeheartedly with the committee's position that every American should have a decent standard of living, but I believe that the government's efforts should be channeled toward providing every individual with an opportunity to earn that standard of living for himself. We will not achieve a solution to the welfare problem by placing increased emphasis on the dole.

(Relative to the Committee Position on Budget Priorities)

I cannot wholly agree with the committee's statement about the President's budget priorities. The Administration has budgeted $73.6 billion for defense expenditures in 1971, a decrease of $7.6 billion from the $81.2 billion for fiscal 1969. The more than $7 billion cut from defense expenditures represents a drastic reduction when considered in light of the war in Vietnam and the continued inflation of costs.

Before we recommend additional cuts in military expenditures, I feel that we should wait to see if $7 billion can actually be cut without impairing national security. I am not at all sure that the President will be able to make this much of a reduction in defense spending, although I believe that such a reduction is desirable.

We should devote as much of our resources as possible to increased funds for human resource programs such as education, housing, environmental improvement, and manpower programs. There is a crying need for additional funding in these areas, but we cannot afford to neglect other programs which are equally vital to the well-being of our nation.

It is a bit shortsighted to urge drastic cutbacks in military expenditures and highway construction so that we may spend more for welfare and education. A continued strong defense is basic to the continued enjoyment of liberty and prosperity in this country. We must make additional improvements in our highways to cope with the ever-increasing traffic load and to prevent the complete congestion and strangulation of many metropolitan areas. In a highly mobile society such as ours, it cannot be said that highway construction is a low priority item.

(Relative to the Committee Position on Import Quotas)

The Committee Report criticizes import restrictions as being inflationary. In this regard, I might mention that the wholesale price index for textile products and apparel as of December 1969 was 109.2 (1957–59=100) as compared with an average of 115.1 for all commodities. For cotton products it was only 106.1. Thus, for these commodities, which the report suggests have risen in price because of import quotas, we find that price rises have been moderate, far below the average for the wholesale price index for all commodities.

Aside from the simplistic and erroneous inference that import quotas are always inflationary, the report does not have any balance in neglecting to deal with foreign quotas and other nontariff barriers. It suggests that the United States should disarm itself of import quotas without reference to any negotiations with foreign countries whose trade policies are far more restrictive and discriminatory.

While the report views import quotas and their alleged consumer effects, it does not recognize the plight of producers and employees who must compete against low-cost imports. In today's world, technology is widespread, and capital is generally free to move across national boundaries in search of the greatest rate of return. But labor is not mobile internationally, and the price of labor is not flexible. Under those circumstances, how is a United States industry to adjust to foreign competition when its labor costs are 4, 5 or even 10 times

the amount its foreign competitor must pay? These factors can justify the use of import quotas when necessary to prevent injury to a U.S. industry.

The case of textiles is clear. Foreign imports of woolen and man-made fibers, particularly from Japan, have been pouring into this country, injuring many U.S. firms and causing growing unemployment. Without protection, our firms will move abroad to take advantage of low-cost labor and ship their goods back to the United States causing further balance of payments problems. They have no other choice. The result would threaten the jobs of over 900,000 textile workers, and 1,400,000 apparel workers, many of whom are disadvantaged and could not easily find other employment.

SUPPLEMENTARY VIEWS OF SENATOR SYMINGTON

I support without reservation the statements in this Report that have to do with our deep concern about the high and continuing rate of inflation currently characteristic of the economy; the rising unemployment—4.2 percent in February, highest level in some five years—the credit squeeze that "has produced devastating effects on homebuilding" and small business in particular; also "the absence of any policy to deal directly with excessive price-wage increases."

In view of the fact, however, that other Senate business incident to Floor action and additional Committee hearings have made it impossible for me to attend all the hearings conducted by the Joint Economic Committee, and also considering the fact that a number of the positions taken in this Report have to do with issues and legislation that are still being considered by the Congress, I do not wish to support at this time the specific recommendations and conclusions contained in this Report.

MINORITY VIEWS
on the
1970
ECONOMIC REPORT OF THE PRESIDENT

NOTE.—These minority views are not directly responsive to the issues and recommendations included in the committee report. The extremely tight schedule prescribed by law does not provide sufficient time for the minority members to receive and analyze the report written by the majority, and then develop views based upon it. Consequently, as has been true in recent years, the two reports have been developed concurrently, and the minority's views are independently based upon the 1970 President's Economic Report, other messages and this committee's hearings. The statement of agreement contained at the beginning of this volume notes areas where the two reports reach similar conclusions, and the careful reader should be able to distinguish the points of disagreement between the committee and minority reports.

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LESSONS OF THE SIXTIES

As the 1960's began, economics was in the ascendant. The challenge was to stimulate expansion of the economy to its potential rate of growth, reduce unemployment and iron out forever the recessionary wrinkles that dotted the preceding decade. An "interim" rate of "full" employment was designated and terms such as "full employment surplus," "growth gap," "fiscal dividend," and "fiscal drag" became the catchwords wherever the "new economists" gathered. The pervading atmosphere was one of optimism that the tools and knowledge were at hand to prove that economic growth, full employment and price stability were not inconsistent goals.

The decade has ended on a more humble note. Indeed, it has become fashionable now to maintain that the goal of economic stability has already been lost, that economics cannot guarantee us anything but both rising unemployment and rising prices, and that inflation will be around for another decade or so. It is true that we have discovered that economic policy is less of an exact science than claimed by "fine-tuners" of earlier years, but we do not share the pessimism that all is lost. To refuse at this point to profit from the mistakes and misconceptions of the last decade would foreclose the opportunity of improving the economic environment in the coming one, a position *we* decline to take.

Fiscal Policy

Economic policy in the 1960's began with the proposition that the economy had a natural tendency toward stagnation, and that the Government had an obligation to manipulate its taxing and spending powers to offset this tendency. Economic expansion became almost an obsession with administration economists, as a cure for all our social ills. The "new economists" seized upon fiscal policy as the primary, and perhaps the sole tool to promote economic recovery and full employment. It became administration policy to fine-tune the economy with frequent changes in Federal taxes. Consequently, we saw enactment of the investment tax credit and liberalized depreciation guidelines in 1962, a permanent cut in individual and corporate income tax rates in 1964, and an excise tax reduction in 1965, all measures designed to stimulate the economy.

In early 1966, it became apparent that the economy was beginning to overheat from the combination of stimulative tax measures and abnormal increases in Federal spending, producing increasingly severe budget deficits. Consequently, we entered a period of tax restraints, albeit much more timidly than the administration had rallied around tax reductions. In 1966, some of the prior year excise tax cuts were restored and the collection of corporate and individual income taxes was speeded up, and later in the year the investment tax credit was suspended for 7 months. In 1968, a 10-percent surcharge was instituted

on individual and corporate income taxes coupled with a mandatory reduction in Federal spending. And in 1969, the surcharge was extended, the investment tax credit eliminated, and individual tax liabilities cut, all in the same Tax Reform Act.[1]

It is a moot point whether we are better off for the "new economics" as far as fiscal policy is concerned. Democratic administrations developed an overpowering willingness to cut taxes and run budget deficits, but found it difficult to act responsibly when the economy overheated. This has been rationalized as the new economics confronting the old politics and coming out a poor second best. We believe that those who develop economic policy must strive hard enough to make those policies become reality; otherwise, those policies might as well have never been designed. The Democratic administrations of the 1960's seemed to lose sight of such practical considerations in their euphoria over expansionism.

Budgets out of Control

In a general sense, the past Democratic administrations, supported by a Democratic Congress, lost control over both the Government's finances and the economy. During the fiscal years 1961 through 1969, deficits were run in every year but the last, whether appropriate or not, and totaled $60.5 billion. Indeed, the $3.2 billion surplus in fiscal 1969 is attributable in no small degree to expenditure controls promptly instituted by the Nixon administration upon taking office. More than 60 percent of this total deficit was run after the economy had crossed its potential in 1965 and, as we had been told by the new economists, surpluses were in order. Control over expenditures was conspicuously absent as outlays doubled during the sixties. This unusual growth cannot be attributed merely to uncontrollably rising military spending. Nondefense outlays rose more than 123 percent while defense outlays grew 77 percent. As a result of this neglect of any semblance of budgetary control during the decade, prices rose more than 20 percent and interest rates soared toward record levels.

We as a nation can learn a lot from these mistakes of economic policy if we want to. The overriding lesson is that we have not yet developed the tools, or the skill to use them that would enable us to fine-tune the economy with Federal Government policies. On the contrary, we have discovered that the Federal Government can be a greater source of instability than the private sector. Further, we have learned that a substantial increase in the rate of economic growth is no panacea for all that ails us. Much more attention must be paid to how the additional real goods and services made available are distributed, and what our productive economy is doing to the environment in the process. It is how we use our increasing national output that is most important.

Policy Fads

More specifically, we found that fads in economic policy cannot substitute for balanced measures aimed at the fundamental causes of instability. For example, we learned that fiscal policy cannot alone call the tune to which the economy dances, but instead that monetary

[1] The long-needed tax reform enacted in 1969 was accompanied by tax relief of such proportions as to substantially offset revenue gains and thus curtail future outlays for desirable health, education, welfare and environmental quality programs. For the three year period 1970 through 1972, the Tax Reform Act of 1969 is estimated to produce only a $5 billion net gain.

policy can undo or eclipse a given fiscal policy. The belated 1968 tax increase and expenditure reduction bill that was finally passed in the interests of dampening the economy did not evidence any appreciable success until monetary policy turned toward restraint in 1969.

We also learned anew that honesty is the best policy in Federal budgeting. Democratic administration attempts to cover up the economic impact of the budget with such gimmicks as participation certificates and revenue "adjustments" merely postponed the day when harsh economic realities had to be faced. And it was in fiscal 1967 that the Johnson administration refused to admit that forces were at work to double projected Vietnam war costs and turn a narrow budget deficit into an $8.7 billion one. This classic case of budget disregard should be a lesson for all administrations and Congresses to come.

Finally, we learned, much to our regret, that basically useful guidelines for noninflationary wage and price behavior turned into weapons of Government coercion cannot be constructive and may do a great deal of harm. Direct intervention by the Johnson administration in price decisions in more than 50 industries in a single year while fiscal policy continued to fuel an overheated economy did nothing to reduce inflation or promote confidence that the powers of Government would be wisely used in economic matters. The price guideposts may have suppressed some increases for a short time, but inflation is not significantly less today as a result of the arbitrary arm twisting. It seems much more likely that imposition of the guideposts directed attention away from the main cause of inflation in the late sixties—soaring Government deficits at high employment—and delayed effective fiscal action from being seriously proposed.

It is fair to say that we are entering a challenging new decade both older and wiser in an economic policy sense. We have passed from the periods of stagnation that seemed to afflict the first 60 years of the century into an era where we know well how to stimulate the economy to maximum employment and production but are weak in insuring that purchasing power remains firm. Our dedication to growth and high employment must be matched in intensity with a dedication to a stable price environment as well.

Further, the Federal Government must be prevented from being the major source of economic instability in the future that it has in the past. We believe economic wisdom gained from the previous mistakes can help us establish Government as a force for stability in the economy, rather than a massive spoiler.

THE NEED FOR ECONOMIC STABILITY

There has been a great deal of loose talk about inflation recently. Some would have us believe that a continually accelerating price rise is not really a problem that deserves national concern. Others would reverse our anti-inflationary efforts because unemployment may begin to rise as the efforts take hold. One witness even told us during the hearings that, "inflation does not reduce income, it increases it." If this were true, our best national policy would be to have the Government print money night and day.

The fact is that inflation is a burden on all, and a particular hardship on certain groups: those least able to protect themselves, including the poor and the elderly living on fixed incomes. And since there have been so many misinformed statements about the effects of continually rising prices, we feel a rational discussion of the effects of inflation would be most useful.

What most of us commonly call income is really a flow of claims to the real goods and resources produced by the economy. These claims, commonly called dollars, are distributed in the form of wages and salaries, business profits and rents, and Government revenue. What determines the real purchasing power of an individual, that is the volume of real goods and services he can command, is the sum of dollars he holds and the price level of the goods and services he wishes to purchase. In simple terms, our dollar holdings divided by the general price level of the things we buy determines our holdings of claims to real resources.

Inflation Is Unfair

A major objection to inflation, or rapid increases in the price level, is that it capriciously redistributes purchasing power in favor of those who can accurately anticipate it and raise their incomes at a rate greater than the inflation. It works to the detriment of those who cannot increase their incomes at a rate to keep up with prices.

In a stable price environment, an individual can be confident that the number of dollars he receives for productive employment will indicate the volume of real goods and services he has the power to purchase. In a period of inflation, however, this is not the case. Here, purchasing power is determined by an individual's power to obtain increases in dollar income greater than the rate of price increase. This power to increase nominal income is not necessarily based upon increased productivity, as it tends to be in a stable economy. Rather, it is determined by other factors, such as economic size and influence, political power, relationships built up by past associations, legal powers and the nature of the goods and services provided. These factors are not normally available to the poor, the retired, and others on fixed incomes.[1] This indicates why inflation is so unfair.

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[1] Even with the 7 percent increase in social security pensions in 1965 and the 13 percent increase in 1968, most social security pensions, by 1969, were worth less in real purchasing power than they were in 1958. During the period between the increase of 1965 and that of 1968, this one segment of our society had $3 billion in purchasing power taken away from them by inflation.

The fact that inflation redistributes real purchasing power is the basis for the contention that it works like a tax. Taxes are levied by governments to shift real claims to goods and services away from individuals and to the government in question. Inflation causes this same type of shift of purchasing power, although it does so capriciously and does not finance the public services provided by governments that taxes do. Those who can stay ahead of inflation benefit while those who fall behind lose purchasing power as surely as if it were taxed away.[2]

Rising Prices and the Poor

Specifically, it has become almost a commonplace in some circles to argue that inflation, far from hurting low-income individuals, actually helps them by opening up jobs and raising wages. This is patently untrue. Inflation helps only those who are able to anticipate it better than others and are in a position to manipulate factors affecting their income stream. Low-income individuals are hardly in a position to do this. What does help the poor in the way described is the existence of tight labor markets where employers, no longer able to find skilled workers, hire the disadvantaged and pay higher wages than otherwise. Although inflation and the increased employment of the poor often go together, they need not. Efforts to reduce structural barriers, such as the lack of necessary skills, discrimination and inadequate job information, can effectively expand employment opportunities for the poor without an accompanying inflation.

It seems clear that recent inflation has hurt the poor. A cursory glance at recent price data indicates that the outstanding advance in 1969 occurred in the price of food, an item that is much more important in the lower income budget than for higher levels. Over the 12 months of 1969, the food price index rose 7.1 percent while the overall price level advanced 6.1 percent. Thus, inflation cut heavily into the purchasing power of low-income households.

An analysis of the effects of inflation in the 1960–68 period by Dr. Albert E. Burger, of the staff of the Federal Reserve Bank of St. Louis, indicates that only certain groups of professional workers could be said to have benefited more with respect to income flows in the 1964–68 period of inflation relative to the 1960–64 period of general price stability. Comparatively unskilled workers were shown to have benefited least of any income groups from the increased inflation. Individuals as asset holders benefited more in the 1964–69 inflation only by owning land and houses, holdings that few low-income families have.

Reduced Economic Growth

There is also good reason to believe that inflation reduces the efficiency of the economy and thus burdens all through reduced real economic growth. For one thing, inflation interferes with the calculation of real values, values that are normally measured in dollar terms. In this way it impairs the use of financial contracts governing terms of employment, sales and loans, contracts that necessarily extend

[2] A study by Senator Miller based upon Government statistics found that for 1969, the total inflation cost came to $100 billion—$46 billion attributable to increases in the cost of living and $54 billion from erosion in the purchasing power of bank deposits, savings accounts, pension and life insurance reserves, and bonds—corporate, Federal, State and local.

over substantial periods and are expressed in dollar terms. If an inflationary economy continually proves price expectations to be erroneous, the use of such contracts will be discouraged, with unfortunate consequences for productive growth of the economy.

Inflation also tends to distort choices between saving and consumption, because it transfers purchasing power from those who save and lend to those who borrow, since the value of the dollars paid back will always be less than the value of the dollars lent out. These inflationary expectations are built into the interest rates that savers and lenders demand and borrowers are willing to pay, so that interest rates soar as they have recently. However, in many instances, savers are prevented from receiving returns on their savings that fully compensate for inflation. Rate ceilings on savings deposits and inappropriately low rates on Government savings bonds come quickly to mind.

Persistent inflation poses a serious threat to long-term economic growth. Its impact disrupts capital markets and distorts investment decisions. In our economy, a large, viable market for fixed-income securities is an essential source of capital for business and Government. Prolonged inflation lessens the willingness of lenders to participate in the long-term end of the financial market. This has caused Chairman Burns of the Federal Reserve Board to remark that we have recently seen the greatest "bear" market in bonds in history.

Inflationary Psychology

Inflation further distorts the saving-consumption choice as it engenders an inflationary psychology. Seeing the purchasing power of their savings eroded on the one hand, and the prospect of paying higher prices for consumer goods on the other, individuals will tend to step up their current consumption at the expense of saving. Businessmen and State and local governments tend to do the same thing by borrowing excessively for capital investment before prices rise further. This can have serious implications both for the long-run efficiency of the economy and for meeting our urgent public needs. Homebuilding, revitalizing the cities and improving the environment over the next decade all require a substantial growth in total saving. Inflation, by stimulating current expenditures at the expense of savings, can only impede this growth.

The stability of our social and political structure is affected by the stability of the monetary unit. This obtains when a Member of Congress stands for election as well as when an entire government tries to remain viable. The history of governments in nations that have undergone substantial inflations is not particularly comforting in this respect. But the most damage is done at the lower levels of government, levels that are least able to offset a rising inflation. Local governments have limited revenue jurisdictions and the least responsive revenue sources, yet have the fastest growing demands and experience most rapidly rising costs. The economic and political viability of large cities has been severely threatened by the current inflation. The tale told during our hearings of New York City's

attempts just to catch up with public service demands during a period of inflation should be enough by itself to convince any concerned individual that inflation must be eliminated.

Another problem with continued inflation is the impairment to our Nation's international trade balance it implies. Imports rise more rapidly than exports as we price ourselves out of both domestic and world markets. Comparative wage rates between the United States and its principal overseas competitors have lessened our competitive position—even when the rate of inflation in these foreign countries has been greater than ours. This is so because these countries can better afford to increase their low wage rates to meet higher rates of inflation than we can afford to increase our high wage rates to meet lower rates of inflation. Our capital account, too, can become adverse as the economic instability indicated by the continuance of price inflation dissuades foreigners from investing here and induces domestic businessmen to invest in more stable economies abroad. Speculation against the dollar tends to mount, and runs on gold and shifts into more liquid international obligations become commonplace, with undesirable consequences for world trade and stability.

Perhaps worst of all, inflation tends to feed upon itself and grow. In the process of attempting to stay ahead of inflation an inflationary psychology develops that produces ballooning excess money demand. People begin to realize that monetary units they hold are depreciating and rush to spend them on real goods and services before their purchasing power declines further.

Inflation and Unemployment

As pointed out during our hearings, an unanticipated growth in price levels will cause profits to rise and physical output to expand. As long as this continues business will pay higher wages and add employees to meet the new rise in demand. Thus when an increase in total demand causes prices to rise and inflation exceeds what has been expected, the problem of unemployment diminishes—temporarily. This evidently happened in late 1968 and early 1969, when the overall unemployment rate on a seasonally adjusted basis fell to 3.3 percent, that for full-time workers fell to below 2.7 percent and the rate for married males, the backbone of the skilled labor force, fell below 1.5 percent. These rates were the lowest since the Korean war years.

For a time, inflation may reduce unemployment in this manner, but meanwhile economic adjustments are taking place that tend to push unemployment back up. Responding to the price changes, businesses and workers develop inflationary expectations which affect their pricing and wage behavior. Employers see their profits shrink as labor costs rise. Workers see inflation eating into their take-home pay and increase their wage demands. The result is a decline in the growth in production as costs rise and an evaporation of temporary employment gains. This is what we have seen since the middle months of 1969.

The only way this readjustment can be postponed, for it cannot be avoided, is for the price level to increase at continually rising rates, and a return to the old "boom and bust" cycles we have worked so

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hard to eliminate. To continue on a course of rising inflation that can only conclude with a depression is irresponsible. The Government has an obligation to return the economy to stability and avoid drastic downturns.

Business and labor should make no mistake: This inflation will be ended and economic decisions made upon any other assumptions will only lengthen and perhaps intensify any economic slowdown. And once the rate of inflation is substantially reduced, the policies of the Federal Government should never again be permitted to engender and contribute to inflation. Inflation is not inevitable and cannot be tolerated in a country dedicated to maintaining a stable economy and high levels of employment.

