THE 1970 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
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INVITED COMMENTS

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THE 1970 ECONOMIC REPORT OF THE PRESIDENT

The letter appearing below was sent to the following organizations: American Bankers Association, American Farm Bureau Federation, American Federation of Labor & Congress of Industrial Organizations (AFL-CIO), American Life Convention and the Life Insurance Association, Chamber of Commerce of the United States, Committee for Economic Development, Communications Workers of America, Conference on Economic Progress, Consumers Union of U.S., Inc., Cooperative League of the U.S.A., CUNA International, Inc., Federal Statistics Users' Conference, Independent Bankers Association, Life Insurance Association of America, Machinery & Allied Products Institute, National Association of Manufacturers, National Association of Mutual Savings Banks, National Consumers' League, National Farmers Organization, the National Farmers Union, National Federation of Independent Business, Inc., National Federation of Independent Unions, National Grange, National League of Insured Savings Associations, Railway Labor Executive Association, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW), United Mine Workers of America, U.S. Savings & Loan League. These organizations were invited to submit their views or comments on the text and recommendations contained in the 1970 Economic Report of the President. Nineteen organizations submitted statements and their views were considered by the Joint Economic Committee in the preparation of its report on the President's Economic Report.

FEBRUARY —, 1970.

DEAR ————: Under the Employment Act of 1946 the Joint Economic Committee has the responsibility of filing each year a report containing its findings and conclusions with respect to the recommendations made by the President in his Economic Report. Because of the limited number of days available for hearings, the Committee is requesting a number of leaders of business and finance, labor, agriculture, and consumer organizations to submit statements for the record on the economic issues facing the Nation. These statements will be made a part of our hearings on the Economic Report in a printed volume containing such invited statements.

We therefore invite your comments on the economic issues which concern the Nation and your own organization. Under separate cover we are sending you a copy of the 1970 Economic Report of the President, filed February 2.

We would like to distribute copies of your statement to the members of the Committee and the staff, and would therefore appreciate your sending 30 copies, by Friday, March 13, 1970, to Mr. Hamilton D. Gewehr, Administrative Clerk, Room G-133, New Senate Office Building, Washington, D.C. 20510.

Very truly yours,

WRIGHT PATMAN, *Chairman*.

THE AMERICAN BANKERS ASSOCIATION

The President's economic message has rightfully focused upon inflation as the Nation's No. 1 domestic problem, the solution to which will determine whether we can alleviate many of our other difficulties. It is not a coincidence that we are faced with severe dislocations of society which must be corrected at a time when we are also finding prices rising at a substantially higher rate than has been experienced in all but a few years of U.S. history. Discovery that correction must be made in our national policies on labor-management relations, in welfare programs, in education, in our treatment of innercity problems and in housing almost inevitably is accompanied by the realization that rising wages and prices have not only created many of the problems but make their solution more difficult.

At this point it perhaps does little good to recall the painful memories of how inflation came upon America. Certainly the policies which now appear to have been the cause had, at the time they were instituted, adequate justification. Stimulative policies in the mid-1960's were followed in the belief that the attainment of full employment would relieve some human problems. It is still being argued whether the excessive rapidity of attainment of high employment or the failure to remove structural impediments to full employment and output resulted in overstimulative policies. Even before the Vietnam escalation, unit labor costs were beginning to rise. At any rate, the increase in military spending and failure to cutback nondefense programs soon took over as prime factors in the overstimulation. While few could question the need for many civilian programs, failure to realize the pressure upon resources imposed by both war and civilian programs resulted in greater stimulation of the economy than could be managed in the context of price stability. A misjudgment of the effect of the surtax and consequent untimely easing of monetary policy played a major role in letting inflation gather momentum just at the time a restrictive stance would have been most useful. Important to the inability to contain the degree of strain upon resources has been both the less-than-perfect informative content of the Federal budget, particularly prior to its recent revision, and the failure of Congress to exercise total rather than piecemeal control over expenditure levels.

The banking industry is gravely concerned about continued inflation and the possibility of premature easing of Federal efforts to contain the overheating before present psychology is reversed. The industry recognizes, however, that little will be served by policies so extreme that they turn a slowdown into a serious recession, with all that could imply for rekindling of inflationary fires as a means of stimulating the economy. Thus, it is the recommendation of the banking industry that the Federal Government persist in the present policy of containing inflation. In recommending this policy we are aware that both the American public and the banks found the necessary lessons of 1969 a bitter commentary upon the lack of responsible economic policy in earlier years, especially in 1965–68.

As 1970 begins, the economic programs of the Federal Government and the fabric of legislation, regulation, and institutional development are rightfully under examination. The strains of the past year, the opportunity of a new administration to develop its own programs, the growing realization of the task ahead all suggest reappraisal is in order in many institutions of our society and our economy. One of the more relevant areas for appraisal is that of the Nation's financial structure.