MOVING IN 1970 TOWARD ECONOMIC STABILITY

We are entering a particularly difficult year in terms of economic stability. Our major objective in the coming months is to reduce the rate of inflation that has plagued this Nation for the last 4 years, an inflation that with each passing month has become more deeply imbedded in expectations and the institutional structure of price and wage decisionmaking. We as a nation have discovered far too late that it is easier and more effective to stifle inflationary pressure when they first develop than attempt to deal with them after they have built up steam.

Witnesses before this committee have reiterated time and again that there is no way to avoid some temporary increase in unemployment while the rate of inflation is reduced. We believe any such increase can and should be kept to a minimum, and that over the long run no significant level of involuntary unemployment is acceptable. There are no shortcut, painless cures for the inflationary excesses that have built up in past years. Those who most strongly criticize any temporary increase in unemployment as the economy is stabilized should have called for measures to prevent the substantial Federal budget deficits which laid the foundation for our present plight. Those who refused to initiate and support actions to prevent Government excesses such as the $25.2 billion deficit in fiscal 1968 are the ones most responsible for any rise in unemployment as anti-inflationary policies take hold.

But while we realize that unemployment may be temporarily higher in the year ahead than in 1969, we believe that this increase can and must be kept from becoming broad and long continued. Some have become impatient with the administration's policies of "gradual" application of restraint; but we stated last year, and still believe, that these policies are the only ones consistent with minimizing any rise in unemployment as the economy is stabilized. The fact that in 1969 these policies ended the excess demand that generated the present inflation while the unemployment rate over the 12-month period rose only 2 tenths of 1 percent is a tribute to them rather than a sign of impotence or misapplication.

The first half of the administration's policy to return the economy to price and wage stability has been accomplished. Excess demand has been eliminated. But now we face the even more difficult task of ending the "hangover" from that excessive binge. The ruinous wage-price spiral as labor tries to compensate for price increases and business attempts to compensate for rising labor costs must be stopped. This, more than ever before will require restraint on the part of business and labor in their wage and price activities as well as appropriate fiscal and monetary policies.

It is particularly difficult to recommend what economic policy should be this year because of the delicate and complex nature of the present disinflation process. If fiscal and monetary policies are made too restrictive for too long

a time, the economy could be plunged into a substantial recession. If, on the other hand, fiscal and monetary policies loosen up too much and too soon, as occurred in early 1967, the economy could well go heading off into another roaring inflation, the end of which could only be an economic bust and depression.

Those who formulate and guide economic policy must not become fixed upon any one single target, whether it be the rate of inflation, unemployment, the balance of payments, the money supply, or the budget surplus. All are important, and Government policies with respect to each must be carefully coordinated. Above all, Congress must cooperate with the administration in designing and implementing the necessary economic policies in the year ahead.

The Outlook

The Council of Economic Advisers projects a decline in real gross national product (GNP) during the first half of 1970, followed by resumption of a slow increase in the second half, but still at a rate below the economy's long-term potential of 4.3 percent. The Council envisions a growth in current GNP of 5.5 percent, a real GNP growth of about 1 percent, a decline in the growth of the GNP deflator from 4.7 percent at the end of 1969 to between 3 and 3.5 percent in the last quarter of 1970, and an overall unemployment rate averaging 4.3 percent for the year.

We view this projection as consistent and reasonable for the coming year. In doing so, we do not rule out the possibility that the economy might deviate in either direction from this projection: Either a recession or a resumption of excessive demand inflation could occur. Both the administration and Congress must tread a fairly narrow path over the next 12 months, and avoid steps that might send the economy off into either equally undesirable directions.

Implicit in our concurrence with the administration's projection is the refusal to believe that we are engaged in economic policies that will inevitably produce a recession. The simple "rule of thumb" that two quarters of decline in real GNP growth constitutes a recession has been seized upon by some as compelling fiscal and monetary ease at the present time. While the rule may be useful for describing economic conditions to the layman, it is not a reliable guide for those who seriously consider and formulate economic policy. The designation of recessions involves much more than merely following the trend line of real gross national product. The job of analyzing the economy, determining which indicators signal present and future levels of economic activity, and when the economy is entering or actually in a recession has been given to professional economists who designate recessionary periods only after examining a substantial number of economic indicators over a considerable number of months after the event.

We join Dr. Arthur Okun, former Chairman of the Council of Economic Advisers, in pointing out that the administration's scenario for the economy in 1970 implies far less of a downturn than any of the four post-World War II recessions. He points out that our postwar recessions involved increases in the unemployment rate of 2 or 3 percentage points, a gap between actual and potential output of 6 to

10 percent, a decline in industrial production of 8 to 15 percent, and a drop in corporate profits before taxes of 20 to 30 percent. We do not foresee such developments over the year ahead, nor would the Government permit such developments.

Fiscal and monetary policy must be potentially flexible over the next 12 months, and those who formulate it particularly sensitive to developments in the economy. Should the economy show signs of veering off the growth path consistent with reducing inflation while maintaining high levels of employment, the administration and the Federal Reserve must act quickly to change policies to restrain the deviation. For its part, Congress must allow monetary and fiscal policy the necessary flexibility and not box it in with inappropriate revenue and expenditure actions. We have entered upon a difficult operation, and there is no room for irresponsible tax and spending decisions that will jeopardize the return to a stable economy.

Fiscal Policy

In order to maintain the proper degree of restraint, it is essential we aim for a budget surplus given the projected economy. Of course, how large this surplus should be will depend upon how the economy progresses; and if the economy should turn unexpectedly downward and unemployment rise to an unacceptable degree, the built-in stabilizers should be allowed to shift the net budget position toward fiscal ease. It would be folly to fix upon some single net budget figure and then attempt to produce that result through thick and thin. Rather, the budget should be permitted its natural flexibility in the face of changes in the economy.

However, the fiscal 1971 budget contains a number of revenue and expenditure assumptions that can be described as uncertain. Given economic projections at this time, the Congress and the administration should join to produce a fiscal 1971 budget that is in appropriate surplus, and make appropriate adjustments if assumptions prove to be inaccurate.

These assumptions can be broken down into two groups: Those where appropriate enactment by Congress is doubtful, and those that hinge upon the state of the economy and its particular sectors. Included in the first group are the President's proposals for transportation user charges ($635 million), program terminations, restructuring, and reforms ($2.1 billion), postal rate increases ($674 million), and a 6-month postponement of Federal employee pay raises ($1.2 billion). It can be argued that Congress will not pass all or perhaps any of the legislation to implement these proposals. If not one of these is enacted, we would have a deficit of at least $3.3 billion in fiscal 1971, even should the economy turn out as projected.

Any administration's budget is no more than a single plan of revenues and expenditures that it believes should result over a period 6 to 18 months later. It is unlikely that the fiscal 1971 budget on the first day of July 1971 will closely resemble the revenue, expenditure, and net budget totals presented this past January. It is up to Congress to decide what the budget will really turn out to be. If certain of the

administration's proposals appear to be unfeasible or undesirable, the Congress should reject them. However, this should be done only after most careful consideration, comparable to that given by the administration, and only if accompanied by action on suitable alternative proposals. We believe the Congress should accept the overall posture of the administration's budget as necessary for economic stabilization in the foreseeable future, and has the responsibility to match each revenue reduction or expenditure increase from the administration's budget with an alternative of producing a budget with a comparable overall effect.

There are also revenue and expenditure items in the budget that depend upon the economy for their totals. Of course, total Federal revenues are closely tied to the level of economic activity, but there are other items in the administration's budget that will be unusually dependent upon the state of the financial markets. Should interest costs rise and the markets tighten, expenditures could be as much as $4.5 billion above current estimates. In such case, the administration must develop budget modifications to offset the threat to an appropriate fiscal posture.

In summary, given the economy that seems to be unfolding, Congress must act upon the administration's budget proposals,[1] ever mindful that action or inaction on revenue and expenditure requests will have important implications for the stability of the economy. Should congressional action on particular revenue or expenditure measures shift the budget to a net position inappropriate for economic stabilization, Congress must enact offsetting measures to shift the budget back to the appropriate position.

Most important, if Congress votes fiscal 1971 spending legislation substantially above administration requests, it will be forced to consider extension of the 5-percent income tax surcharge beyond the end of fiscal 1970, or some comparable emergency measure.

Congressional action on the fiscal 1971 budget will determine to a major degree whether or not the economy returns to stability. It was an ill-advised and unreasoned rise in the budget deficit that engendered the current inflation in the first place, and irresponsible actions on appropriations and revenue requests for the year to come will delay a return to economic stability. In addition, whether monetary policy can ease up and maintain this posture as so many of us hope will depend on the adequacy of fiscal policy. The monetary authorities have been forced to shoulder an unacceptable share of the anti-inflationary burden during most of the past 4 years, and this must be avoided in the future.

[1] Senator Miller and Senator Jordan point out that the original estimated budget surplus is based on the so-called "unified budget", which takes into account surplus funds in the various trust accounts. These surplus funds are to be borrowed to meet operating expenses of the federal government, and they must be repaid through taxes collected from the people in later years. The total of such trust account surpluses so used have been estimated at about $8.7 billion. Actually, there is a projected operating deficit for both fiscal 1970 and 1971 of over $7 billion.

Monetary Policy

Monetary policy was quite restrictive in 1969, judging by either the growth of the money supply or the level of interest rates. During the second half of 1969, the money stock was essentially unchanged, in contrast with a 4-percent increase during the first half and the 7-percent rate of growth in 1967 and 1968. Interest rates reached historical highs, although there have been some recent developments indicating an easing in interest rates can be expected.

A number of economists have predicted that a continued "no monetary growth" policy by the Federal Reserve would produce a substantial recession, and a few have maintained it has already begun to do so. We are not among those in the latter category, although we do believe that zero growth in the money supply, if continued, would produce interest rates even higher than recently, a substantial liquidity crisis, and possibly lead to a severe recession.

Consequently, given the currently projected economic environment, and adherence to a budget comparable to the one proposed by the administration, we believe that the money supply must soon be allowed to grow at an annual rate around 2 to 3 percent, to help reduce interest rates and prevent a drastic economic downturn. However, if the state of the economy changes dramatically, or if fiscal policy no longer provides the restraint appropriate for a return to stability, the Federal Reserve must be free to influence the money supply accordingly, but within the 2 to 6 percent band of annual money supply growth we have advocated since 1968. This places all the more burden on Congress to mold fiscal policy so as to help stabilize the economy and release monetary policy to follow a less confined course.

One step that monetary policy must avoid is a sharp reversal to a very expansionary posture such as occurred during the 1967 pause in economic expansion. We cannot afford the resumption of accelerating inflation that excessive loosening of monetary policy in 1967 allowed.

It is also important to mention here the unfair burden that a restrictive monetary policy places on the housing sector. Given this Nation's housing needs, we cannot afford to allow housing to become dangerously depressed when the overall nature of the economy calls for monetary restraint. Measures must be taken to insure that housing can maintain access to the necessary materials and financial resources it needs to reach our goals. We believe the President recognized the high priority of our nation's construction needs in his March 17 message and applaud his proposals for expanding the rate of residential construction. We discuss some of these same proposals at length in the housing section of "Toward Achieving Longrun Objectives" (p. 91).

Contingency Planning for Increased Unemployment

There has already been some increase in unemployment from recent unusually low levels as anti-inflationary policies have taken hold. The Council of Economic Advisers has estimated unemployment for 1970 will probably average 4.3 percent, up from 3.5 percent in 1969. We believe it is essential now to design a number of programs that can be "taken down off the shelf" to alleviate the adverse effects of an increase in the number of unemployed and the lengthened duration of unemployment. It is not enough to merely rely on structural programs developed to reduce unemployment during periods of generally high employment, for the challenges of increasing unemployment are significantly different from those of rising employment To its credit, the administration has proposed specific means to orient the unemployment compensation system and manpower training programs toward meeting the problems of rising unemployment more effectively.

The administration's proposed legislation to strengthen the unemployment insurance system would extend this program to cover additional workers, and in periods of high unemployment to automatically extend the duration of benefits. Eligible workers would receive benefits for up to an additional 13 weeks beyond the present limit if insured unemployment were to reach 4.5 percent for 3 consecutive months. This would extend the maximum duration of such benefits to 39 weeks in most States.

This proposal should be closely examined by the Congress with an eye to improving its effectiveness. Specifically, this "trigger" mechanism seems somewhat crude since it increases the duration of benefits all at once rather than phasing them in as the unemployment rate among insured workers approaches the specified rate, and not providing for the contingency of an increase in the duration of unemployment benefits from that presently forecast as needed. Further, the relationship of the insured unemployment rate to the overall rate may be such that only a large increase in total unemployment would trigger increased benefits. Recently, the rate of insured unemployment has been a little more than half that of the overall rate. Surely we would not want to see overall unemployment reach 8 or 9 percent before the trigger allowed a lengthened period of benefits.

The Manpower Training Act of 1969, currently being considered by Congress, also includes a trigger mechanism for periods of unusually high unemployment. If the national unemployment rate reaches 4.5 percent for 3 consecutive months, a 10-percent increase in the manpower appropriation would be authorized. This could provide additional funds for training workers laid off their jobs by a slowing economy. A period of rising unemployment would seem an excellent time to provide training for additional individuals, since the individual worker's opportunity cost of foregone earnings to undertake this training would be minimal.

In designing contingency manpower plans for increased unemployment, we recommend the administration take a number of important factors into account. For example, projections should be made now of the characteristics—age, color, sex—of those most likely to be among any additional

unemployed. Further, estimates should be made of the industry and regional impacts of generally rising unemployment. With these estimates in hand, the administration can then devise effective specific programs to insure the newly unemployed workers are given the opportunity for job training.

Specifically, the Job Opportunities in the Business Sector (JOBS) program of the National Alliance of Businessmen has been a major effort to train and provide meaningful employment for the hard-core unemployed. By helping finance this program, the Federal Government has indicated its responsibility toward assuring that these formerly unskilled and unemployed are effectively trained and employed. We are deeply concerned that the recent rise in unemployment has resulted in the layoff of many of the participants in this program.

We believe that these participants should have highest priority in Federal contingency training and placement programs for rising unemployment. The Government has the responsibility to guarantee as much as possible that the hopes in the hard-core who have participated in this program are not shattered in the difficult period of return to economic stability.

The question of the specific occupations for which manpower training should be offered during a slowdown is essential. The kinds of training that should be offered during rising unemployment will be different from those in a booming economy with tight labor markets. Specifically, training for jobs that are quite sensitive to cyclical fluctuations in the economy should be avoided. If a worker, after receiving the necessary training, could only be assured of employment during a rising economy and is unable to retain his job if the economy slows, the stability of his employment has not been secured. A period of rising unemployment should be the time to train workers for jobs less sensitive to the economic cycle and closely related to the longer run needs of the nation.

Consequently, the administration should begin to determine which specific jobs have been relatively insensitive to economic downturns in the past and occupations which a growing U.S. economy will continue to demand. For example, a cursory glance at past economic cycles indicates that white collar and service employment seem relatively less vulnerable to generally rising unemployment than unskilled labor. Programs to provide training and jobs for workers displaced in a downturn should focus on the former categories and avoid the latter. Perhaps even some contracyclical employment sectors can be discovered, where employment actually increases during a softening in the economy.

A period of rising unemployment, when there is an increase in the number of workers who are willing to enroll in manpower training programs, is a good time to train individuals to assume jobs in areas of high national priority and rising manpower needs. For example, the administration has placed particular emphasis on improving the quality of the environment and reducing crime in the years ahead. And employment in the building trades, which must expand substantially if

we are to meet our housing goals, is another area of high national priority. Job opportunities in these areas should be identified and training designed to provide workers with skills to fill them.

The entire area of public service employment is also one where the unemployed could be trained to fill productive jobs. For example, the health services sector is already experiencing substantial shortages and additional job opportunities will become available over the longer run. Reorienting training programs to equip individuals to fill these jobs and others of high priority would both provide stable and remunerative employment for those usually "last hired and first fired" and help toward achieving our national goals.

Among its contingency programs for rising unemployment, we believe the Federal Government should include measures to directly provide a limited number of public sector jobs. If unemployment becomes especially severe, the Federal Government should offer jobs in areas of high national priority for those displaced. We feel this would be an effective way to mitigate the hardships imposed by anti-inflationary stabilization policies. There should be a tight ceiling on the number of jobs so provided and the program should in no way guarantee long-term employment for a significant portion of the labor force during periods of high employment.

Administration plans to decentralize the administration of manpower programs to State and local governments need not interfere with contingency planning for rising unemployment. State and local agencies should be required to develop and submit to the Department of Labor for approval contingency plans for allocating additional funds that would be triggered by a substantial rise in unemployment. In these ways can cyclical effects on unemployment be kept to a minimum and the opportunity to train workers for high-priority occupations be fully and swiftly utilized.

Expenditure Control

In 1969, Congress imposed an expenditure ceiling on the executive branch. This ceiling allowed the administration leeway to include unforeseen increases in uncontrollable expenditures to the amount of $2 billion over the administration's April budget message. The ceiling was flexible with respect to Congress, whose action on appropriations and other bills affecting outlays in fiscal 1970 would raise or lower the ceiling the appropriate amount. What actually happened was that the original ceiling of $191.9 billion has been revised upward by $3.8 billion: The full $2 billion leeway for uncontrollable spending has been used up, and congressional action on legislation affecting spending raised it another $1.8 billion. Moreover, the 1970 budget, despite sizable spending cuts in some areas by the administration and Congress, has risen $5 billion over the originally estimated $192.9 billion, as the result of increases in uncontrollable expenditures, and certain congressional actions and inaction. Consequently, the budget is now estimated at $197.9 billion compared to a revised ceiling of $195.7 billion. The entire difference between the level of spending and the ceiling in fiscal 1970 is accounted for by an increase in uncontrollable expenditures more than twice as much as originally provided for.

The Congress at this point is faced with several choices. It can maintain the present ceiling and force the administration to cut relatively controllable spending enough to bring the budget down to the ceiling by June 30, it can raise it enough to include the increase in uncontrollable spending unforeseen and not provided for, or it can do some of both.

The first alternative is quite unacceptable as far as we are concerned. This would force the administration to cut the particular programs that constitute the controllable part of the budget. For fiscal 1970, this is estimated at only 34 percent of total outlays. A gross cut of $2.2 billion would fall quite heavily on the programs that comprise such a small portion of the budget. Unless we are prepared to accept the notion that controllable programs are less beneficial than uncontrollable programs, such an alternative is quite inefficient from the point of view of allocating Federal resources to meet the Nation's needs.

In view of the lateness in the current fiscal year, we believe the Congress must look primarily to raising the fiscal 1970 spending ceiling to include the increases in uncontrollable expenditures over the original allowance.

The experience with this last budget ceiling indicates that overall spending ceilings are fraught with difficulties. The object of any effort along these lines should be to maintain overall Federal outlays within some boundary consistent with domestic stabilization needs. This cannot be properly done when a ceiling applies rigidly to the executive but is adjustable to compensate for congressional actions. Nor is it efficiently done if the increase in uncontrollable expenditures forces cuts in programs that are relatively more controllable. A ceiling that would exempt all increases in uncontrollable program spending would be an easy way out, but would ignore the basic problem of Federal budget control: The budget tends to grow automatically from past actions taken by Congress. Further any ceiling exempting uncontrollable programs but rigidly restraining controllable spending might influence the Congress and the executive to shift more programs over to the uncontrollable category.

Of course, in the final analysis all expenditures are controllable by Congress because they all flow from congressionally enacted laws. But as a practical matter, only a small portion of the total budget is subject to effective discretionary control through the normal annual budget and appropriations process. A considerable amount of spending, such as interest on the debt and trust fund expenditures, arises from permanent appropriations which do not pass through the annual appropriations process. Several programs, such as veterans pensions and public-assistance matching grants, involve mandated expenditures fixed by previous law, and unless the law is changed they cannot be controlled through the appropriations process. Finally, payments on prior-year contracts and obligations running throughout the whole Government cannot be effectively cut or even postponed.

We believe the problem of uncontrollable spending must be faced squarely if the budget is to be used as an effective tool of stabilization policy and is to reflect accurately the needs and priorities of the Nation. It is true that relatively

uncontrollable items are expected to grow $7.2 billion in the fiscal 1971 budget compared to an overall budget increase of only about $3 billion. Furthermore, uncontrollable expenditures have grown to comprise 69 percent of the 1971 budget. Unless action is taken to reverse the trend, it is not inconceivable that the day will arrive when virtually all of the budget is beyond effective control during the annual budget cycle.

We believe too much emphasis has been given to controlling Government spending at the end of the budget process, when the funds are actually spent. It is much more effective and prudent to exert substantial control over the budget at the authorization and appropriation stages, where the authority is first granted for future spending. It is here that the growth of uncontrollability in the budget can be substantially reduced, both by reducing the uncontrollability specified in the law and by limiting appropriations that give rise to future spending. There is presently unspent Federal funds authority amounting to $126 billion arising from past congressional actions. It is to this total that Congress should annually address substantial efforts to control Federal spending.

Of course we realize that cuts in authorizations and appropriations only reduce federal outlays several years in the future. Efforts on the part of the Administration and the Congress to effectively control current federal spending must not be relaxed as we devote more attention to the appropriations stage of budgeting.

The failure of Congress to enact legislation until far into the fiscal year has immensely complicated the development of clear fiscal policies and the efficient allocation of Federal resources. The current fiscal year began without any of the 14 major appropriations bills enacted. There was still an appropriation bill outstanding at the beginning of the new session of Congress. The question can well be asked how any of the departments of Government can be expected to make rational program and expenditure plans given this extreme tardiness on the part of Congress.

We call upon the Democratic leadership of this Congress to insure this sad state of affairs does not develop for the 1971 fiscal year. The executive cannot develop reasoned fiscal policies, nor can the particular agencies efficiently monitor and allocate program expenditures when congressional action on appropriations is so delayed. We are convinced that dedicated efforts on the part of the Democratic leadership to facilitate the passage of this legislation can insure enactment of this legislation in an expeditious and timely manner.

Debt Management

In an economy where the gross Federal debt is expected to reach $375 billion by the middle of this year, and the debt held by the public is expected to average around 30 percent of gross national product, the way the Government manages its debt is most important. Even during periods of budget surplus, the Treasury's need to refinance existing debt can have substantial impact on financial markets

and even affect the monetary policy pursued by the Federal Reserve. Furthermore, the type of security chosen by the Treasury to finance its debt has important implications for the liquidity of the economy and aggregate demand.

We are most disturbed to learn that since mid-1965, the average maturity of the public debt has fallen about 1½ years, and at the end of 1969 stood at only 3 years and 8 months. This means, of course, that the Treasury must make frequent demands on the money and capital markets, even though the debt held by the public is declining. Furthermore, the short-term debt securities being issued are much more liquid than longer term issues, and the resultant increase in the economy's liquidity can aggravate inflationary pressures.

We believe that the major element contributing to the decline in the term structure of the public debt, is the 4¼-percent ceiling on the interest rates payable on long-term Government bonds. This ceiling has meant the Treasury has not been able to market an issue of longer than 7 years maturity since early 1965, due to the high levels of market interest rates. We believe the 4¼-percent interest ceiling on Government bonds materially reduces the flexibility of Government financing and is contrary to responsible fiscal management and we strongly urge that Congress act to eliminate it.

Presently, however, the Treasury does have the authority to issue securities of up to 7 years' maturity at market rates of interest. We believe that more aggressive sales of notes of medium-term maturities would help arrest the alarming decline in the debt's term structure, reduce the Treasury's incursions into the financial markets, and help restrain the liquidity in the hands of the public.

Wage and Price Policies

During the Joint Economic Committee's hearings on the President's economic report, it was suggested at several points that wage and price controls should be imposed in the year ahead. The most frequently mentioned proposal was a total wage and price freeze for at least 6 months.

The Federal Government has found it necessary to impose general wage and price controls during only two critical periods in this Nation's history. The first was during World War II, a period of total national mobilization and defense demands on the domestic economy amounting to about half of GNP. The second period and the one more comparable to the present situation, was during the Korean war. We believe a recounting of that period of control would be valuable at the present time.

The United States entered the Korean conflict in June 1950, and between that month and March 1951 the natural economic recovery from the 1948–49 recession, coupled with "scare" buying in anticipation of wartime controls and shortages, forced wholesale prices up at an annual rate of 20 percent and consumer prices at an annual rate of nearly 11 percent. The economy's production was pushed toward its limits as manufacturing capacity utilization rose from 80 percent to 96 percent in the space of a year.

Unlike the recent experience, immediate action was taken to make fiscal policy appropriately restrictive. Individual income taxes were raised twice, corporate income taxes three times and an excess profits tax imposed, all in slightly over a year. The entire Federal budget on a consolidated cash basis turned from a $2.2 billion deficit in fiscal 1950 to a $7.6 billion surplus in fiscal 1951. Monetary policy as well was tightened. The Federal Reserve raised reserve requirements twice in 1951, and the discount rate twice. The rate of growth of the money supply fell steadily from 5 percent in 1951 to 1.6 percent in 1953.

Controls During the Korean War

In August 1950, Congress passed the Defense Production Act giving the President the power to impose direct controls on wages and prices, and in January 1951, the President activated these measures, which lasted until decontrol in March 1953. The price controls appear at first glance to have been quite effective. The wholesale price index actually fell during the 2 years of controls, while the consumer price index only registered a 4.6 percent increase over the 2-year period. The success on the wage front was much less dramatic. Average hourly earnings rose 20 percent from 1950 to 1953, and the rise in unit labor costs for the private nonfarm sector actually accelerated in 1951 after a decline over the previous 2 years.

Although we cannot say with certainty, it is doubtful whether the price controls were responsible for restraining inflation. The prices of many commodities never really tested the ceilings. It has been noted that the wholesale price index actually *fell* during the control period, a result that cannot be laid to the ceilings. And the fact that, when controls were lifted in March 1953, there was nothing like the general price explosion that followed the lapsing of wartime controls after World War II would further indicate that little if any price inflation was suppressed by direct control.

It seems much more reasonable to conclude that the restraint on demand exerted by substantial fiscal and monetary measures early in the war was the potent force. Aggregate demand was successfully restrained before inflation could really grow and take hold.

Wage and Price Controls in the Present Environment

The most that can be said for direct controls on wages and prices is that they treat the symptoms of inflation. Much of their appeal rests on their directness and apparent simplicity: if prices and wages are rising the best way to stop them is by direct regulation. Direct controls surely do not go to the cause of general inflation, whether it be excessive aggregate money demand relative to real supply or cost push pressures. If inflationary pressures are real, price controls only conceal or temporarily postpone inflation, but do not eliminate it. Instead of nominal price increases, inflation takes the form of declines in quality or the shift of transactions to black markets or the failure of industry to produce the kind and quality of goods the market demands.

Ceilings on wages are also of limited effectiveness. They tend to produce evasions in the form of fictitious upgradings of workers, increases for particular groups to remove suddenly discovered "inequities," and the shift of demands for higher employee compensation

from salaries and wages to other benefits: more paid holidays, longer vacations, higher pensions and sick benefits, rules promoting increased overtime and overtime rates.

Price changes for goods and services have a legitimate role to play in our market economy. The free, competitive market is the most efficient allocator of resources that one could devise. Many Government programs, such as antitrust policies and the wage-price guidelines as originally formulated, are attempts to induce sectors which are not freely competitive to function in a competitive manner.

The structure of relative prices and wages prevailing when controls are imposed may be optimum for that point in time, but frequent shifts in demand on the part of business, consumers, or Government can rapidly make that structure obsolete. If, because of direct controls, *relative* prices cannot shift to the new pattern of demand as they do in a market economy, there will certainly be shortages of some goods and services. In the normal market situation, prices of goods with increased demand would rise, signaling that more labor and capital resources should be devoted to their production. When relative prices cannot shift in this manner, producers have no indication they should shift resources from production of one good to another, nor any incentive to do so.

In practice, there can be no such thing as an absolute wage and price "freeze". Exceptions have always been made, and should be made, for individual firms, workers, industries or sectors which, by some criterion or another, deserve special treatment. By the end of September 1951, 63 special regulations had been issued to relieve particular manufacturers and retailers during price control in the Korean war. And in August of that year, cost-of-living adjustments were authorized for all workers. The distortions in the economy caused by the exceptions bore heaviest on those who were not able to obtain relief, and the resulting inequities contributed nothing to economic stability.

Inequities and Rigidities

There are other inequities and rigidities inherent in the control system. For example, how fairly can wage controls treat workers who have succeeded in obtaining multiyear wage contracts with successive increases built in? And how can a price administrator determine the "right" price for a new product? Certainly, the slow and laborious process of form-filing and documentation must discourage real invention and innovation. And what about those industries where productivity increases relatively faster than in others and are thus relativey unconstrained?

Perhaps the greatest damage that direct controls do is hinder economic freedom. In a time when it is generally agreed that the flow of power over the last decade should be redirected from the national Government to the people, direct controls on wage and price decisions are particularly abhorrent. And just as we have found that there is no such thing as just a little inflation, wage and price controls beget further controls designed to make the inherently ineffective first round of controls work. And if controls appear to be restraining inflation, the cry will arise that they cannot be removed for fear of unleashing runaway prices and wages.

We strongly oppose the imposition of wage and price controls to fight the current inflation. They are ineffective at best, and at worst distort the allocation of resources, penalize those with limited access to the market and breed contempt for Government and the observance of its laws. Our market economy has shown itself to be a powerful engine of economic progress and the shackles that wage and price controls would place on it during this critical period would seriously jeopardize our nation's economic advance.

Other Direct Intervention

While rejecting wage and price controls in the present environment we do not necessarily rule out moral suasion by Government leaders. Nor do we reject the productivity standard embodied in the wage-price guideposts as originally formulated. We have always believed this standard could be a useful *guide* to wage and price behavior in markets where substantial monopoly power exists. What we have strongly objected to is the arbitrary and unfair manner in which they were imposed during the Johnson administration.

The past Chairman of the Council of Economic Advisers during the Johnson administration has gone to great pains to point out how the guidelines seem to have moderated price pressures in the 1966–68 period. He has also indicated what we have always maintained, that the imposition of the wage-price guidelines served to direct attention away from the basis of the current inflation—excessive Federal budget deficits—and delayed more meaningful fiscal action. We believe it is clear from studies done subsequent to this period that in several cases the administration pressured industries and under situations where the guideposts clearly were never meant to apply. Finally, as Dr. Okun points out, "similarly favorable responses by labor leaders in wage decisions could not be reported."

While rejecting the Johnson administration guidepost policy, we do believe that this administration has a responsibility to use its considerable powers of moral suasion and its ability to focus national attention on particular wage and price decisions to help stabilize the economy. The administration has devoted considerable effort to several areas where price or wage pressures have seemed to be particularly excessive, notably the lumber, construction, and copper industries. We applaud these efforts to determine the causes of excessive cost pressures in these industries and to find agreeable alternatives. We are encouraged to hear from Secretary of Labor Shultz, "The administration is now considering proposals for establishing such evaluative and analytical capabilities on a more formal basis, not with the intention of intervening in the wage and price decisions of the market but to provide information on what underlies these decisions." We believe this effort should be expanded to include all bottleneck industries and sectors where unusual monopoly power exists in business or labor.

We recommend that the administration immediately announce the inflationary implications of unusually significant wage and price decisions. The Council of Economic Advisers should calculate and make public how much each price increase adds to the wholesale or consumer price

index, and indicate other prices which would be adversely affected by such an increase. It should publish specific arguments why a particular industry feels it necessary to raise its prices, and suggest Government studies of situations where particular bottlenecks or unusual supply and demand conditions exist.

Similarly, on the wage front, the Council should publish the price implications of unusual collective bargaining agreements, including the timing of the wage increases under different assumptions, the productivity experience of workers in the industry, the industry's profit situation and whether industry officials feel the increases will necessitate price increases.

These activities should not be considered the foundation for more detailed intervention by the Government in individual wage and price decisions. However, we see no harm in opening up price and wage decisions which significantly affect the economy to the eyes of the public. Public scrutiny could well have a salutary effect in discouraging price and wage increases that would have inflationary consequences.

In addition, a vast number of the Government's own activities have a direct impact on costs and prices. These include policies relating to employment and pay of federal workers, contracting and procurement, direct lending and loan insurance, commodity stockpiling, agricultural price supports, import restrictions, federal regulation and many others. The activities of the Department of Labor in administering the Walsh-Healey and Davis-Bacon Acts, under which wage determinations are made on jobs connected with federal procurement or construction, should also be included.

Professor Raymond Saulnier, former Chairman of the Council of Economic Advisers, has pointed out that during the final years of the Eisenhower Administration, all government activities so affecting the economy were under continuous scrutiny by the Committee on Government Activities Affecting Costs and Prices. The activation of such a group now, or the explicit placement of this responsibility in an existing group, such as the Cabinet Committee on Economic Policy, is essential at this time when the Government is bending its efforts to reduce price and wage pressures in the private sector. The Government cannot be allowed to promote price and wage instability on the one hand while attempting to reduce it on the other.

The present state of the economy requires that the traditional fiscal and monetary approaches to reducing inflation be supplemented by a somewhat more specific approach. Last year at this time, the situation was much different. Actual GNP was still above its potential and growing at a 7.5-percent annual rate in current dollars. Unemployment averaged around historically low rates of 3.4 percent. Aggregate demand was clearly excessive in relation to the economy's supply and reliance on aggregate fiscal and monetary policies to reduce inflationary pressures was clearly appropriate. Today, actual GNP has dipped below its potential and current dollar GNP grew only 4 percent at an annual rate in the fourth quarter. Real growth has declined somewhat, and unemployment has risen. The challenge is no longer to reduce excessive demand but to reduce the rate of residual inflation.

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Using monetary and fiscal policies alone at this point is like turning down the furnace in a steel plant: it will take time for the furnace to cool off. Serious damage is done if the furnace is cooled suddenly. In our economy, there is a danger that fiscal and monetary restraint aimed toward price stabilization might be applied too harshly leading to excessive levels of unemployment. A policy of exposing wage and price decisions to public scrutiny can help reduce the rate of inflation without promoting increases in unemployment. In other words, we are now sweating in an overheated economy, but no longer exposed to the demand excesses that caused it. Prices and wage increases can be restrained by public opinion because they no longer reflect demand pressures.

TOWARD ACHIEVING LONG-RUN OBJECTIVES

It has become abundantly clear that we cannot fine-tune the American economy with continuous short-run adjustments in fiscal and monetary policies. The art of economic forecasting has not been developed to the point where policymakers can estimate within small margins the economic outlook for 6 to 12 months later. Even more frustrating is the dearth of knowledge of the precise timing and impact of fiscal and monetary changes, particularly small and frequent ones. Finally, the practical problems of changing Federal tax or spending policies quickly and such as to prevent even the fine-tuning of government policies.

> **We believe that efforts to fine-tune the economy with frequent changes in Federal economic policies during previous administrations have been the cause of a significant amount of the instability we have seen over much of the last decade. For the decade to follow, we recommend that national economic policies be framed to avoid extreme fluctuations in both the net Federal budget posture and the rate of increase in the money supply.**
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> **As rough guides in time of high employment, acceptable rates of economic growth and price stability, the Federal budget should aim toward surplus and monetary policy should keep the rise of the money supply in rough alinement with the potential growth in real output. This latter means adherence to the band of a 2 to 6 percent annual rate of increase in the money supply on a quarterly basis recommended by this committee in 1968. Any marked deviations from these guidelines should be permitted only after there is clear and convincing evidence that the economy needs unusual stimulus or restraint.**

HIGH EMPLOYMENT AND PRICE STABILITY

It would be impossible to totally eliminate unemployment in a large, complex and mobile industrial society. People change jobs frequently, and when between jobs, are counted as unemployed. There is a fairly large reserve of casual workers, such as housewives and students, who move in and out of the labor force as job opportunities expand or contract. During the process of such movement they are included in the unemployment figures. Finally, there are the hard-core unemployed, those who lack the training or the motivation for the jobs available. A low overall unemployment rate is a necessary but not sufficient condition for reducing unemployment among this latter group. This must be attacked through structural measures such as manpower training and education programs.

Given the present size and quality and potential growth of the labor force, we believe the administration's current long-term target for unemployment is reasonable. This is consistent with economic stability and the efficient functioning of labor markets. Of course, this should not be the ultimate rate we should ever accept.

We believe that over the long run, the unemployment rate consistent with economic stability can be reduced to 3 percent by determined efforts to improve the functioning of the labor markets, promote labor mobility, upgrade the quality of the labor force, increase the flow of job information and eliminate job discrimination.

The technical problems in constructing fairly accurate price indexes are many and varied, and include the difficulty of designating the group of goods and services the index should represent, how to estimate quality changes, what discounts are given from list prices, and how to compute prices for new items. Studies by the National Bureau of Economic Research support the position that the Consumer Price Index and the GNP deflator may overstate actual price increases by as much as 1½ percent a year. However, the former Director of the Bureau of Labor Statistics and the Joint Economic Committee's Subcommittee on Economic Statistics have stated that evidence indicates both upward and downward biases and that no firm conclusion could be reached.

We believe our long-run objective must be an economy where the Consumer Price Index and the GNP deflator rise at a maximum rate of 1½ percent a year and unemployment averages below 4 percent, given our present institutional structures and the current state of our statistical resources and techniques. An annual increase of 1½ percent in the Consumer Price Index and the GNP deflator could in fact represent zero inflation in the economy.

We recommend that determined efforts be made to improve the quality and functioning of labor markets to help reduce the unemployment rate while maintaining the necessary degree of price stability over the long run.

Housing

The housing sector has been particularly hard hit in recent years by both inflation and a monetary policy aimed at reducing inflation accompanied by historically high interest rates. Annual housing starts have fallen toward the 1 million mark, and this year we will do well to prevent housing starts from going any lower. Projections by the Department of Housing and Urban Development (HUD) and the National Association of Home Builders indicate that housing starts should begin to rise in the second half of the year. Nevertheless, the rate of new household formation and net loss of rundown units combining with low rates of housing production have created a housing shortage estimated by HUD of a least 1.2 million units over the last 5 years.

If we are serious about meeting the housing goals set forth in the Housing and Urban Development Act of 1968, substantial measures must be taken to assure the housing sector access to both the financial and real resources required to meet these goals. We cannot be optimistic that these resources will be available in adequate supply without considerable efforts on the part of business, including financial institutions, labor, and government at all levels. The major responsibility for initiating improved flows of physical and financial resources falls to the Federal Government. However, the Federal Government cannot singlehandedly insure that the housing goals are met. Significant efforts by the private sector will also be required, as outlined below.

Discussions of tight money and high interest rares have tended to obscure the question of the availability of sufficient labor and material resources, combined with the necessary technological advance and business management for a high rate of housing production. There is no reason to assume that these real resources will automatically be available in adequate supply. Developments in the construction labor market in 1969 have indicated that there will be substantial trouble there in the years ahead. Last year there was no real increase in construction spending, and unemployment in construction averaged 6 percent, yet collective bargaining agreements called for median first year wage increases of 14 percent. The labor resources required for the increased levels of housing products implied by our housing goal of 26 million new and rehabilitated housing units over 10 years will be much too costly if current institutional structures and trends continue.

Construction Labor Shortages

More than this, there is good reason to believe that the required labor may not be available at any price. The National Association of Homebuilders has estimated that the number of new job openings in construction in 1974 will increase 2.8 million over the 1966 level, or more than 75 percent. Leonard Lecht of the National Planning Association has estimated that if the economy grows at recent rates, employment in construction will increase 42 percent between 1964 and 1975; but if we hope to meet our construction goals, including those for housing, the construction labor force must grow by 80 percent over those years. In sharp contrast to these future needs, from 1966 to 1969, when the overall labor force increased 6.7 percent, the construction labor force increased only 3 percent.

The shortage of construction labor projected for the future is the result of a number of factors. For one, the cyclical nature of the housing industry produces a heavy outflow of workers during downturns. During the 1966 drop in construction, it is estimated that the industry lost hundreds of thousands of workers who found other employment and never returned to housing construction. For another, many of the building trades unions have been unable or unwilling to admit enough new members. Racial discrimination seems to be a particularly strong barrier to an expanded inflow of unskilled blacks willing to learn the building trades. Restrictions on the available labor supply will continue to cause scarcity and high labor costs unless effective measures

are taken to reduce these obstacles. Finally, the duration and other requirements of construction apprenticeship programs could well be liberalized. Along these lines, the administration should step up its efforts to train the unskilled for skilled construction jobs and promote their gainful employment.

Construction material costs do not seem to be an obstacle to increased building in the housing sector. In the 1965–1969 period, the price index for construction materials rose at a greater rate than the overall Wholesale Price Index, but this was almost entirely due to lumber and plywood. Sharp rises in lumber and plywood prices such as took place in late 1968 can be ameliorated by Government actions to affect supply constraints and to influence demand. Care must be taken that the Federal Government's own purchases do not aggravate this market.

The cost of land does, however, seem to be a major barrier to a high rate of housing production at reasonable costs. Despite a steady decline in average size, the average price of new homesites rose nearly 25 percent from 1965 to 1969. Ways must be developed to insure an adequate supply of usable land for housing construction. Revision of local zoning codes, the use of air rights over urban freeways and the judicious disposal of excess Federal real property should all be investigated as means to alleviate the potential shortage.

There are other rigidities built into the construction industry that must be reduced before an ample supply of housing is assured. These problem areas include:

1. Restraint of technological advance and labor productivity by union work rules and local building codes.
2. Lack of sufficient standardization in buildings and components.
3. Construction seasonality which produces excessive overtime costs and high labor turnover.
4. The local nature of construction combining with labor immobility to produce pockets of labor surplus and labor shortage.
5. The large number of small firms which reduces the opportunities for economies of scale such as through increased and better access to necessary capital.