THE LESSONS OF 1969

The consequences to financial institutions of the inflation that rapidly became recognized during 1969 as the foremost economic problem became increasingly severe. Demands for funds increased because of the surfeit of profit opportunities, desire to escape even higher interest rates or further lack of availability of funds and the knowledge that borrowing even at prevailing high interest rates would, in the long run, prove to be cheap as paybacks were made in depreciated dollars. As it should, monetary policy attempted to cut down on the rate of credit creation and money supply growth by severely limiting the injection of bank reserve funds. Less evidently beneficial were supplementary methods aimed at reducing bank lending such as special requirement on Eurodollars. Most suspect of all was the attempt by supervisory authorities to hold down the rate of interest financial institutions including commercial banks, mutual savings banks, and savings and loan associations could offer on deposit funds. On the supply side, the public shifted to direct investments in market securities instead of saving at deposit institutions as a consequence of artificial interest ceilings. As 1969 ended, therefore, many financial institutions were finding it difficult to function and borrowers were increasingly ingenious in finding alternative financing in market securities that were largely unregulated.

Concentration of the attack against inflation in the area of monetary policy during 1969 produced a number of bad effects. First, it tended to make financial institutions the focus of public misunderstanding about Federal anti-inflation policies since it was their high lending rates and inability to make loans that was the immediate impact of anti-inflation policy for nearly all of the public. Second, commercial banks more than other institutions felt the brunt of public displeasure for their involvement in business finance, which to many was the cause rather than a symptom of economic overheating. Third, high interest rates and lack of funds adversely affected housing, State and local government finance, and long-run capital projects. As 1969 went on there was growing recognition of the uneven effects of general monetary controls and increasing doubt about the ability of monetary policy to control inflation.

The obvious way to assist monetary policy in the circumstances that prevail at the beginning of the 1970's is a much tighter fiscal policy. The administration has been successful in slowing the annual increase in Federal spending from $20 billion in the last 3 years to $9 billion in 1969 and contemplates a rise of less than $3 billion for the next fiscal year. Since some part of the expenditure rise is necessitated by the rising cost of goods and services, even holding the spending increase to this amount represents a considerable accomplishment. While the Committee for Economic Development recommended a high employment surplus in fiscal 1971 of $6 to $9 billion, the administration has budgeted a more modest figure, perhaps at least partly in the hopes of holding down appropriations. Even this modest surplus may be in jeopardy as a result of unanticipated expenditures or a short-fall of receipts. Despite the clear intent to continue a restrictive fiscal policy it is doubtful that the mix of policy during 1970 and 1971 will offer any relief to the economy from the need to place primary reliance on a restrictive monetary policy.

With full realization that the administration this year has made a genuine effort to present a budget holding down Federal expenditures at some cost to its own ambitions, the fiscal position it is able to present bears an ominous portent for the future. The commercial banking industry is very much concerned that the 1970's, desite short-term temporary slowdowns from time to time, will be characterized by endemic inflation and that government efforts are likely to rely excessively on monetary policy and on less desirable selective controls to achieve its goals.

If this condition occurs, both commercial banks and nonbank thrift institutions will have difficulty. Major long-term investments to meet the social needs of our expanding population will increasingly be dependent upon direct intervention by the Federal Government either to subsidize housing and State and local government construction or in the form of artificial encouragements to some private lenders and discouragement to others depending on the social needs served by the institution.

Alternatives

The administration has eschewed recommending the adoption of price and wage controls despite both a popular belief in their effectiveness at the present time and, in fact, a belief to this effect on the part of some bankers. Such controls at best are expedients that require considerable administrative staff and work best when there is a strong patriotic appeal, but they create many problems. Below the level of formal controls is the suggestion that the Office of the President use the influence of the administration in pricing decisions. Again, this measure seems less than satisfactory to a nation with a strong tradition of freedom in economic matters.

The banking industry remains opposed to the principle of controls on wages and prices. Likewise the banking industry cannot accept, as a matter of principle, the continued active participation of the Federal Government in what are essentially private negotiations and contracts. As time has gone by, however, failure to achieve sure signs of victory over inflation raises the possibility that measures that are undesirable in the long run may be necessary in the short run. At this writing, therefore, bankers are not inclined to shut the door on temporary measures such as wage and price control that could be of assistance in holding back cumulative wage-price developments while the longer term measures of monetary and fiscal policy have time to take effect.

Long-Run Implications

If there is to be inflation produced by runaway government deficits, long-run reliance upon general monetary policy to offset such inflation would have substantial implications for the Nation. Almost inevitably the most profitable opportunities are likely to lie in quick exchange of goods and other assets and a general shortage of savings for productive investment may result in a channeling of most credit into these areas. The higher interest rates prevailing will enormously increase the cost of long-term investments to the detriment of facilities such as housing, public construction, utilities, and the like. During periods of inflation when the pricing system is prevented from functioning as an efficient means for allocation of credit resources, the remedy is not abandonment of free markets but reduction of the inflation.

The final effect of overreliance upon monetary controls to fight inflation is the reordering of the financial structure, reducing the functions of regulated institutions such as banks, savings and loan associations, and insurance companies and increasing the importance of direct market instruments. Moreover, in attempting to preserve or increase the shares of some financial institutions in the savings market because of concern over particular social goals at the expense of other institutions, broader social goals such as encouragement of aggregate savings and investment may suffer.