Financial Resources for Housing

If there is some doubt about whether the real resources will be available to reach our housing goals, there is no doubt that a financial capacity for achieving them is not assured. In 1968, when total private housing starts for the year topped 1.5 million, total mortgage loan requirements were $22.4 billion. The Department of Housing and Urban Development has estimated that if we are to reach our 26 million unit housing goal by 1978, total mortgage loans in that year must reach $50 billion, or more than twice the recent level. We cannot be at all confident that these funds will be available to support the needed level of housing.

Last year's experience paints an especially bleak picture. Net new residential mortgage lending fell from an annual rate of more than $20 billion in the fourth quarter of 1968 to only $5.8 billion in the final quarter of 1969. The level was kept from going even lower by massive infusions by Government-sponsored lending agencies.

Progress toward insuring that needed funds are available to finance housing necessitates a two-pronged attack. First, the access of mortgage borrowers to loanable funds must be improved. The residential mortgage sector has too long been the orphan of the financial markets, receiving the residual lendable funds not required by large business firms and the Federal Government. Part of this is due to the structure of the major institutions that service the mortgage market and part is due to lack of general investor familiarity with mortgage market instruments.

The Nation's savings and loan associations hold about one-third of all mortgage debt outstanding and more than 40 percent held by major private financial institutions. However, their asset structure makes them particularly vulnerable to periods of tight money and high interest rates. They depend upon essentially short-term savings deposits for virtually all of their lendable funds, savings which have become increasingly sensitive to market rates of interest. In 1969, when rates on short-term Treasury securities and long-term high-grade corporate bonds rose far above what savings and loan associations were allowed or could afford to pay, there was a net outflow of savings during the year of over $1 billion. Although in January the Federal Home Loan Bank Board modestly raised the ceilings on the rates savings and loan associations can pay, few feel this will reverse the net outflow.

Savings and loan associations have been able to maintain a significant degree of mortgage lending despite net deposit outflows through advances by the Federal Home Loan Bank Board. In 1969, these advances were nearly double their amount in 1968. Over the last year, Federal Home Loan Bank advances increased by a net of $4.6 billion and reduced member liquidity requirements freed another $1.3 billion for savings and loan lending. However, the rate on advances, governed by Federal Home Loan Bank's borrowing costs, have risen substantially over the past year, and have recently approached 8 percent. In order to keep costs to savings and loan associations at a level they can afford to pay, the administration is proposing to temporarily subsidize the rates on advances. We actively support this measure.

There are other measures that should be considered. Variable interest rate mortgages have been suggested as a means to permit associations' income to move more closely with market rates and thus allow them to be more competitive on the interest rates they can offer on deposits. Governor Maisel of the Federal Reserve Board has suggested that deposit institutions issue longer term savings certificates; 3- and 5-year certificates paying reasonable and relevant rates of interest would help attract the long-term funds that the mortgage lending industry severely needs.

Ways must be found to make mortgages a more acceptable investment instrument for other lenders. For example, the administration

should step up issuance of the mortgage-backed securities authorized by the 1968 Housing Act to attract pension fund investment. This seems a particularly useful device to channel new flows of capital into the mortgage market. Some have even suggested issuing shares in FHA and VA mortgage pools in $100 denominations to attract smaller individual savings. Mortgages should be made eligible paper for Federal Reserve lending and the authority of national banks to lend on mortgages should be expanded. Finally we believe the development of a secondary market facility for conventional mortgages to deal in instruments originated by institutions insured by FSLIC or FDIC is worthy of support. Such a market facility would improve the liquidity of conventional mortgages and thus attract lendable funds.

Housing's Share of Credit

We all look forward to some easing in the money and credit markets in the year ahead, and such easing should make more credit available for the residential mortgage sector. However, we do not feel this should be left to chance. Business plans for expanding plant and equipment expenditures this year, coupled with a substantial backlog of credit demand deferred by other sectors until the markets ease, do not at all guarantee that housing can substantially increase its share of credit as all potential borrowers scramble for funds.

Consequently, we recommend that the President establish a National Voluntary Credit Allocation Committee with the responsibility for enlisting voluntary support for the allocation of increased credit on a priority basis. The Committee, composed of leaders of the commercial banking, life insurance, investment banking, mutual savings banking and savings and loan industries, would develop a national credit allocation program as a guide to lending for all organizations of any kind engaged in the business of extending credit, making loans, or purchasing, discounting, selling, distributing, dealing in or underwriting securities. Regional committees would be set up to develop programs relevant to particular local problems.

In effect, the national program would urge financial institutions to screen applications for credit for their contribution toward reaching our housing and other immediate goals. This would in every sense be a voluntary program on the part of financial institutions. Any lender could freely ignore the lending standards at his discretion.

We believe such an effort could be quite successful in helping to assure that housing and other worthy sectors receive a fair share of the increased credit made available by monetary ease. The Federal Reserve and the American Bankers Association found the voluntary credit restraint program of the early 1950's worked very well in reducing flows to lower priority demands. This program we recommend

is even more promising since it would not require a lender to reduce the normal amount of credit going to any borrower, but merely insure that some sectors, particularly housing, receive a "first lien" on additional credit provided by monetary easing.

Secretary Romney of HUD has indicated that the Treasury Department has already begun to hold discussions with representative investor groups to enlist their voluntary support for the mortgage market this year. Financial leaders have apparently indicated a desire to help reverse current trends. The program we are recommending would rationalize these initial efforts and concentrate on assuring the housing sector the share of credit expansion it needs to meet our national goals.

Long-Run Financial Capacity

Proposals such as these only work to improve the residential mortgage sector's share of total saving. However, if we are to reach our housing goals, more than twice as much capital must be devoted to housing in future years than has been the case recently. There are a number of emerging factors that indicate the level of total savings necessary to make our housing objectives a reality will not be forthcoming.

The prospective shift in the 1970's to a relatively much younger work force will mean a shift toward a lower propensity to save, as young people follow more liberal spending habits than their elders. On the demand side, State and local governments will be clamoring for more capital funds to build schools, roads, sanitation and other facilities to both keep up with rising population trends and whittle away at the substantial backlog of unmet social needs. Corporations, too, will be tapping money and capital markets to supply a growing work force with the needed tools of production.

It does not appear that the savings necessary to finance our capital needs at reasonable rates of interest over this decade will be automatically forthcoming from the private sector. If the level of savings falls short of the potential demand, we will experience continually rising prices and interest rates and a ruinous shortfall between our needs and capital resources.

It is our feeling that the Federal Government must now begin to plan for providing substantial Federal budget surpluses on a national income accounts basis at high employment over the decade ahead. The generation of these surpluses of course depends on an economy following a path of high employment growth and stability. These surpluses, used to retire Government debt, would augment the savings provided by the private sector and expand the funds available for meeting this Nation's needs, particularly housing.

The need for these surpluses emphasizes all the more the necessity for detailed reappraisal of our Federal tax system and expenditure policies. But if our housing and other high priority objectives are to be achieved in the 1970's, this examination must begin now.

Tax Policy

It was generally believed at the time of the enactment of the 10 percent income tax surcharge in mid-1968 that a temporary tax increase was a powerful means of returning the economy to stability The Council of Economic Advisers at the time maintained the surcharge would withdraw $10 to $11 billion from the income stream in fiscal 1969 and definitely dampen the overheated economy. Specifically, a decline in the rate of real economic growth to 2 percent between mid-1968 and mid-1969, an immediate decline in consumer spending, a significant slowing of business investment and a gradual and progressive deceleration of inflation were forecast. If anything, the surcharge, coupled with a $6 billion cut in Federal spending, was felt to be an "overkill' measure that would break the back of the economic expansion. A number of prominent economists predicted unemployment rates substantially above 4 percent in early 1969, and one even told this Committee that all the econometric models he was familiar with indicated a recession in 1969 as a result of the proposals.

These fears and predictions, of course, turned out to be mistaken. Real GNP grew 3 percent between the second quarter of 1968 and the comparable quarter in 1969, and price increases as measured by the GNP deflator *accelerated* until the second quarter of 1969. Personal consumption jumped 11.5 percent at an annual rate in the quarter following the surcharge enactment and grew at an 8.5 percent rate during the first half of 1969. And business investment in new plant and equipment, after declining during the first half of 1968, spurted 10 percent in the second half and rose 11.5 percent in 1969 over 1968. Further, the recession forecast by some never even gave any signs of appearing. Unemployment, instead of rising above 4 percent as so many pessimists had forecast, dropped to below 3.5 percent.

There are several explanations for the surcharge's apparent lack of restraining effect on the economy. Some argue that the strength of the economic boom, particularly in the consumer sector, was grossly underestimated, and that only a surcharge of larger dimensions and earlier enactment could have effectively restrained the economy. Others have pointed out that the fears of overkill infected the Federal Reserve, with the result that monetary policy was eased during the second half of 1968, and the money supply allowed to continue to grow at an excessive rate. There is little doubt that this expansionary monetary policy counteracted the restraining effects of the tax surcharge.

Finally, the temporary nature of the surcharge must be mentioned as reducing its predicted anti-inflationary effects. Consumers did not view their decline in after-tax incomes resulting from the surcharge as permanent and apparently did not bother to quickly reduce their consumption in line with the income reduction. Business investment was even less restrained by the temporary surtax. Investment is undertaken

with a view to profitability in the long run. The momentary decline in after-tax profits implied by the temporary surcharge apparently did not affect these calculations, especially when consumption was continuing to show strength. At best, the corporate surcharge reduced the amount of internal funds available for investment and forced business to obtain the funds necessary by borrowing in the capital markets.

This recent experience with a temporary tax increase for short-run stabilization purposes has provided a number of lessons. For one, timely enactment of temporary tax increases is not assured: the 10 percent tax surcharge was first proposed by the Johnson Administration in August 1967, but was not passed by Congress until nearly a year later. For another, tax increases work to restrain the economy with much longer and more uncertain lags than originally believed. This reduces their effectiveness as a short-run stabilization tool. Finally, and perhaps most important of all, we found that an expansionary monetary policy can substantially offset tax policy restraint.

For the future, these characteristics of temporary tax increases must be taken into account when short-run measures to restrain the economy are under consideration. We believe that expenditure reductions may well be more powerful stabilization devices and operate with shorter lags. Certainly, they can in most cases be implemented more rapidly than tax changes. And a dollar reduction in federal purchases reduces aggregate demand a comparable amount with more certainty than do tax changes. Most important, monetary policy has the power to effectively offset temporary tax increases and reduce the restraining effects of expenditure cuts, and it is essential, therefore, that it be coordinated with fiscal policy measures.

Beyond the use of temporary increases in income taxes as effective anticyclical devices, recent developments have raised the question of the dominance of the income tax in the Federal revenue system. If the recent experience with the Tax Reform Act of 1969 is any indication, there is a widespread feeling in this country that income taxes should be reduced. Of course, at high levels of employment, reductions in one source of revenue must be offset by reductions in spending or increases in other taxes if we are to avoid inflation. It is unlikely that this country can afford to reduce its spending on public programs appreciably, given the great demands being made by our cities, our general environment and our underprivileged. Consequently, tax reductions of one sort must be offset by tax increases of another.

In the context of insuring that our public needs are met while our economy maintains stability at high employment, we believe nonincome sources of Federal revenue should be more seriously considered. These include excise taxes, user

charges, value-added or turnover taxes, and expenditure taxes. We believe there should be a continuing effort by the Executive and the Congress to examine our present overall revenue system and inquire into our continued primary reliance on the income tax. We wish to make no recommendations as to particular revenue changes that should be studied or adopted, but we do believe this country's needs will be better served if the present revenue system is not taken for granted.

One area where urgent inquiry is definitely indicated is the tax load on businesses. The Tax Reform Act of 1969 will raise the corporate share of the overall U.S. income tax burden. In 1970, the repeal of the investment tax credit and other reforms will increase corporate liabilities by almost $3 million. In 1971 and 1972, corporate liabilities will be raised by an additional $660 million and $100 million respectively while individual liabilities will be lowered $3.4 billion in 1971 and $2.2 billion in 1972.

If the 7-percent investment tax credit for productive machinery and equipment was instrumental in raising business investment and production in the 1960's, as seems to have been the case, its repeal can be expected to dampen economic growth significantly in the 1970's. We believe some alternative relief from the recent unfair shift of burden on to business investment must be provided.

Along these lines, we think liberalization of the depreciation schedules for income tax purposes is long overdue. The last time methods for calculating useful tax lives were altered was in 1962, and the last time there were changes in the methods of depreciation was in 1954. We applaud the Treasury's statement that it is currently working on proposals for liberalization of these schedules. We urge the Treasury to complete work on modernizing the depreciation and amortization schedules and submit proposals for passage during this session of Congress.

Government Expenditure Policy

The Congress recently completed action on the most comprehensive tax reform bill in more than 15 years. However, it is becoming more and more evident that the need for expenditure reform is just as great. Government spending seems to grow automatically despite considerable efforts to control it. Moreover, the growth of the population, the need to improve our social and physical environment and the widening concept of governmental responsibility will almost inevitably lead to larger Federal budgets in the decade ahead.

In the face of such potential growth, it is more essential than ever that we effectively control and efficiently allocate Government spending to avoid straining our physical pro-

ductive resources, to assure continuance of vigorous economic growth without inflation, and to focus discriminating judgment on national priorities.

A major innovation in the 1971 budget is the inclusion of a 5-year projection of the overall level of Federal spending. Further efforts should be made, however, to supply information on the future growth of particular programs. Full projections of the multiyear cost implications of new and existing Government programs would enable both the Executive Branch and the Congress to exercise better control over Government spending.

We further believe that continued efforts should be made to implement and improve the planning-programing-budgeting system (PPBS). This system attempts to stimulate a more rational and comprehensive approach to Federal program and spending decisions by improving the organization and the quality of the information the Government needs to make rational program decisions. Program objectives are clearly identified, alternative methods of achieving objectives are rigorously analyzed, and the costs and benefits of each method are compared. Further, the PPBS focuses attention on the total time-stream of program costs and benefits, assessing as fully as possible the future cost and benefit implications of both programs and objectives. We are pleased that the present administration is continuing and improving the PPBS work begun by the previous administration.

Another reform of vital significance is the adoption by the Congress of "zero-base budgeting." The current procedure is for the appropriations committees to examine only the proposed spending increment in a particular program over the previous year's total. What is already being spent is accepted as necessary without examination. The Congress should require agencies to justify their entire budget requests every several years on a staggered basis just as if they were new programs. This would not only sharpen program control within the Executive Branch but give the Congress a basis for deciding where particular cuts in existing programs might be made to accommodate new initiatives.

The Federal trust funds have been shown to be a powerful means for financing particular Government activities. Currently, $50 billion of Federal budget outlays are made through these funds for programs ranging from railroad retirement to highway construction. Recently, there have been further proposals to finance mass transit and airport construction through the trust fund instrument.

However, any discussion of Federal expenditure control would be remiss if it did not point out the budget uncontrollability that the trust fund mode of financing generates. The trust fund method locks in funds for future spending on particular programs, and effectively removes this spending from congressional scrutiny and control. In its future appropriations and expenditure decisions, both the Congress and the administration must be fully aware of the implications for efficiency in Government spending of the Federal trust funds.

There are a number of other reforms that we believe deserve particular attention as means to improve executive and congressional control over the budget.

1. The earmarking of particular revenues for specific programs should be carefully reappraised by Congress at frequent intervals, to insure the programs continue to provide valuable benefits.

2. Agency heads should be required to propose specific cuts in their budget to finance new programs or provide additional funds requested for existing programs after the overall budget has been transmitted to Congress. Congress should likewise match revenue and spending changes with offsetting ones if the budget is to maintain a particular degree of economic restraint.

3. New programs should be typically undertaken on a pilot basis first and not launched on a national scale until their soundness has been reasonably tested. The current pilot study of the effect of guaranteed income on work incentives of the poor is a good example of such an approach.

Defense Spending

It is clear that the administration has mounted a major new effort to develop the Federal budget to reflect accurately both civilian and military priorities by eliminating structural obstacles to intense scrutiny of defense spending. We think the Congress can do no less. Neither defense spending nor civilian spending should be considered as "sacred" and beyond the pale of close scrutiny and control. It seems likely that the defense budget can be substantially cut in the years to come, especially given our reduced participation in the Vietnam war.

However, this can come only after a long, rational analysis of our national security requirements and the defense programs needed to meet them. Specific programs must be singled out as particularly low priority and reduced or eliminated. We reject as pure demagoguery statements that the defense budget can be cut $10 or $20 billion without a specification of where and why particular programs should be ended.

As far as criticizing the size and allocation of the defense budget, 1969 was a vintage year. We have always argued for determined efforts to reduce Government spending wherever possible. However, it is disturbing that only one segment of the total budget has been singled out recently by some for so much scrutiny and criticism.

Major congressional efforts have been focused on cost overruns on major weapons systems. This committee has performed an important service in insuring that cost increases on major weapons contracts are reported in a clear and timely fashion. However, it is as yet unclear why these overruns have occurred. All we know is that programs such as the C–5A transport plane and the Poseidon missile are currently

estimated to cost considerably more than originally planned. We do not know how much of the cost overruns is the result of unforeseen technical difficulties, change orders, improved design and general cost inflation and how much is pure waste, resulting from contractor inefficiency and poor planning.

Certainly, any large construction project is subject to substantial cost increases over original estimates, witness the Rayburn House Office Building and the John F. Kennedy Center for the Performing Arts. What we should be most concerned with is wasteful Federal spending resulting from inefficient procurement policies and practices. Those who condemn the "military-industrial complex" and charge the Pentagon with being invulnerable to Government control are not being responsive to this concern. If anything, they make it more difficult for the public and the Congress to place this Nation's security and its defense effort in proper perspective.

Spending for defense is not wasted if it provides the country with the necessary degree of national security in an efficient manner. There is no reason to believe that military spending is inherently and necessarily more wasteful than spending for civilian programs. However, we believe there is sufficient evidence that earlier military budgets did not receive the careful scrutiny that all Government spending should receive, by either past Congresses or past administrations. This administration has instituted several new procedures to insure that defense spending is brought under adequate control, measures which have already resulted in cuts of $4.4 billion in fiscal 1970 defense spending from that proposed by the previous administration. A further reduction of $6.3 billion has been proposed for 1971.

New Procedures

The Nixon administration has radically overhauled procedures for shaping the defense budget. For one, the military services are given ceilings as they develop their initial budget proposals, instead of asked how much defense the country "needs" for national security. Thus the services are forced to work within spending constraints rather than allowed to submit astronomical budget requests with little regard for what the Nation can afford. For another, the President has set up a Defense Program Review Committee, including among its members the Budget Director and the Chairman of the Council of Economic Advisers, to balance defense demands against other national objectives. The Committee will review individual weapons systems to determine how these programs affect progress toward all national objectives, civilian as well as military. This is a radical improvement over the situation in the previous administration, where one former cabinet member noted there was not even a forum where one could argue domestic priorities against military priorities.

Finally, the subtlest and perhaps the most important change of all is the new procedure for submission of the defense budget to the

President. In the last administration, civilian agency requests were first submitted to the Budget Director for his approval and then to the President, with the agency heads having the right to appeal Budget Bureau decisions. However, the Secretary of Defense submitted his budget request to the President directly and the only recourse given to the Budget Director was appeal to the President. In other words, the defense budget was under less Budget Bureau control than civilian spending, and not sufficiently weighed against civilian spending.

The Nixon administration has changed all of this. The President has directed the Bureau of the Budget to treat all budgets, both civilian and military, in the same fashion. The Budget Director has the final say on every particular budget before it goes to the President. Spending cuts are to be applied to all agencies equally. The Budget Bureau's intention to exercise closer control over the defense budget than before is underlined by the appointment of an Assistant Director concentrating on defense spending, the first such high level Bureau official to have this responsibility. Graphic proof of the Bureau's new-found power was provided last June, when the White House ordered the cancellation of the manned orbiting laboratory program on the recommendation of the Budget Bureau and over the objections of the Defense Department and the Air Force.

State and Local Governments

Inflation in recent years has severely aggravated the fiscal mismatch at the State and local levels of government. During periods of price stability, the demands for public services, such as education, health and welfare, normally outrun revenues which tend to rise only as fast as overall gross national product. The *costs* of providing State and local services, however, tend to rise at a rate about 50 percent higher than the overall rate of price inflation. These factors have combined in recent years to produce annual deficits for all State and local governments around $1 billion. Estimates by Professor Otto Eckstein of Harvard indicate these deficits could rise to as much as $7 to $11 billion in the early 1970's, depending on the real and inflationary growth of the economy and the flow of Federal aid.

In an attempt to meet growing service demand, States implemented more than 300 rate increases in major taxes over the past decade. In 1969 alone, 36 States approved new taxes or increased existing ones that will augment receipts by a record $4 billion. However, it is clear that despite such Herculean efforts, State and local governments will be hard-put to finance public needs over the coming decade.

We have long endorsed the concept of Federal revenue sharing as a significant means of insuring the continued viability of State and local governments through increased unencumbered funds. The present administration has become the first to introduce a revenue sharing proposal.

We support the general approach to revenue sharing embodied in the administration's proposal.[1] This involves providing a given percentage of Federal resources to lower levels of Government for use as they choose. We feel that over-reliance on the use of traditional categorical grants in aid is an undesirable way of augmenting the financial resources of State and local governments. This approach involves too much cost in terms of Federal control, bureaucracy and rigidity. We support administration efforts to consolidate and streamline current Federal aid programs and reduce their cumbersome conditions and requirements.

[1] Senator Miller has periodically introduced his proposal for revenue sharing for educational purposes, since this is the area where local costs have been rising most rapidly.

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AGRICULTURE AS WE ENTER A NEW DECADE

THE STATE OF AGRICULTURE IN 1969

On the whole, the agricultural segment of our economy fared better in 1969 than in most previous years. Realized gross farm income in 1969 was $54.6 billion, up $3.5 billion from the previous high in 1968. Although this sharp increase was partially offset by the gain of $2.3 billion in production expenses, realized net farm income still rose $1.2 billion over 1968 to a level of $16 billion. This level of net farm income was the third highest on record and was exceeded only in 1947 ($17.1 billion) and 1966 ($16.3 billion). Producers of livestock and livestock products, particularly, had a better year in 1969 with livestock prices averaging 12 percent higher than in 1968. With a decline of about 3 percent in the number of farms, realized net income per farm in 1969 was $5,401, up about 11½ percent over 1968, and about $350 per farm higher than the previous record of 1966.

There was a sizable increase in the aggregate personal income of farm people from both farm and nonfarm sources in 1969. After taxes, the per capita personal income of the farm population is estimated at $2,375 for 1969, up 10 percent from 1968. The ratio of average disposable income of farm people rose to 75.7 percent of the nonfarm population average, the highest on record, and 3 percentage points above 1968. In recent years, this ratio has stabilized around 75 percent, compared to 50 percent in the latter part of the 1950's. However, this narrowing of the income gap is due in large part to steady gains by many farmers in adding to their income from off-farm work, substantial declines in the farm population, and increased Government farm program payments which partially offset lower than adequate market prices.

On the other side of the coin, national farm debt rose from $54.6 billion in 1968 to $58.1 billion in 1969, an increase of 6 percent, while debt per farm rose 8 percent, from $18,106 to $19,588. Although the prices received by farmers for all farm products rose about 5½ percent in 1969, the prices paid by farmers for all items, including such things as interest and taxes, rose nearly 5 percent, and the parity ratio remained at 74. (See note on p. 129.)

AGRICULTURE'S LEGACY OF THE 1960'S

Notwithstanding that 1969 was a better year for American agriculture, the legacy of the 1960's shortchanged the producers of our food and fiber. While realized net farm income had a cumulative increase of nearly $21 billion since 1960, total farm debt increased nearly $32 billion during the same period. At the same time, the 1960's saw a decline in our farm population of more than 5 million (from 15.6 million in 1960 to 10.3 million in 1969) and a decrease in the number of farms of nearly 1 million.

Some consolation can be taken from the fact that farm equity increased during this period by over $71 billion—most of it in inflated land values. However, it should be noted that national net farm income last year represented only about a 5½-percent return on net farm equity—not particularly good in the present state of interest rates, and leaving nothing whatever for the farmers' labor and managerial skills.

The social and economic hardships accompanying this record underscore the seriousness of the cost-price squeeze on the Nation's farmers and their families. Generally, throughout the 1960's farmers were plagued by relatively higher prices for the products they had to buy compared to prices received for the commodities they produced. Using 1958 as a base year with an index of 100, in 1960 the index of prices received by farmers stood at 99 and the index of prices paid was at 102. By 1969 the index of prices received had risen to 114, but the index of prices paid had jumped to 127. The increase in the index for prices paid is even more dramatic when selected items are viewed. Thus, from 1960 to 1969, interest costs soared from 120 to 315, taxes from 117 to 206, and wage rates from 109 to 174. The parity ratio, which averaged 80 in 1960, averaged only 74 during 1967, 1968, and 1969, although it rose to 76 by the end of 1969.

In short, inflation pushed up the costs of production while prices received by farmers fell behind. The relative cost of food declined from 20 cents per consumer dollar in 1960 to 16½ cents in 1969. For 1969, this represented a savings to consumers of $20 billion compared to a cost to them, in taxes, of under $4 billion for farm program payments—a bargain for consumers at the expense of our Nation's farmers. Of course, inflation increased the overall cost of food to consumers, but there were more consumer dollars available to spend, too.

We commend the administration for the firm stand it has taken with regard to stopping inflation—to be achieved gradually, however, to not unduly aggravate unemployment. Unlike many other producers, farmers are unable to pass on to the buyers of their products the effects of rising production costs. Stopping inflation is vital to help farmers on the cost side of the cost-price squeeze. This, along with improved follow-on farm programs which will lead to fair prices for farm products, will improve the farmers' situation immeasurably.

Agricultural Trade [1]

Over the years, one of the major elements of our favorable balance of trade has been the favorable balance of agricultural exports over agricultural imports. In fact, had it not been for this, our overall trade balance would have been in deficit for 1968 and 1969. (Indeed, if one adds shipping costs to the value of our imports, as we do in the case of some of our exports, such as food for peace shipments, we had actual trade deficits for these years.) But the trend has been steadily downward in the volume of our agricultural exports since 1966. This has been true both in Public Law 480 shipments and in commercial shipments, except that last year commercial shipments did go back up some $200 million—a small, though favorable, component of the total.

[1] Consistent with prior year Agriculture sections, we are commenting on the trade aspects of agriculture, which are of deep significance to the future of American agriculture. Our concern for other aspects of U.S. foreign trade policies is just as deep, but upcoming hearings by the Subcommittee on Foreign Economic Policy compel us to limit coverage of foreign trade to agriculture in this report.

Total U.S. agricultural exports in 1969 fell 5 percent below 1968, to $5.9 billion, which was 14 percent below the record level in 1966. Our agricultural imports in 1969 also dropped slightly to $4.9 billion, but only 1 percent below the record high in 1968.

Since 1967, we have actually been in a deficit position as far as commercial exports of agricultural commodities versus commercial imports are concerned. And while our food-for-peace program is an integral part of our foreign relations policy, these exports do not help our balance of payments deficit problem, which came to nearly $7 billion last year, on a liquidity basis.

It is these considerations and the pressing need to meet price competition in world markets which have caused the Secretary of Agriculture to propose a lowering of price supports or loan rates—on the one hand, to help meet our overseas competition, and some increase in diversion payments to farmers, on the other hand, to offset any loss of income from lower price supports. Direct subsidies of agricultural exports, it should be noted, are somewhat restricted by the General Agreement on Tariffs and Trade (GATT) as detailed later on.

The following tables illustrate the trends in agricultural imports and exports during the last 6 years.

TABLE I.—AGRICULTURAL IMPORTS, CALENDAR YEARS 1964-69

[In millions of dollars]

Commodity	1964	1965	1966	1967	1968	1969
Supplementary:						
Animals, live	56	117	118	80	113	119
Dairy products	62	73	118	115	101	101
Meat and meat products	483	525	619	664	764	886
Sugar, cane	458	441	502	587	641	638
Tobacco, unmanufactured	89	130	127	129	142	128
Wool, apparel	115	157	157	102	110	85
Other	675	627	986	1,019	1,167	1,146
Total	1,938	2,070	2,627	2,696	3,038	3,103
Complementary:						
Coffee (green, roasted)	1,027	1,064	1,069	964	1,144	896
Cocoa beans	131	139	122	147	136	168
Rubber, crude natural	201	182	177	170	188	275
Wool, carpet	90	71	72	38	48	43
Other	357	384	424	437	470	473
Total	1,806	1,840	1,864	1,756	1,986	1,855
Grand total	3,744	3,910	4,491	4,452	5,024	4,958

Source: Economic Research Service, U.S. Department of Agriculture.

TABLE II.—AGRICULTURAL EXPORTS, CALENDAR YEARS 1964-69

[In millions of dollars]

Commodity	1964	1965	1966	1967	1968	1969
Cotton, excluding linters	682	486	432	464	459	280
Dairy products	224	196	126	121	143	133
Feed grains, excluding products	855	1,135	1,334	1,054	926	866
Fruits and preparations	279	313	315	310	277	326
Soybeans	567	650	767	772	[1] 810	822
Tobacco, unmanufactured	413	383	482	498	524	540
Vegetables and preparations	158	155	176	164	173	180
Wheat and flour	1,532	1,183	1,534	1,206	1,100	830
Other	1,638	1,728	1,715	1,776	1,816	1,959
Total	6,348	6,229	6,881	6,365	6,228	5,936

[1] From census unpublished data.

Source: Economic Research Service, U.S. Department of Agriculture.

TABLE III.—SHARE OF U.S. AGRICULTURAL PRODUCTION EXPORTED· FISCAL YEARS 1964-69

[In percent]

Commodity	1964	1965	1966	1967	1968	1969
Wheat, including flour equivalent	75	55	65	56	49	34
Rice milled basis	64	56	60	67	64	59
Nonfat dry milk	62	44	37	24	20	25
Dried edible beans	49	17	17	18	16	16
Tallow	44	40	37	40	38	38
Soybeans [1]	41	48	43	39	40	39
Hops	41	43	42	40	36	39
Rye grain	34	6	11	16	12	5
Cotton	32	30	20	48	55	26
Dried prunes	30	27	37	35	27	29
Lard	28	18	9	9	9	10
Dried whole milk	28	17	21	16	16	23
Tobacco, farm sales weight	26	25	29	38	32	38
Cottonseed	23	32	19	5	0.1	0.1
Raisins	21	25	23	24	38	27
Dried edible peas	20	60	65	82	74	84
Grain sorghums	17	24	36	39	23	14
Barley, grain	17	14	19	11	8	3
Flaxseed	11	27	15	32	25	36
Corn, grain	11	15	17	12	12	12
Cattle hides	45	56	41	41	36	42
Lemons and limes	9	17	21	19	18	19
Variety meats	9	10	10	10	9	10

[1] Includes bean equivalent of soybean oil for export.

Source: Economic Research Service, U.S. Department of Agriculture.

One reason for the decline in our agricultural trade balance is the increasingly adverse effects of the trade policies of foreign nations. We believe that the policy of some countries, particularly the European Economic Community, of trying to shift the burden of their surplus agricultural production adjustment to other countries through the intensification of import restrictions and export aids is shortsighted and cannot be tolerated.

Last year, in our minority views, we discussed the latest trade barrier which had been proposed by some leaders in the EEC—an internal tax on oilseeds and oilseed products amounting to $60 a ton on soybean oil and $30 a ton on soybean meal. If this proposal had been adopted, it would have severely affected our exports of these commodities—exports which amount to more than $1 billion annually with more than one-half going to the EEC. And, equally severe retaliatory action by the United States against imports from the EEC would have been inevitable.

We are pleased to note that, after vigorous opposition to this proposed tax on the part of several minority members of this committee and on the part of the Secretary of Agriculture and the administration, the EEC has wisely deferred action on this proposal. We commend the administration for its part in heading off this tax, but Congress, itself, must continue to maintain a close watch on future developments.

Indeed, the entire Common Agricultural Policy (CAP) of the EEC bears watching. This policy is costing those countries in the neighborhood of $14 to $15 billion a year—equal to $28 to $30 billion in this country in comparison to our respective gross national products. EEC Government subsidies account for about $8 billion [2] of this total and $6 to $7 billion is accounted for by costs to EEC consumers

[2] This includes expenditures by EEC governments in support of domestic agriculture of $5.5 billion and expenditures by the Community's European Agricultural Guidance and Guarantee Fund (FEOGA) of $2.4 billion. Source: Economic Research Service, U.S. Department of Agriculture.

resulting from artificially high prices. Of course, we have no direct interest in the economic adjustments between EEC consumer-taxpayers and EEC farmers; but we do have a concern over any artificial fallout effects from their CAP on international trade, such as reduced imports (including those from the United States), surplus production (wheat and dairy products, for example), and subsidized exports. These have increased competition among other exporting nations in remaining markets and caused a downward pressure on world prices. Indeed, the excessive stimulus to EEC wheat production resulting from the CAP has been one of the factors leading to a world surplus of wheat.[3]

The following tables show that while our agricultural imports from the EEC and the United Kingdom have increased steadily in recent years, our agricultural exports to those countries have decreased. Our imports and exports to other major trading partners are also shown.

TABLE IV.—U.S. IMPORTS, CALENDAR YEARS 1964-69

[In millions of dollars]

Year and area	Total imports	Agricultural imports	Agricultural imports as percent of total imports
1964	18,600	4,082	22
1965	21,283	4,087	19
1966	25,360	4,491	18
1967	26,733	4,452	17
1968	33,066	5,024	15
1969	35,870	4,958	14
From EEC:			
1964	2,831	258	9
1965	3,316	270	8
1966	4,098	306	7
1967	4,441	331	7
1968	5,849	362	6
1969	5,787	363	6
From United Kingdom:			
1964	1,132	23	2
1965	1,403	24	2
1966	1,761	30	2
1967	1,710	28	2
1968	2,016	32	2
1969	2,129	35	2
From Japan:			
1964	1,763	40	2
1965	2,401	37	2
1966	2,948	37	1
1967	2,994	32	1
1968	4,044	37	1
1969	4,849	37	1
From Canada:			
1964	4,227	176	4
1965	4,813	234	5
1966	6,106	240	4
1967	7,099	201	3
1968	8,918	226	3
1969	10,345	244	2

Source: Economic Research Service, U.S. Department of Agriculture.

[3] Senator Miller states, "Because entry of the United Kingdom into the EEC could, depending on the ground rules, worsen the situation, the United States should watch carefully any negotiations to accomplish that entry. If Britain's entry would be accompanied by her adoption of a variable levy system and high price supports, thus raising the level of protection against agricultural imports into the United Kingdom, artificially stimulating her local production of cereals and meat, and encouraging the purchase of European wheat and feed as a substitute for imported grains from the United States and other countries, neither the United States nor other exporting nations could stand idly by. Furthermore, opening of the British market to surpluses from other members of the EEC might well prolong the time for the inevitable changes these other members must make in their agricultural policies."

TABLE V.—U.S. EXPORTS, CALENDAR YEARS 1964–69

[In millions of dollars]

Year and area	Total exports [1]	Agricultural exports	Agricultural exports as percent of total exports
1964	26,156	6,348	24
1965	27,135	6,229	23
1966	29,884	6,881	23
1967	31,142	6,380	20
1968	34,199	6,228	18
1969 [2]	37,444	5,936	16
To EEC:			
1964	4,481	1,416	32
1965	4,904	1,476	30
1966	5,264	1,564	30
1967	5,582	1,460	26
1968	5,994	1,367	23
1969	6,875	1,269	18
To United Kingdom:			
1964	1,445	448	31
1965	1,537	390	25
1966	1,645	471	29
1967	1,929	424	22
1968	2,132	374	18
1969	2,278	361	16
To Japan:			
1964	1,894	720	38
1965	2,042	876	43
1966	2,312	942	41
1967	2,665	864	32
1968	2,924	933	32
1969	3,462	934	27
To Canada:			
1964	4,653	[3] 615	13
1965	5,486	[4] 620	11
1966	6,487	[5] 626	10
1967	7,053	[6] 556	8
1968	7,936	[7] 595	7
1969	8,956	[8] 710	8

[1] Including Department of Defense shipments.
[2] Preliminary.
[3] Includes $160,000,000 in transit shipments.
[4] Includes $176,000,000 in transit shipments.
[5] Includes $140,000,000 in transit shipments.
[6] Includes $70,732,000 in transit shipments.
[7] Includes $111,166,000 in transit shipments.
[8] Includes $201,099,000 in transit shipments.

Source: Economic Research Service, U.S. Department of Agriculture.

We are encouraged to note that the Canadian Government has recently announced its intention to sharply reduce wheat production to help relieve the world wheat surplus problem, and, at the same time, to refrain from shifting the surplus production problem to other grains. This action is in line with drastic U.S. action which has reduced our own wheat producers' allotments by some 37 percent over just the last 3 years.

In our view, all countries of the world, both exporters and importers, should work together to solve overproduction problems. Each country must shoulder some of the responsibility and not try to shift that responsibility to others. Moreover, nontariff trade barriers can be just as harmful as visible tariffs themselves, and in some cases even more so. We strongly believe that in any future trade negotiations the administration should vigorously cope with nontariff trade barriers affecting not only agricultural but nonagricultural commodities as well.

FARM PROGRAMS FOR THE 1970's

With present farm programs scheduled to expire at the end of 1970, the Agriculture Committees of both the House and the Senate are

currently engaged in developing follow-on farm programs. An economic analysis made by Iowa State University of what would happen if farm programs were discontinued shows that projected 1970 net farm income would fall to about $10 billion in the short run and about $11.3 billion over the long run. This should be compared to $16 billion in net farm income last year. The harmful economic and social effects are easy to imagine. On the other hand, we reiterate our previous recommendations that follow-on programs be oriented toward a market economy such as will assure our farmers of fair prices and a fair share of the national net income.

As we stated last year, we believe it would be a terrible admission of defeat for the capitalistic economic system if the farmers of the Nation could not look forward to a market economy rather than a never-ending Government payment and regulated economy. To simply continue present farm programs would perpetuate the dependence of farmers on Federal Government payments for an increasing portion of their net income—now running in excess of 20 percent.

We recognize that in moving toward a reasonable balance between production and consumption, which is required for fair market prices, there must be a prudent use of governmental tools, including income supports, and careful timing to make the transition as free as possible from the social hardships which have characterized the mass migration from the farms during the last decade. Encouragement by the Federal Government of location of industries in rural areas is a major step that must be taken, along with job training and retraining programs.

We commend the administration and the Secretary of Agriculture for suggesting follow-on programs which move in the right direction for a change. There may be disagreements over just how or how fast to move. What is most important is that the inevitable compromises move deliberately and in the right direction taking into account the need to improve our favorable balance of agriculture trade.

We believe that serious consideration should be given to proposals to retire more cropland on a long-term bid basis. However, this should be done only if there is a limitation on the amount of land (measured by productive capacity) that could be retired in any community area; also employment opportunities for tenant farmers should not be unduly jeopardized in the administration of such a program. The Iowa State study mentioned above discloses that a long-term land retirement program of 60 million acres (compared to the well over 50 million acres now retired—mostly on an annual contract basis) would yield annual net farm income somewhat near present levels. (The study shows that a mandatory acreage retirement program would come out about the same way.) Also, such a long-term land retirement program would cost about $2 billion less than present programs; and some of these savings could be used for programs of rural economic development and social readjustment, or export incentives. Surveys show that farmers are overwhelmingly opposed to compulsory programs and greatly prefer voluntary programs with incentives for participation.

On the one hand, we state an objective of fair prices for farm produce in our domestic market. On the other hand, we state an objective of not only restoring but increasing our share of overseas markets—markets where competition from other exporting nations is keeping prices below those that obtain in our domestic market.

Achievement of both objectives will require some form of Federal Government incentive to producers. On this point article XVI, section B, of the General Agreement on Tariffs and Trade must be considered.[4] This has been interpreted (Annex I, Ad Art. XVI, par. 3) to mean that a system for the stabilization of the domestic price or of the return to producers *independently of the movements of export prices*, which results at times in the sale of the product for export at a price lower than the comparable price charged domestic consumers, shall not be invalid if the system has also resulted, or is designed to result, in the sale of the product for export at a price *higher* than the comparable price charged domestic consumers *and* also is operated in a manner not to unduly stimulate exports or otherwise prejudice the interests of other parties to the agreement.

It seems clear that direct subsidies would only be permitted to restore and/or maintain our export market. On the other hand, there is nothing to prevent the EEC, for example, from imposing an equivalent amount of countervailing duty to protect its own producers and thus denying access to our exports. Subsidies for exports to third countries in order to meet competition from other exporting nations could be effective—within the limitations of GATT rules. Accordingly, farm programs covering crops of which we are exporters should provide both the incentives and flexibility needed to meet different forms of competition in different markets, and at the same time, to do so within the GATT rules.

Limitation on Payments

There have been increasing complaints that present farm programs unduly favor large landowners. A recent analysis of payments to producers (excluding wool and sugar payments and undistributed funds) in 1968 reveals that payments in excess of $25,000 to individual producers totaled over $270 million. While comprising 8.5 percent of the total payments, these went to fewer than 0.2 percent of the 2.3 million producers. On the other hand, 67 percent of the producers received less than $1,000 each and only 18.7 percent of the total payments. The argument of the previous administration that smaller producers are benefited through better prices than would be received under surpluses resulting if large producers failed to come into the programs has a hollow ring in the face of the low parity ratio that has existed under these programs.

We note that the Secretary of Agriculture has recognized the need for a change by proposing a sliding scale of reductions in payments under which the first $20,000 would have no reduction, the next $10,000 would be reduced by 10 percent, the next $10,000 by 20 percent, and so on. Various other approaches have been suggested, most of them seeking to encourage larger producers to remain in the programs so that the surplus problem will not be aggravated. For example, one would encourage large producers to remain in the program, notwithstanding a payment ceiling, by relaxing their minimum

[4] "* * * contracting parties should seek to avoid the use of subsidies on the export of primary products [these include agriculture products]. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to *increase* the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having *more* than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a *previous representative period*, and any special factors which may have affected or may be affecting such trade in the product." [Italics supplied.]

acreage diversion requirements. Another would strike at the problem by limiting the coverage of price supports on the theory that, unless limited, they tend to benefit large producers. Still another approach would establish payment limitations by commodity groups, recognizing that there are more large producers in cotton than in feed grains, for example.

We do not take a position on any particular proposal, but we do believe some limitation approach should be adopted—one which will not, at the same time, defeat the very purpose of the programs—avoiding surplus production.

Bargaining Power for Farmers

One way for farmers to obtain better prices for their produce is to increase their bargaining power. Although this idea is quite popular, and there are a number of proposals before the Congress, it is not easily reduced to specifics. Moreover, as we pointed out last year, any increased farmer bargaining power could be easily undercut by unsound fiscal, monetary, and foreign trade policies of our Federal Government; accordingly, these policies should be harmonious with the goal of eliminating the cost-price squeeze.

Bargaining power might be increased somewhat by the extension of marketing order laws, now covering milk, to other commodities. However, it is unlikely that such an approach would work in the case of major crops and livestock; nor do we believe the producers would want it. At the same time, it might be possible to let producers of specialty crops have an opportunity to try the marketing order approach if they wish to do so.

Finally, "bargaining power" for farmers already exists in the form of cooperatives, and trends suggest that increased mergers and affiliations of farm cooperatives will provide growing strength at the marketplace.

Agricultural Research

One of the perennial comments in our minority views has been that the United States is not making full use of its vast research resources in finding industrial uses for agricultural commodities. We believe the present administration should reverse the policy of the previous administration of allocating the major portion of the USDA agricultural research budget to what may be called production research instead of utilization research. Actually funds proposed in the fiscal 1971 budget for utilization research are about the same as last year, while funds proposed for general farm research have been increased slightly. At the same time, we commend the administration for increasing USDA's research efforts toward control of pollution from processing of agricultural commodities and in seeking a better balance between crop and livestock research.

Recommendations

1. That Congress enact improved follow-on farm programs which will be oriented toward a market economy rather than a Government payment and regulated economy, and which will insure a more equitable distribution of benefits to our farming population than has

occurred under present programs, which clearly favor a relatively few large operators. Consideration should be given to retirement of more cropland on a long-term, bid basis, with limitations on the amount of productivity to be retired within a community area and with protection to tenant farmers on employment opportunities. There should also be a reasonable limitation on payments and/or price supports benefiting any one producer.

2. That the administration continue its efforts to stop inflation with a view to reducing interest costs and checking the increasing costs of other agricultural production items, and that the Congress cooperate in these efforts.

3. That strong emphasis be given to improving our agricultural balance of trade, and that the competitive position of our agricultural commodities in world markets be provided for, within the limitations of rules of the General Agreement on Tariffs and Trade, in structuring follow-on farm programs.

4. That our food-for-peace program be continued and well-funded, with appropriate amendments to improve its effectiveness, including the use of actual cost to the Government of commodities, including Government costs of price supports and certificates, in administering the programs.

5. That, in any future trade negotiations, vigorous efforts be made to lower or eliminate both nontariff and tariff barriers affecting not only agricultural but nonagricultural trade as well, and that any reciprocal agreements negotiated be fairly balanced between agricultural and nonagricultural products.

6. That the administration continue to encourage foreign governments to assume a fair share of the responsibility for curtailing the production of world surplus crops and not shift the burden of their own supply adjustment problems to other countries through import restrictions and export subsidies.

7. That, in establishing mechanisms to help farmers obtain more bargaining power, the fiscal, monetary, and foreign trade policies of the Federal Government be made harmonious with the goal of eliminating the cost-price squeeze on agriculture.

8. That our antitrust laws be reviewed with a view to amendments to make certain that farmer organizations are exempt in their negotiations for fair prices.

9. That the research activities of USDA be reoriented to give greater emphasis on the development of new and increased uses for agricultural products.

10. That a broad program be established to provide satisfying and self-fulfilling employment opportunities in rural areas to include—

(*a*) wherever possible, locating offices and installations, both Federal and State, outside the large urban centers, along with adequate housing facilities;

(*b*) awarding more Government contracts to firms located in rural areas;

(*c*) stepping up conservation and recreation activities as a new source of employment for rural unemployed;

(*d*) providing employment and counseling services to rural residents on a basis comparable to those provided urban residents.

THE UNITED STATES IN THE WORLD ECONOMY

As the 1960's drew to a close, significant developments were taking place in our international economic relations which will affect our policies of the 1970's. Some of these developments themselves had their origins more than a decade ago; our persistent balance of payments problem is an example. Others—such as the Special Drawing Right facility—open new fields of international growth and cooperation which stretch for decades to come. Notwithstanding their apparent distance from domestic affairs, the fields of international trade, aid, and monetary relations will offer challenges to the administration equally as severe as the task of maintaining balanced economic growth at home.

In the field of trade, our achievements in the Kennedy round of the General Agreement on Tariffs and Trade (GATT) are coming into effect, and our attention has shifted to the rising relative importance of nontariff barriers among other trading nations, including some of the Common Market countries, as a device for favoring their domestic agriculture and industries. Most of these barriers are substitutes for assistance based upon the generally accepted principle of adjustment and change in response to import competition; some of these barriers are inequitable at best, and at the worst a clear violation of the GATT rules. An additional issue in this regard is the present legal inability of the President in the absence of a new trade law to negotiate further tariff reductions as a reciprocity for liberalized trade by our trading partners.

We believe that the administration's trade bill, which was sent to Congress last November, and is presently pending before the Ways and Means Committee recognizes the major issues and goes far toward offering reasonable solutions. In particular, we note that the bill accords with recommendations which we made in 1968 and 1969 to grant the President limited tariff-cutting authority, to implement the American selling price (ASP) package negotiated during the Kennedy round, to liberalize adjustment assistance to firms or groups of workers injured by increased imports, and to provide a means for acting decisively against countries which compete unfairly against U.S. exports.

We shall follow with interest the course of this bill through Congress, and work for an act which will satisfy our—and the administration's—firm commitment to trade liberalization.

We also note that the Foreign Economic Policy Subcommittee of this committee has held two sets of hearings on trade and aid policy, as part of a series of hearings scheduled to take place throughout this session. Similar hearings held by this subcommittee 10 years ago helped provide the impetus which finally resulted in the Kennedy Round of tariff reductions. Considering the fact that world trade has grown by 110 percent since 1950, and that the issues now differ

in kind as well as degree from that date, we believe these hearings will be both timely and portentous in the development of a U.S. trade policy for the 1970's.

Because of these developments, this report need not address itself further to trade and aid policy issues.

In the international monetary field, we have also reached a watershed. After a decade which witnessed a continuing balance of payments problem for the United States and several speculative runs against other major currencies, the dollar is remarkably strong and the future for international monetary cooperation quite promising. The continued viability of the two-tier gold agreement has prevented drains of gold from official reserves. The ratification and activation of the Special Drawing Right facility, albeit on a relatively small scale, will hopefully ensure the continued growth of world reserves according to the demand imposed by increased international trade. The devaluation of the franc and the revaluation of the German mark have brought the parities of these currencies more into line with reality, and successfully dampened the rather large speculative capital flows which preceded each action.

As we note in more detail below, however, much remains to be done.

We do not believe that the current strong state of the dollar should allow us to turn our eyes away from a continuing balance of payments problem at home, and a continuing international payments adjustment problem abroad. In this regard, we believe that the apportionment of the burdens of achieving monetary stability, which presently enables some countries to maintain disproportionately strong payments positions, needs to be reexamined. We are concerned with the inadequacy of institutions to channel capital into developing countries. And although the Eurodollar market has helped improve capital markets in the industrialized world, we view with some discomfort its uncontrolled and potentially troublesome character.

The U.S. Balance of Payments—A Continuing Problem

In 1950 the United States registered a $3.5 billion deficit in its balance of payments, on a liquidity basis. This was a record at the time; however, it was only the beginning of a 20-year period, lasting to the present, during which U.S. liquidity deficits have averaged $2.2 billion per year. This measure of our balance of payments was in deficit by $6.98 billion in 1969. Total liquid liabilities to all foreigners now amount to approximately $44 billion. Testimony by private as well as administration witnesses cautioned against being optimistic about our long-run balance-of-payments picture.

From 1950 to 1958, when the major European currencies achieved external convertibility, the liquidity deficit was a byproduct of our deliberate policy to fill the "dollar gap" between the existing and the desired amounts of international reserves needed for conducting growing amounts of both private and official transactions. During those years we encouraged American travel and direct investment abroad, engaged in considerable offshore procurement in our military and economic assistance programs, and tolerated the exchange and trade restrictions imposed by others. Our deficits were not large enough, according to most economists, but even at these levels they were the major factor in the rebuilding of Europe and Japan.

In 1958 our balance-of-payments deficit rose sharply. This coincided with a time when the rationale for continued deficits was beginning to weaken, for the official holdings of gold and foreign exchange reserves of other countries were being brought up to levels which central bankers of those countries found desirable. With no end to U.S. deficits in sight, concern began to be raised about the strength of the dollar, and our deficits began to be reflected increasingly in foreign demands upon our gold reserves.

We regret that until 1969 the Government response to this balance-of-payments problem was, for all practical purposes, a long-term and apparently ineffective effort to achieve a payments surplus by restricting capital movements and distorting free market forces.

In 1959 development loans were tied to purchases of U.S. goods. Up until that time this and other foreign aid programs had operated under a policy of "worldwide procurement," whose purpose was to employ aid funds as efficiently as possible. In the following year similar restrictions were placed upon grants-in-aid. In 1962 the use of dollar grants to finance local costs of aid projects was tied to equivalent U.S. purchases, through irrevocable letters of credit. In 1966 new development assistance was subjected to the requirement of additionality, which required aid to be spent on certain U.S. commodities which would not otherwise have been purchased.

In 1961 the Defense Department instituted a policy of utilizing U.S. supplies and services overseas where the price differential between the U.S. product and its foreign counterpart was 25 percent or less; this figure was changed to a minimum of 50 percent the next year. In 1967 the 50-percent formula was imposed on a government-wide basis.

In 1963, President Kennedy proposed the interest equalization tax (IET) in order to stem the outflow of investment capital. While its purpose was euphemistically called "interest equalization," an examination of interest rate structures here and abroad compels the conclusion that the IET was merely a protective tariff on the importation of foreign securities. The IET has been renewed on three occasions, and at the start of the present administration it had the effect of a 15-percent premium on foreign-owned common stock.

In 1965 President Johnson instituted a voluntary program for limiting capital exports associated with foreign direct investment and foreign lending. Although the program was partially successful—the foreign credit restraint program of the Federal Reserve continues to this day—it was largely over-shadowed by the Vietnam buildup in 1966 and the increased payments deficits which our military commitments directly or indirectly brought about. The burgeoning foreign exchange costs of Vietnam and other military programs, a sudden rise in imports, and the continued pace of direct investment abroad in spite of the voluntary program placed strains on the international monetary system as well as the dollar.

In January 1968, President Johnson therefore announced a new set of controls and other measures. The voluntary program for foreign direct investment was made mandatory. The Federal Reserve foreign credit restraint program was tightened, and the Board was given standby authority to impose mandatory controls. The Treasury Department was instructed to develop ways to curb foreign travel, which resulted

in an administration proposal to tax tourist expenditures abroad and to reduce the value of allowable duty-free purchases by U.S. tourists abroad. Increased resort was made to special financial transactions, including military offset transactions, to improve our balance of payments statistically without any impact on our real payments position. These special transactions accounted for a $2.8 billion statistical improvement in our balance of payments in 1968.

The new administration therefore inherited a deteriorating balance-of-payments situation, a seriously weakened trade surplus,[1] a fragmented balance-of-payments strategy, and a modest payments surplus which was supported by a significant amount of "window dressing" financing.

Since assuming office the President has begun slowly to dismantle the complicated set of controls which were imposed over the last decade—and especially the last 2½ years. In April 1969 the Office of Foreign Direct Investments announced the first liberalization of its rules, the chief feature being a rise in the minimum investment quota from $200,000 to $1 million. On January 1 of this year, the quota was raised to $5 million for companies investing their additional funds in less developed countries. The Federal Reserve credit restraint program has been altered to facilitate the financing of U.S. exports. Although the President asked for renewal of the IET last June, he has reduced the rate to an effective 11.25 percent. Finally, the Treasury Department has reverted to its pre-1968 policy of allowing the level of special financial transactions to be governed by market forces, which resulted in a shift of $3.45 billion in this account.

While the new administration's measures show some signs of progress toward eventually doing away with burdensome controls, we believe that these restrictions on capital movements have outlived whatever usefulness they may have had, and that their long-run effect will be negative. We therefore urge the administration to proceed with dismantling these restrictions at a faster rate, and as an immediate first step to remove the minimum investment quota for investment in lesser developed (schedule A) countries.

Testimony by the Council of Economic Advisers pointed out that the balance of payments in general cannot serve as a justification for long-maintained restrictions. Such restrictions not only tend to misallocate our resources into inefficient and obsolescent industries; they also deny to expanding U.S. industries the markets—and the long-term balance-of-payments gains—which would maintain this country's economic strength. They result in a loss in real income which must be weighed against the balance-of-payments considerations favoring controls. They raise diplomatic problems when their effect on foreign industries or financial institutions becomes marked. They present a picture to the world of a country with uncontrolled and uncontrollable inflation whose economy is in fact very strong.

Our recommendation that the minimum investment quota for developing countries be removed accords with our discussion, below, on the need for developing stronger institutions for directing capital flows to these countries.

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[1] Actually the "surplus" was a deficit if only commercial exports and imports—excluding government-financed exports—are counted.

We note with approval that the April 1969 statement by the President on the balance of payments places emphasis on developing the fundamental conditions for sustained balance-of-payments equilibrium and a balance-of-trade surplus, while at the same time dismantling the network of direct controls. We believe the most fundamental of these conditions is a restoration of noninflationary growth in the domestic economy.

Inflation works two ways to inhibit a trade surplus. Excess demand-induced price inflation provides a market for increased imports; thus, merchandise imports in this country have grown more than 92 percent from 1964 levels. Domestic inflation also tends to make U.S. goods less price competitive overseas; U.S. exports for the 1964–69 period increased only 43 percent, and our terms of trade (unit value of exports compared with the value of imports) over the same period were significantly poorer than those of the free world as a whole. **Until price inflation is brought down, and domestic demand is reduced as well, we shall probably not be able to develop the conditions necessary for regaining a healthy trade surplus.**

However, we also believe that, notwithstanding the lipservice which has been paid to export promotion in the past, our efforts fall far behind those of other countries. Our historical success in developing the domestic economy has been partly responsible for this; for American business has generally found fertile markets at home, and the incentive to export is not very great. Those firms which do sell abroad often have the resources to invest directly, thus frustrating any balance-of-payments gain which would arise from exporting U.S. manufactures. The President's balance-of-payments statement sets a goal of a 10-percent per year expansion in our exports between now and 1973. This compares with 8 percent over the previous 5 years. Our export experience thus shows that neither the organization nor the proper incentives yet exist for the kind of export expansion which will be needed in the seventies, despite the laudable efforts now being made by the Export-Import Bank.

The last significant and imaginative organizational proposal in the field of export expansion was made by President Eisenhower in 1960, with the creation of the National Export Expansion Council. This Council, drawing upon the volunteer talent of major international businessmen throughout the country and backed up by regional councils, has over the years become the major vehicle for government-industry cooperation in the field of exports. It serves primarily in an advisory capacity to the Secretary of Commerce on matters of U.S. foreign trade policy and performance.

We would be most reluctant to propose new organizations for accomplishing essentially what existing ones have set forth to do. However, **we believe that the seventies will call for a vastly increased effort at export expansion in order to keep pace with the market opportunities abroad, the increased complexities of international business which cut across departmental lines, and the rising levels of commercial imports.**

Therefore, we recommend that the President examine and report on the export expansion apparatus of this country in order to find out how it can be utilized more effectively to help achieve our export goals of the seventies.

Our basically domestic orientation and the consequences which this has for increasing exports can be seen not only in the conduct of domestic business enterprises, but also in legislation. Nothing in the Congressional statements of transportation policy, for example, reflects the fact that the price competitiveness of an exported good will often depend upon the domestic (U.S.) surface or air tariff. A recent Interstate Commerce Commission case interpreting these statements as well as the Interstate Commerce Act ruled out the balance of payments as a factor to be considered when deciding the lawfulness of transportation charges for certain export products.

The United States Travel Service, which is responsible for attracting foreign tourists and is therefore responsible for redressing the extremely poor balance in our travel account, is still a small office in the Commerce Department funded at $4.5 million per year. It corresponds to the several, cabinet-level tourism agencies which can be found abroad and which are funded at many times the U.S. effort.

Our antitrust laws ignore traditional business practices overseas and thus place U.S. corporations who must compete with foreign cartels at a substantial disadvantage. Our tax code, unlike the codes of most industrial countries, provides inadequate incentive for a domestic firm to export.

Even our immigration laws affect our balance of payments by inhibiting foreign direct investment in this country: the executives of foreign firms investing here must wait many months before getting permission to enter this country for the purpose of managing U.S. subsidiaries.

The subject is of course a large and complex one. It will demand a persistent and searching examination of present and future legislation in order to ensure that our international interests become expressed in our laws. Two recent proposals are of interest.

The Treasury Department has recently sent to Congress a proposal to place the tax treatment of exporters more on a par with those international corporations which earn their income abroad. **We believe that this Domestic International Sales Corporation (DISC) proposal is a promising first step in developing modern export incentives.**

We also note that the administration intends to increase the appropriation for the U.S. Travel Service, for fiscal year 1971, from the present $4.5 million to $6.5 million. **We have consistently urged increased funding for USTS and believe that the administration move, while commendable, falls short of the real need and the real opportunities.** Legislation is presently before Congress which would raise the authorization ceiling to $15 million. This latter figure reflects more accurately the scale on which our international tourism efforts must be taken if they are to achieve needed results.

Balance-of-Payments Accounting

We believe that our balance-of-payments accounting should reflect more realistically the implications of the large and growing amount of foreign direct investment, not only by U.S. investors abroad but by foreign investors in this country. Thus, we recommend that the executive publish a balance-of-payments series which projects our capital account into the future, in order to provide an understanding of the likely future repatriated earnings of present foreign direct

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investment. Such a series would supplement, but notsu bstitute for, the conventional balance-of-payments accounting on the liquidity and the official settlements basis.

At the present time, an overseas direct investment of funds originating in the United States is recorded as a deficit in our balance of payments. Nevertheless, this investment is usually reflected in later years by repatriated earnings. A 1963 study by the Brookings Institution, using a methodology developed by the Treasury Department, concluded that the weakening in the balance of payments caused by new foreign direct investment is eventually matched by the cumulation of annual inflows of funds resulting from the original investment somewhere between the fifth and sixth year following the investment. While conventional balance-of-payments accounting can tell us much about the first-year effects of the investment, it cannot shed as much light on the medium- and long-term implications of the outward capital flow. On the other hand, while the series we recommend is not intended to express our current liquidity position, it will enable policymakers to make more informed judgments about actions, such as direct controls on capital movements, which affect the future level of foreign direct investments.

THE U.S. BALANCE OF PAYMENTS—WHO SHOULD BEAR THE BURDEN OF ADJUSTMENT?

The process of adjustment entails both an individual and a collective effort. As the preceding section implies, the United States has a primary individual responsibility to conduct its domestic affairs in a way that does not impair the world monetary system. This responsibility is all the more pressing given the leading world role of the dollar. Testimony before this committee pointed out that the administration's determination to bring inflation under control is one of the factors contributing to the stability of the dollar at the present time. We also note that both the present and past administrations have taken the lead in improving the machinery of the international monetary system. **Subject to our misgivings about export performance, we believe that the United States cannot be faulted for avoiding its individual responsibility both to improve its internal postition and to help develop a stable world economy.**

However, since the dollar is *sui generis* as a reserve currency in demand by other countries as well as the currency to which other par values are pegged, **we believe that it is essential and proper to raise the question of burden sharing when discussing the U.S. balance of payments.** And since the balance of payments was a matter for concern some years before the recent inflation and a declining trade surplus became major issues, **we doubt whether the United States can unilaterally achieve long-run balance-of-payments equilibrium. Therefore, we fully support administration statements in the balance-of-payments and foreign policy messages to the effect that the apportionment of burdens and responsibilities in achieving international monetary stability must be altered.**

Collectively over the past 2 years we have come a long way toward developing institutions which will assist in the adjustment process.

The two-tier gold agreement in March 1968 all but eliminated the threat that liquidity deficits would be translated quickly into claims

upon our gold reserves. The December 1969 IMF agreement governing South African gold, by addressing itself specifically to a problem raised by the two-tier agreement—the disposition of newly mined gold, lent an implicit official sanction to the two-tier agreement which it formerly did not enjoy.

The activation of the Special Drawing Right facility, and its use in recent weeks, will hopefully insure that member countries of the IMF can augment their reserves according to the requirements of increased world trade without unduly impairing the reserves of deficit countries.

These particular collective efforts have contributed much in the way of protection to the international monetary system; they have also given IMF member countries more room for maneuver. Notwithstanding these benefits, however, they have not eliminated the problems caused by the fact that some countries have adopted policies in the postwar period which aimed at persistent balance-of-payments surpluses in order to accumulate additional reserves. Nor do they facilitate adjustments in the system which may be necessitated by the conflicting policies of individual countries or the misalinement of exchange rates. **We believe the areas where the issue of burden sharing becomes most apparent are harmonizing economic policies, allocating the costs of defense expenditures, and adjusting exchange rates.**

Harmonizing economic policies.—Interdependence carries with it the need and responsibility to consult with one's partners before he takes any bold steps. In the international economic sphere, rates of economic growth, rates of inflation, expected public and private investment abroad, and interest rate policies all have an effect on capital flows and the balance of payments. We are satisfied with the many forums which exist for consulting with the economic policymakers of other governments on matters of harmonizing domestic policies—forums which are discussed in part on page 165 of the Economic Report. **However, we are concerned over some examples of poor coordination—notably the premature cashing by Germany of $500 million in U.S. Treasury notes—and we fail to see any evidence of an announced and coordinated interest rate policy.**

Allocating the costs of defense expenditures.—According to testimony filed with the committee by the Treasury Department, military expenditures accounted for approximately $4.8 billion of the 1969 balance-of-payments deficit. This has been a consistently large item; overseas military expenditures amounted to $3.1 billion in 1960. A little more than a third of the present deficit can be traced to the U.S. effort in Vietnam and thus is tied to the overall level of activity in that conflict. But another third, or approximately $1.6 billion in annual deficits, can be traced to our NATO activities. Additional costs can be traced to our long-term defense establishment in Japan. Dr. Houthakker pointed out to the committee that our dollar contributions to the security of Germany and Japan have enabled these countries to concentrate on the improvement of the efficiency of their private industry. Even at the present time, the defense effort of these countries—measured by the level of defense outlays as a percentage of GNP—is but a small fraction of that of the United States. **Under such circumstances, the rationale for our large military balance-of-payments costs in NATO and in Japan simply cannot be sustained.**

Twenty-five years after the end of World War II, actions should now be taken to reduce these unacceptable costs. This does not call for a strategic shift in our forces abroad unless military strategy—not financial reasons—so dictates. But it does call for better financial arrangements for such forces.

Past administrations have utilized military purchase agreements and loan agreements to offset the balance-of-payments costs of these overseas defense efforts. We believe that such procedures not only obscure the issue, but also damage our balance of payments in the long run. Military purchase agreements cannot be considered a dollar-for-dollar offset, since some of these military purchases would probably have taken place without the agreements. Ironically, we felt free for some years to impose so-called additionality requirements on the developing countries in our aid agreements with them in order to avoid this phenomenon. A good argument can be made that more such purchases might be made if the United States were to keep fewer troops in NATO, thus requiring greater outlays for defense materiel on the part of other NATO countries.

The offset loan agreements, of course, merely postpone balance-of-payments costs, and in the meantime the United States must pay interest—which is exempt from all present and future U.S. taxes—on these loans. The fact that offset loans cannot be taken for granted was demonstrated last January with the unannounced and premature cashing by Germany of $500 million in offset paper.

Not coincidentally, the countries where this phenomenon is most aggravated, Germany and Japan, currently enjoy surpluses with both the world at large and the United States.

We urge the administration to follow through strongly on its intention to share the burden of the common defense and to initiate negotiations for reducing our military balance-of-payments costs. At a minimum, these negotiations should aim at a real balance-of-payments offset through the direct payment by the host government of the wages of local nationals, construction costs, and the costs of such services as transportation and communications. One particularly trying practice, which should be terminated even prior to the institution of across-the-board negotiations, is the payment by the U.S. Government of foreign taxes in connection with our military activities abroad.

Adjusting exchange rates.—The procedures under which exchange rates are adjusted are governed by article IV of the Bretton Woods agreement which established the International Monetary Fund. At the time the agreement was signed (1944), the chief concern among monetary planners was how to avoid the economic disasters of the thirties, and specifically the competitive devaluations which afflicted the international economy at the time of our depression. In view of this threat, made very real by historical experience, article IV set forth a system of exchange rates moving within fairly narrow bands; collaboration with the Fund in order to avoid competitive exchange alterations; changes in parities only to correct fundamental disequilibrium; and sanctions for unauthorized changes. The system was not intended to establish a rigid exchange rate system, but it has generally been considered the major factor in achieving exchange rate stability in the postwar years.

Considering the pace of postwar development, the Bretton Woods signatories drafted a remarkably durable agreement. However, the very success of the agreement at facilitating international transactions, plus the political reluctance of countries to revalue their currencies, have revealed some of the weaknesses of the system.

Ironically, one of the weaknesses has been the relative absence of pressures in the system for revaluating an undervalued currency, the one contingency which was not given very serious thought in the thirties. The speculative flows associated with such a situation tend to strengthen rather than weaken the reserve position of the country in question; thus, the economic incentive to revalue is relatively small. Not surprisingly, devaluations since World War II have outnumbered revaluations by a wide margin.

Among major countries, political pressures also tend to postpone beyond the appropriate time a decision to devalue a currency. The delay invites large movements of speculative funds away from the overvalued currency, thus weakening the reserve position of the country in question and causing speculative turmoil in international capital and foreign exchange markets.

Because the dollar plays a passive role in the exchange rate adjustment process, the United States has no shortrun option but to weather these occasional speculative storms. But since dollars are inevitably involved in the course of currency speculation, and since an undervalued currency will tend to attract our dollars in the normal course of trade, the effect of prolonged parity misalinements on our balance of payments and our financial relations can be considerable.

While we believe that the devaluation of the franc and the revaluation of the German mark in the past year have contributed substantially to the present stability of the exchange markets, we note that these exchange adjustments were preceded by an unfortunate amount of uncertainty and speculative activity.

Therefore, we urge the administration to lend its full support to the efforts now underway at the IMF to draft an improved procedure for exchange rate adjustment.

In view of the complexity of the subject and the honest grounds for difference on individual plans, we do not intend at the present time to endorse any particular procedure as being preferable to others. However, we believe that any amendment to article IV must provide for a more automatic and less discretionary means for exchange rate adjustment, both upward and downward, in order to harmonize international exchange rates.

Facilitating Capital Flows to Less Developed Countries

Notwithstanding their identical effect on the balance of payments, dollar flows from the United States to the less developed countries have different implications than flows to the developed ones. Because the capital-short governments of the developing world tend to spend their convertible reserves rather than accumulate them, dollar outflows to those governments are likely to show up within a short time as claims upon the manufactures and services of the developed world. Taken altogether, capital flows from the developed to the less developed world tend to have only short-term balance-of-payments effects.

Therefore, our balance-of-payments problems can be generally traced to industrial countries. The widely touted deterioration of our trade surplus, for example, cannot be blamed on our relations with developing countries, where merchandise exports and imports registered a $1.9 billion surplus in 1969. In our AID program the practice of tying, together with the inflows coming from interest payments on prior loans, have resulted in annual balance-of-payments gains since 1967. Net capital outflows attributable to direct investment in developing countries in 1968, the latest year for which statistics are available, were only $1.1 billion, a figure which was more than offset by our trade surplus with those countries in the same year. Development lending through international institutions has generally favored our balance of payments, since the subscriptions of other donor countries are sometimes used to purchase U.S. manufactures and the headquarters of most of these organizations are located in the United States.

Notwithstanding these facts, we note with regret that misconceptions still persist as to the true burden which the foreign aid process involves. In order to cast this burden in a more accurate light, we believe that our balance-of-payments statistics should be presented so that the breakdown between our balance with developed and developing countries is readily apparent.

We also believe that both the United States and the developing world can stand to gain through the establishment of more effective incentives and institutions for promoting the capital flows which are necessary to direct additional real resources into less developed countries. We urge that the President give serious consideration to improved tax incentives for this purpose, also to the recommendations of the recently published report of the Task Force on International Development (Peterson Commission). We welcome the establishment of the Overseas Private Investment Corporation, which will in time become a major factor in directing U.S. private capital, especially in association with private capital of other capital-exporting countries, into capital-short areas of the world.

In the past year the International Exchange and Payments Subcommittee of this committee has formulated a proposal to use the special drawing right device as a means of financing aid. The plan envisaged by the subcommittee would involve an amendment to the

IMF articles of agreement to direct a proportion of the industrial countries' quotas of SDR's automatically back to the Fund, where the proceeds of their sale would be channeled through the International Development Association into economic assistance projects. While the amounts involved would necessarily be modest and while we harbor no illusions over the reception which this plan is likely to get among other industrial countries, we believe that the United States should take the lead in perfecting this promising and symbolically important plan.

We recommend that the President as a first step submit legislation to utilize this device for adding to the U.S. contribution to the International Development Association which is due in November 1970.

GOLD AND SDR'S

With the conclusion of the SDR amendments to the IMF Articles of Agreement, the way was paved for creating new reserve assets similar, and in some respects superior, to gold. **During the SDR negotiations proposals were made to allow SDR's to be used instead of gold for the required 25 percent "gold subscriptions" towards countries' IMF quotas. We believe that SDR's should be allowed to be used for this purpose.**

This proposal, which would require an amendment to the IMF Articles of Agreement, reflects the guarantee which IMF members have given to SDR's and the relatively declining role of gold in the world monetary system. During hearings of the Subcommittee on International Exchange and Payments last fall, Under Secretary Secretary Volcker raised this proposal as a possible favorable development for the use of SDR's. Other witnesses at the same hearing emphasized the inevitable decline in the amount of gold as a percentage of world reserves, with all that this implies for the role of gold. Now that the IMF Board of Governors has approved a needed quota increase for the Fund, they should take the next step and negotiate the use of SDR's for the gold subscription in future increases on a trial basis.

Either SDR's, the new reserve asset, carry a guarantee equivalent to gold or they do not. We believe that this guarantee would be reaffirmed if SDR's were put to this additional use.

EURODOLLARS—A HELPFUL HAZARD

For the international banker 1969 was the year of the Eurodollar. Generally speaking, Eurodollars are interest-bearing U.S. dollar deposits abroad (including deposits in the foreign branches of U.S. banks). The "Euro" prefix reflects the fact that most Eurodollar activity takes place in Europe, although banks in Canada and Japan also carry large dollar liabilities. According to figures published in the Economic Report the Eurodollar market has grown from an approximate $9 billion level in 1964 to about $25 billion in 1968. Indications are that this market is still growing.

The events of 1969 proved the importance and also the potential danger of this uncharted and uncontrolled market. At a time when monetary policy was placing a squeeze on liquidity in this country and regulation Q ceilings prevented banks from attracting funds into savings accounts and certificates of deposit, U.S. banks were able to resort to the unregulated Eurodollar market in order to meet loan commitments and to satisfy the remarkably strong demand for commercial investment capital.

Borrowing from this source reached a peak of more than $14 billion during the summer of 1969; and the high interest being paid on Eurodollar deposits forced some European countries to place curbs on the outflows from their own domestic capital markets. Some of these curbs—notably those of France, Belgium and Italy—arose from domestic considerations somewhat unrelated to Eurodollar borrowing. Nevertheless, their effect on the Eurodollar market was pronounced.

The Eurodollar market attracted deposits from U.S. depositors as well, giving rise to circular flows of capital as the money was reborrowed by U.S. banks. Because of differences in reserve requirements, and other factors, this circular flow tended to increase the amount of available credit at a time when the Federal Reserve Board was trying to limit it. The flow also tended to redistribute bank reserves away from smaller banks into those large ones which are active in Eurodollar borrowing. On September 4, the Federal Reserve Board imposed a reserve requirement on Eurodollar deposits in U.S. branches overseas, which had the effect of making this source of funds more expensive.

The implications of this chain of events have not yet been fully digested. Under Secretary Volcker pointed out that the circular flows of dollars showed statistically as a liability in our liquidity balance; the effect was estimated at $2½ to $3 billion toward our liquidity deficit last year. There can be no doubt that Eurodollar borrowing may have blunted the effect of monetary policy during 1969, but the extent of the blunting and the effect of Eurodollar flows on the redistribution of investment capital are matters for speculation. There was also speculation before the committee whether the easing of the domestic credit situation would prompt a large reverse flow, as U.S. banks acted to reduce their high-cost borrowings of dollars on deposit abroad. Under Secretary Volcker conceded that one probable result of any credit easing in the United States would be a deficit in our official settlements balance for 1970, since a reflux of dollars abroad would bring some of these dollars back into official hands.

While the Eurodollar market was able to finance the needs of commercial banks in 1969, we are not confident that it is immune from abuse in its present state. As we have seen, Eurodollar activity can influence capital markets and the reserve positions of major countries throughout the world; it has implications for the effectiveness of stabilization policy at home.

We have also seen that the Eurodollar market in turn can be adversely affected by the domestic policies of several countries. **With the 1969 experience behind us, we believe that the present affords us a good opportunity to examine the workings of the Euro-**

dollar market more closely and to plan realistically for its use as a complement to our domestic and international economic policies.

Senators	*Representatives*
JACOB K. JAVITS	WILLIAM B. WIDNALL
JACK MILLER	W. E. BROCK 3d
LEN B. JORDAN	BARBER B. CONABLE, Jr.
CHARLES H. PERCY	CLARENCE J. BROWN

[Note refers to "The State of Agriculture in 1969," p. 106]

NOTE.—It is vital to the national economy that the parity ratio be improved. If net farm income were to erode, there would be a serious adverse impact on the general economy, including particularly agribusiness which employs over 20 million people. A recent economic study by Kansas State University concluded that, on the average, each dollar of farm income generated $3.33 of the total income as compared to $1.46 total income generated by the average dollar of nonfarm income. A second, and perhaps even more significant, fact relating to farm income and its disposition is the point that almost 85 percent of the Nation's farm income is expended in the nonfarm sector.

While the number of farmers has declined sharply in recent years, agriculture is still the largest single consumer of steel, rubber, petroleum products and chemicals in the Nation. It is true that the farmer has become increasingly dependent on nonfarm inputs for crop and livestock production, but at the same time, the strength and vitality of the rest of the Nation's economy is highly dependent on agriculture.

SUPPLEMENTARY VIEWS OF SENATOR JACOB K. JAVITS

The Minority views contain a section entitled, "The Need for Economic Stability." This is a fine analysis of the anatomy and dangers of inflation. But already in the rapidly changing economic situation, I believe inflation is no longer the primary problem still facing our economy.

The primary problem now facing our economy, the economic planners in the administration and the Congress is to avoid a serious recession with unacceptable unemployment and to get our economy moving again—from the present practically negative rate of real economic growth to a 4 percent real annual growth rate.

We must be sobered by the fact that we are already in a mini-recession or on its threshold. It is not yet clear whether from this transitional period will emerge a strengthened stable economy, a continuing inflationary spiral or a recession deeper than any presently foreseen. Because of this, it is critically important that we aim at the right target, and in my view this target must be a sustainable rate of economic growth.

In my view, this is the principal target because I am convinced that the highly restrictive monetary and fiscal policies of 1969 and early 1970 will soon begin having their repressive effect on the price level. It would be a great illusion and involve even more danger of a recession to project policy to attain a zero price increase. Let us recognize that to encourage optimum productivity and employment, if our annual price increase is in the range of 2 percent, we would be doing far better in terms of price stability than most of the other developed countries of the world and doing enough to maintain and improve our international competitive position.

Turning to monetary policy, I trust that monetary policy has already shifted toward ease.

What we faced in the last 6 months of 1969 extending into 1970 was monetary repression—not monetary restraint. If this country is to avoid a serious recession, monetary policy must be eased gradually, and now. This easing should initially be in the 3 percent range and then move to the 4–5 percent range as the economy moves out of the temporary valley of reduced growth toward steady economic growth in the context of reduced inflation. In this regard, it is encouraging that the administration's originally proposed $1.3 billion surplus will not be a shibboleth. The administration has adopted the right course in easing its fiscal policy in an effort to get the economy—especially housing—moving again, even though this might move the budget into a slight deficit position. Shifts of a few billion dollars one way or the other in relation to the balanced budget line need have little substantive meaning in a trillion dollar economy—it is the order of magnitude of a reasonable budget balance which is vital.

COMMITTEE AND SUBCOMMITTEE ACTIVITIES IN THE PAST YEAR

The Employment Act of 1946 (Public Law 304, 79th Cong.) requires that the Joint Economic Committee file a report each year with the Senate and House of Representatives setting forth its findings and recommendations with respect to each of the main recommendations made by the President in the Economic Report. The statute requires filing by March 1, but in view of the late convening of the Congress this year and the fact that the President's Economic Report was submitted later than usual, the filing date was extended to April 1. This report is submitted in accordance with that requirement. It is intended to serve as a guide to the several committees of the Congress dealing with legislation relating to economic issues.

The terms of the act require the President to set forth in his report to the Congress, among other things, current and foreseeable trends in the levels of employment, production, and purchasing power; a review of the economic program of the Federal Government; a review of economic conditions affecting employment in the United States; and a program for carrying out the policies of the act, together with such recommendations for legislation as he may deem necessary or desirable.

The work of the full committee and the subcommittees for the past year is summarized below:

FULL COMMITTEE

January 1969 Economic Report of the President

On January 17, the committee began hearings on the 1969 Economic Report of the President, receiving testimony from the outgoing Secretary of the Treasury, the chairman of the Council of Economic Advisers, and the Director of the Bureau of the Budget. In mid-February, the committee resumed its hearings and for 8 days received testimony from the newly appointed Chairman of the Council of Economic Advisers, Secretary of the Treasury, Director of the Bureau of the Budget, Secretary of Labor, Secretary of Commerce, Under Secretary of the Treasury for Monetary Affairs, Chairman of the Board of Governors of the Federal Reserve System, former Special Representative for Trade Negotiations, academic experts, and representatives of labor and business. The printed record of the hearings, in four parts, contains in part 1 the testimony of the outgoing administration witnesses, together with a U.S. Treasury Department report entitled "Maintaining the Strength of the U.S. Dollar in a Strong Free World Economy"; further testimony in parts 2 and 3; and in part 4 invited comments from organizations representing financial institutions, business, labor, agriculture, and economic research groups.

The 1969 Joint Economic Report

The annual economic report of the committee was filed with the Congress on April 1, the March 1 deadline having been extended by unanimous consent. The report also contains minority, supplementary and dissenting views. (H. Rept. 142, 91st Cong., first sess.)

The Economics and Financing of Higher Education in the United States

In October, the committee released a compendium of papers by 27 authorities on the financial structure of higher education today. This compendium is intended to serve as a means of focusing attention on the serious economic issues confronting our higher education system and to provide a context within which the essential debate on the future of higher education might take place, both within and outside the Government. The study is divided into six parts: part I, an introduction to the structure and economics of higher education; part II, efficiency and equity in higher education; part III, the quality of output and the costs of higher education institutions; part IV, the structural outlook for institutions of higher learning; part V, the economic prospects for private institutions of higher learning; and part VI, financing higher education in the 1970's, covered by two sections: section A, the potentials for non-Federal higher education financing, and section B, strategies for Federal financing of higher education.

SUBCOMMITTEE ON ECONOMIC PROGRESS

The subcommittee continued staff analysis of requirements in the human resource sector. Preliminary research was undertaken on the subject of energy resources of the United States, looking toward completion of a study in 1970.

Staff study of public facility financing requirements of States and localities continued throughout the year.

Members of the Subcommittee on Economic Progress are Representative Wright Patman (chairman), Representatives Martha W. Griffiths, William S. Moorhead, W. E. Brock 3d, and Clarence J. Brown; and Senators William Proxmire, J. W. Fulbright, Herman E. Talmadge, Len B. Jordan, and Charles H. Percy.

SUBCOMMITTEE ON ECONOMY IN GOVERNMENT

Guidelines for Estimating the Benefits of Public Expenditures

The Joint Economic Committee has had a long-standing interest in the question of applying economic criteria to public investments. In recent years, this concern has focused on the procedures employed in the planning-programing-budgeting system. In May, the subcommittee held 2 days of hearings on the procedures applied by Federal agencies in evaluating the economic benefits of public expenditures, with particular attention given to the dual problems of informing the legislative branch of the value of PPBS and encouraging the Bureau of the Budget to frame guidelines for agency use for the calculation of expenditure benefits. Testimony was received from Government officials and academic experts.

The Economics of Military Procurement

In May, the subcommittee released a report entitled "The Economics of Military Procurement." This report is based on hearings held by the subcommittee in November 1968 and January 1969. The report documents the enormous waste and inefficiency in the Department of Defense and further suggests that these practices have wasted the taxpayers' dollars and created an inflated defense budget.

The Military Budget and National Economic Priorities

Ten days of hearings were held in June on the relationship of military spending to civilian spending, and the need for the Government to balance its expenditure policy. The subcommittee heard a variety of viewpoints ranging from those who were critical of the defense budget to those who believed our present rate of military spending must be maintained or increased over the next few years. Many witnesses focused their testimony on how to eliminate waste and inefficiency in the Federal budget. The hearings concentrated on the size of the military budget in relation to other national needs and the outlook for defense spending in the 1970's. Witnesses were Government officials, former Government officials, members of the Senate, academic experts, representatives of labor, business, and private research groups.

The Economic Basis of the Russian Military Challenge

The subcommittee's examination of the U.S. military budget n the light of overall national economic priorities led to two additional days of hearings in June on the "Economic Basis of the Russian Military Challenge." Witnesses were outstanding experts who have long followed the course of events in the Soviet Union and the subcommittee received their appraisal of current developments and near-term prospects in Soviet affairs. It was the subcommittee's objective to obtain the best and most current information dealing with such matters as the rate of economic growth in Soviet output; the proportion of its output going to the military, present and prospective; the progress of projected plans for farming, housing, and consumption; changes in the decisionmaking process and the influence of China and Czechoslovakia on the course of developments within the Soviet Union and among the other members of the bloc.

Based upon the above 12 days of hearings, the subcommittee released its report entitled "The Military Budget and National Economic Priorities" in December. The report contains a discussion of military and civilian priorities, a comparative analysis of the United States and Soviet military budgets, recommendations, and supplementary views.

The Analysis and Evaluation of Public Expenditures: The Planning-Programing-Budgeting System

In June, the subcommittee released a three-volume study entitled "The Analysis and Evaluation of Public Expenditures: The Planning-Programing-Budgeting System," containing papers by 57 economic experts who are recognized authorities on Government spending. This study lays out, in a comprehensive way, the principles which must be adhered to in analyzing and evaluating spending programs.

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Moreover, it provides the advice of economic experts on the kinds of analyses which should be undertaken in all the major functional areas of the budget. Volume 1 contains three parts: Part I, the appropriate functions of Government in an enterprise system; part II, institutional factors affecting efficient public expenditure policy; and part III, some problems of analysis in evaluating public expenditure alternatives. Volume 2, part IV, covers the current status of the PPB system; and volume 3, parts V and VI, contains respectively, the performance of program budgeting and analysis in the Federal Government and an analysis and evaluation in major policy areas—unresolved issues and next steps.

Economic Analysis and the Efficiency of Government

As a followup to the above study and earlier inquiries undertaken by the subcommittee, 9 days of hearings were held in August, September, and October to pinpoint areas of waste and inefficiency in Federal Government policy and to focus attention on the potential contributions of improved budgetary procedures and policy analysis in attaining efficiency in Government. A number of case studies describing Federal policy which has encouraged waste and resource misallocation were presented to the subcommittee. In addition, the subcommittee looked at a number of Federal regulatory practices which encourage undesirable and wasteful practices by the regulated sectors of our economy. The subcommittee heard from Government officials, former Government officials, and prominent economists and experts on such problem areas as maritime subsidies and other transportation policies, Federal water resource and pollution policy, and Federal expenditures on urban development, higher education, and medical care.

In February, the subcommittee issued its report based on the above hearings. This report, a companion piece to the subcommittee report on defense spending, points out that billions of dollars of nondefense spending are at stake. The report contains 15 recommendations and additional views.

The Air Force A-7D Brake Problem

On August 13, a 1-day hearing was held to hear testimony on the charges that B. F. Goodrich Co. falsified test data to hide defects in brakes they were making for the Air Force. Witnesses were representatives of the Air Force Systems Command, representatives of the Defense Division of GAO, the assistant general counsel of GAO, the vice president and projects manager of the B. F. Goodrich Co., and former employees of Goodrich.

Innovations in Planning, Programing, and Budgeting in State and Local Governments

In September, a study prepared by the subcommittee entitled "Innovations in Planning, Programing, and Budgeting in State and Local Governments" was released. This study supplements the three-volume study of public spending policies released by the subcommittee in June. It includes 12 papers prepared by budget officials responsible for programing, planning, and budgetary reform in State and local governments, together with a statement by the Assistant Director of the U.S. Bureau of the Budget.

The Dismissal of A. Ernest Fitzgerald

Two days of hearings were held in November on the dismissal of A. Ernest Fitzgerald by the Air Force in an attempt to determine whether his dismissal was in reprisal for his previous testimony to the subcommittee. Witnesses were Mr. Fitzgerald, the Secretary of the Air Force, and the Assistant Secretary of the Air Force for Financial Management.

The Acquisition of Weapons Systems

Three days of hearings were held in December, focusing on the Navy shipbuilding programs and on problems of military purchasing policies and practices. Witnesses were the Assistant Comptroller General, the Director of Procurement Control and Clearance of the Navy Material Headquarters, and the Assistant Secretary of the Navy (Installations and Logistics).

Toward Economic Development for Native American Communities

In January 1970, the subcommittee released a two-volume study "Toward Economic Development for Native American Communities." This study contains papers by individual experts and statements by native organizations and by Federal agencies concerning existing economic conditions among the Indians and the urgent need for more effective economic development policies. The study is primarily concerned with the Federal Government's role in assisting Indian economic development and the possibilities for achieving more effective Federal programs. Volume 1, part I, contains 16 studies by outstanding experts summarizing current economic conditions among the American Indians, the frustrations and failures of earlier assistance efforts, the mixed results of the new initiatives undertaken since 1963, and the history of the Indian's own attitudes toward Federal assistance programs. Volume 2 contains 2 parts: part II, statements by Federal agencies which have responsibility for programs affecting the American Indian and by native organizations describing present programs and providing various views of currently unmet needs and the manner in which programs should go forward in the future; part III discusses the resource basis available to the American Indians.

Members of the Subcommittee on Economy in Government are Senator William Proxmire (chairman), Senators John Sparkman, Stuart Symington, Len B. Jordan, and Charles H. Percy; and Representatives Wright Patman, Martha W. Griffiths, William S. Moorhead, Barber B. Conable, Jr., and Clarence J. Brown.

SUBCOMMITTEE ON URBAN AFFAIRS

Industrialized Housing

In April, the subcommittee released a 237-page report consisting of papers discussing housing developments in this country, the Soviet Union, Western Europe, the United Kingdom, and Scandinavian countries. These papers were written by specialists in housing and related fields.

As a supplement to the above compendium, and to develop valuable background for the subcommittee's further studies of long-range planning, both here and abroad, 3 days of hearings were held in July.

Testimony was received from the Assistant Secretary for Research and Technology of the Department of Housing and Urban Development, and individuals in the industry actually working to put housing on an industrialized basis.

In September, the subcommittee undertook a field study trip to England, Finland, Sweden, West Berlin, and Israel to discover the strengths and weaknesses of the attempts by the people of the several countries to achieve quality living for themselves regardless of age, ability, size of income, and all the other personal factors which tend to determine how much an individual shares in the potentially available goods, services, and satisfactions of his society. The subcommittee sought insights into the creation of quality living environment, not statistical information on housing. A chronological report of the trip will be issued shortly.

Members of the Subcommittee on Urban Affairs are Representative Richard Bolling (chairman), Representatives Henry S. Reuss, Martha W. Griffiths, William S. Moorhead, William B. Widnall, W. E. Brock 3d, and Clarence J. Brown; and Senators Abraham Ribicoff, William Proxmire, Jacob K. Javits, and Charles H. Percy.

SUBCOMMITTEE ON INTER-AMERICAN ECONOMIC RELATIONSHIPS

The subcommittee continued its review of inter-American economic developments and will shortly issue a staff analysis of the changing role of thrift institutions in Latin American development.

Members of the Subcommittee on Inter-American Economic Relationships are Senator John Sparkman (chairman), Senators J. W. Fulbright, Abraham Ribicoff, Jacob K. Javits, and Len B. Jordan; and Representatives Richard Bolling, Hale Boggs, Martha W. Griffiths, Barber B. Conable, Jr., and Clarence J. Brown.

SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY

A Foreign Economic Policy for the 1970's

The subcommittee undertook a year-long study of the whole spectrum of issues that go to make up our international economic policy. An initial set of hearings on December 2, 3, and 4 on "U.S. Trade, Investment and Aid Policies" began an extensive series of hearings to establish guidelines and objectives for U.S. trade, investment, and development assistance policies through the 1970's. The December hearings set the framework for subsequent investigation into the external economic problems that the United States will be likely to confront in the 1970's and solutions that should be considered. Witnesses were distinguished businessmen, academicians, and former civil servants from both the United States and abroad.

It is the subcommittee's objective to establish goals and guidelines for U.S. foreign economic policies throughout 1970 and that these hearings will provide a vital service to the legislative committees in defining issues, in gathering information from diverse viewpoints, and in formulating a positive foreign economic policy for the next decade.

Members of the Subcommittee on Foreign Economic Policy are Representative Hale Boggs (chairman), Representatives

Henry S. Reuss, William S. Moorhead, William B. Widnall, W. E. Brock 3d, and Barber B. Conable, Jr.; and Senators John Sparkman, J. W. Fulbright, Herman E. Talmadge, Stuart Symington, Abraham Ribicoff, Jacob K. Javits, and Jack Miller.

SUBCOMMITTEE ON ECONOMIC STATISTICS

Progress Report on Key Areas of Federal Statistics To Meet the Needs of Public Policy

On April 30 and May 1, hearings were held on a comprehensive review of our Federal statistical programs, with particular emphasis on the scope of questions asked in taking the census since wide-range controversy has arisen in recent years concerning this operation. Testimony was received from a Member of Congress, the Secretary of Commerce, the Chairman of the Council of Economic Advisers, the executive director of the Conference of Mayors of the United States, the director of the Institute for Research on Poverty at the University of Wisconsin, and the senior vice president of the National Industrial Conference Board.

Continuing the subcommittee's review of Federal statistical programs with a consideration of programs producing statistics on prices and job vacancies, a hearing was held on May 15. The Commissioner of the Bureau of Labor Statistics and a former member of the 1960–61 Price Statistics Review Committee discussed actions which already have been taken to carry out past recommendations of this subcommittee, and those of the Price Statistics Review Committee, together with the BLS's own plans for future improvements in its statistics programs.

Members of the Subcommittee on Economic Statistics are Senator Herman E. Talmadge (chairman), Senators J. W. Fulbright and Jack Miller; and Representatives Richard Bolling, Martha W. Griffiths, Barber B. Conable, Jr., and Clarence J. Brown.

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

On Linking Reserve Creation and Development Assistance

In April, the subcommittee released a staff study entitled "On Linking Reserve Creation and Development Assistance." This study was prepared for the subcommittee as background material for hearings on the various linkage proposals.

On May 28, a 1-day hearing was held on proposals to use reserve creation, such as the distribution of special drawing rights by the IMF, as a means of increasing financial assistance to developing countries. In addition to reexamining the desirability of linking reserve creation and development assistance, the subcommittee hearing appraised the potential of this mechanism. Testimony was received from administrative officials from multilateral organizations and academic experts.

A subcommittee report entitled "A Proposal To Link Reserve Creation and Development Assistance" was released in August. The report recommends that SDR's be used to finance additional development assistance for poor countries and suggests that this be done by

allocating a portion of the SDR distributions to the International Development Association for subsequent disbursement to poor countries. It notes the technical complication in achieving redistribution of this type and it lists six arguments in favor of and criticizes four counter-arguments that have been offered against such proposals.

The Proposed IMF Quota Increase and Its Implications for the Two-Tier Gold Market

Two days of hearings were held in November to review U.S. policies stemming from the March 1968 two-tier gold marketing agreement and from the proposed IMF quota increase. Witnesses were the Under Secretary of the Treasury for Monetary Affairs and international monetary experts.

In December, the subcommittee released its report entitled "The Pedigreed Gold System: A Good System—Why Spoil It?" This report contains conclusions and recommendations based upon the hearings held in November.

Members of the Subcommittee on International Exchange and Payments are Representative Henry S. Reuss (chairman), Representatives Richard Bolling, Hale Boggs, William S. Moorhead, William B. Widnall, and W. E. Brock 3d; and Senators William Proxmire, Stuart Symington, Jacob K. Javits, and Charles H. Percy.

SUBCOMMITTEE ON FISCAL POLICY

The Federal Budget, Inflation, and Full Employment, 1970–75

Seven days of hearings were held in October on the budget, inflation, full employment, and the changes in policies needed over the next several years to correct existing inflationary conditions. In addition to examining the budget and other broad economic policies that the administration has to propose, the subcommittee heard from witnesses in regard to inflation in three particularly significant areas, namely, construction, medical costs, and food prices. Witnesses were the Secretary of the Treasury, Director of the Bureau of the Budget, Secretary of Agriculture, chairman of the Council of Economic Advisers, Commissioner of the Bureau of Labor Statistics, Commissioner of the Social Security Administration, a representative of the Department of Transportation, representatives of private research groups, and prominent economists and experts.

The subcommittee report, based upon these hearings, was released in November. The report contains conclusions and recommendations on the Federal economic policies needed in the months immediately ahead as well as in the longer run.

Members of the Subcommittee on Fiscal Policy are Representative Martha W. Griffiths (chairman); Representatives Hale Boggs, William S. Moorhead, William B. Widnall, and Barber B. Conable, Jr.; and Senators William Proxmire, Herman E. Talmadge, Stuart Symington, Jacob K. Javits, Jack Miller, and Charles H. Percy.

OTHER COMMITTEE STUDIES COMPLETED SINCE MARCH 1969

On March 10, the committee issued another study in its series on international economic policies as practiced by leading industrial na-

tions. Study paper No. 12 entitled "The Euro-dollar Market and Its Public Policy Implications" was prepared by Dr. Ira O. Scott, Jr., professor of finance and dean of the Arthur T. Roth School of Business Administration at the C. W. Post Center of Long Island University. This paper includes a nontechnical description of the origins of the Euro-dollar market, how it operates, its current stage of development, and the policy questions its existence has raised.

STAFF PARTICIPATION IN MEETINGS WITH OUTSIDE GROUPS

In addition to conducting formal studies and arranging hearings for the committee and subcommittees, the staff participated in discussions of economic problems and research techniques with outside groups. The following list of meetings illustrates the nature of these activities in which the staff took part in 1969.

American Bankers Association—Symposium on public policy and economic understanding.
American Economic Association—Annual meeting.
American Enterprise Institute—Seminar on Federal income tax laws.
American Statistical Association—Annual meeting.
American Statistical Association—New York chapter outlook conference.
Business Week—Conference on the economic outlook (New York City).
Brookings Institution—Forum for business leaders.
Business Council—Technical consultants.
Federal Statistics Users' Conference—Conference on quarterly estimates of GNP by Office of Business Economics.
Federal Statistics Users' Conference—Conference on the President's economic report and budget.
Government Economists on Regulatory Problems—Seminar.
Harvard University, John F. Kennedy School of Government and Massachusetts Institute of Technology—Seminar on systematic analysis and planning, programing, and budgeting in Government decisionmaking.
Industrial College of the Armed Forces—Annual meeting of the Mobilization Readiness Division of the American Ordnance Association.
Joint Council on Economic Education—20th anniversary of the council.
McGraw-Hill—Annual meeting of the Informal Conference of Business Economists.
Makah Indian Reservation—Meetings on economic development program.
National Association of Business Economists—Annual meeting.
National Association of Tax Administrators—Conference on revenue estimating.
National Council for Indian Opportunities—Meeting.
National Economists Club—Weekly meetings.
National Industrial Conference Board—Economic forum.
National Institute of Public Affairs—Regular meetings.
National Manpower Policy Task Force—Meeting.
President's Task Force on Aging.
Resources for the Future—Fellowship Advisory Council.
Washington Statistical Society—Meeting.

The executive director and other professional staff members made addresses or presented papers to the following groups:

Air Force Academy.
American Bankers Association—Annual conference of university professors.
Economists Club, Washington, D.C.
Federal Executive Seminar, Kings Point, N.Y.—Current economic policy issues.
George Washington Law School—Graduate seminar on corporation law.
Massachusetts Institute of Technology.
Michigan State University.
National Congress of American Indians.
New York University Graduate School of Public Administration—Centennial address.
U.S. Civil Service Commission—Round table for executives.
U.S. Steel Workers of America—Executive board conference on the military-industrial complex.
University of Minnesota—Seminar on Government contracts.
University of Wisconsin—The Center for the Advanced Studies in Organization Science.

The executive director and other members of the professional staff submitted papers for publication to the following:

Federal Natural Resources Development.
Monthly Labor Review.
Saturday Review.
Water Resources Research.

The executive director also conducted a seminar on public law and economic policy at the George Washington University Graduate School of Law. The committee's international economist taught a course in international economics at the University of Maryland. One of the staff economists conducted a congressional staff seminar on military spending and is participating in a Brookings Institution seminar on national security policy.

Conferences were held with Government officials or groups of foreign visitors seeking information on the activities of the Joint Economic Committee, representing the following nations:

Argentina
Canada
France
Italy
Norway
Philippines
Sweden

The executive director testified before the Special Committee on Aging (U.S. Senate).

Student interns

The committee participated in the student intern program by having college students working in the committee offices during the past year.

CHANGES IN COMMITTEE STAFF

During 1969, Loughlin F. McHugh joined the staff as senior economist, and Mrs. Courtenay M. Slater joined the staff as economist in the fields of labor and manpower problems and public expenditure policy. George D. Krumbhaar was added to the staff as minority

economist. Robert H. Haveman resigned to accept a position with a private economic research organization and Frazier Kellogg left the committee staff in late fall. Mrs. Frances Tillinghast, who was with the committee for 22 years, retired as publications clerk in August and Mrs. Juanita L. Entrekin was appointed to this position.

CHANGE IN COMMITTEE MEMBERSHIP

Representative Clarence J. Brown, of Ohio, was appointed to fill the vacancy on the committee caused by the appointment of Donald Rumsfeld to the position of Director of the Office of Economic Opportunity.

DISTRIBUTION OF COMMITTEE PUBLICATIONS

The Joint Economic Committee issued 37 publications in 1969 including studies, hearings, and reports. Copies of the current and previous years' publications distributed to fill individual requests totaled approximately 130,000. Depository libraries located in various parts of the country were sent 25,000 copies.

The Superintendent of Documents ordered 48,000 copies of publications and sold over 27,000 of the current year's output. An additional 110,000 copies were sold of the previous years' publications. Over 36,000 publications were distributed by the Government Printing Office to Government departments and to the U.S. Capitol for the two document rooms.

Economic Indicators reached a new high in 1969. Monthly subscriptions were about 10,000.

SUBCOMMITTEE MEMBERSHIP

Economic Progress

REPRESENTATIVES	SENATORS
Wright Patman, *Chairman*	William Proxmire
Martha W. Griffiths	J. W. Fulbright
William S. Moorhead	Herman E. Talmadge
W. E. Brock 3d	Len B. Jordan
Clarence J. Brown	Charles H. Percy

Economy in Government

SENATORS	REPRESENTATIVES
William Proxmire, *Chairman*	Wright Patman
John Sparkman	Martha W. Griffiths
Stuart Symington	William S. Moorhead
Len B. Jordan	Barber B. Conable, Jr.
Charles H. Percy	Clarence J. Brown

Urban Affairs

REPRESENTATIVES	SENATORS
Richard Bolling, *Chairman*	Abraham Ribicoff
Henry S. Reuss	William Proxmire
Martha W. Griffiths	Jacob K. Javits
William S. Moorhead	Charles H. Percy
William B. Widnall	
W. E. Brock 3d	
Clarence J. Brown	

Inter-American Economic Relationships

SENATORS	REPRESENTATIVES
John Sparkman, *Chairman*	Richard Bolling
J. W. Fulbright	Hale Boggs
Abraham Ribicoff	Martha W. Griffiths
Jacob K. Javits	Barber B. Conable, Jr.
Len B. Jordan	Clarence J. Brown

Foreign Economic Policy

REPRESENTATIVES	SENATORS
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Henry S. Reuss	J. W. Fulbright
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