The Financial System in Relation to the Economy and the Budget

In the first half of the 1960's the presence of unused resources permitted a generally easy fiscal and monetary policy. Conditions of nearly all types of financial institutions were such to encourage lenders to develop new markets and, as a result, many institutions sought greater lending powers. In the second half of the decade, financial institutions had an increasingly difficult time supplying their newly expanded markets with funds as monetary policy tightened and the demand for funds increased. Thus, a salient characteristic of the latter half of the 1960's was attempts by all types of lenders to increase the types of instruments they could offer savers as well as the rate they could pay. As substantial deficits occurred in 1967 and 1968 and price pressures began to mount, monetary policy finally became the first line of defense against inflation. To the higher rates produced by restrictive credit supplies, investors apparently added a premium to offset the loss of purchasing power anticipated over the life of the obligation. Housing, State and local government capital projects, and many other deserving needs went partially unfilled as a result. As investors sought higher yields they also diverted funds to commercial building where they could arrange to receive equity interests in projects, another hedge against inflation. Nowhere were these effects felt more seriously than in housing starts, with the result that protection of the rate of home building has become a major goal that now, by influencing decisions of Federal agencies, appears to be shaping the structure of the financial system.

The banking industry recognizes the extreme importance of maintaining a high level of residential building and urges that major efforts be made to sustain the rate of housing starts. If more of the burden of the fight against inflation is taken by fiscal policy, monetary policy will be less restrictive and housing credit will be easier. Accordingly, we caution that any changes made in the financial system for the 1970's should be adopted with the realization that fiscal policy must play a major role in economic stabilization which it has not done effectively, particularly from 1965 to 1968.

THE TASK AHEAD FOR THE FINANCIAL SYSTEM

After several years of extreme shifts in monetary policy and over a year of supertight money the strains on the economy are beginning to appear. It is imperative, therefore, that the implications be understood of the practice whereby monetary policy has been either determined by Federal tax and expenditure decisions of the Congress or by preconceived notions of desirable interest rate levels. It is quite likely that unless inflation is moderated and those parts of the financial structure which have borne an undue share of credit restraint are once again allowed to function normally, there will be permanent effects on the rate and type of capital formation in the U.S. economy.

In recent years it has become evident that one key to enlarged credit for housing in coming years will be the reduction of borrowing demands from the Federal Government sector. Certainly the moderating effect of a restrictive fiscal policy on prices and the working of easier monteary policy and lower interest rates should assist in financing America's housing needs. Beyond that, however, the successful curtailment of a rise in Federal spending is imperative in liberating real resources for housing. If Federal expenditures and credit demands are held down, lowered yields and a scarcity of Treasury securities will mean more individuals will begin to save again through banks and intermediaries. In turn, these financial institutions will find more desire to push into substitutes for Treasury obligations such as housing agency bonds, etc., and more importantly, the quantity of funds available for mortgages will increase. This process, of course, presupposes that other sectors do not preempt the funds intended for housing.

MEETING THE NEEDS OF THE 1970'S

Recognition of the problem of 1969 and 1970 is not the only, or even the major, reason for reexamination of the financial structure at any early opportunity. Already the size of capital demands of the decade of the 1970's is becoming evident. Recent studies have suggested that credit demand by 1975 may be at least twice as great as the demand in the last years of the 1960's. Under these circumstances it is not too early to begin to discuss the form of the financial structure in the immediate years ahead.

It is noted that plans are presently being drawn up to appoint a national commission to examine needed changes in financial institutions. The administration's proposal, according to preliminary statements, will exclude some financial institutions and will not cover matters such as monetary policy. Its major areas for investigation include functions of depository institutions, regulatory agency jurisdictions, and deposit rate ceiling. We would hope that the Commission will not be unduly restricted in its assignment as to topics and institutions it may consider, for the capital needs of the 1970's cannot be met by producing changes in only a limited group of financial institutions, regulatory bodies, and policy areas.

The banking industry welcomes the proposed commission's inquiry. What functions financial institutions are permitted to perform, how they are supervised and what they are permitted to pay for savings bonds will not be unrelated to the ability of the financial system to support the needed level of capital investment in the 1970's. That financial resources alone, when manpower and real resources are scarce, cannot produce housing or schools or hospitals or nursing homes should be self-evident. Indeed, the lessons of 1969 may be very bad ones from which to design major parts of a new financial system.

The Prospect of an Economic Decline

As this statement is issued there are increasing signs of an economic downturn. Such a downturn could necessitate a significant modification of monetary policy which, combined with a slackening of credit demands, could make greater mortgage funds available for housing. Alternatively, such a downturn could result in the creation of a substantial budget deficit as recession-connected expenditures rise and revenues fall off, which could siphon off some of the credit that might otherwise go to housing. Both results would be unfortunate in the sense that they would slow down recognition of a need for fundamental fiscal policy reforms as a precondition of a viable financial system for the 1970's.

The banking industry continues to be impressed by the basic underlying strength of the economy. In a world where it is recognized that great needs exist for improved standards and quality of living, cooling off of the economy will not have nearly the disturbing long-term effects that a short-run capitulation to inflation will have. From the standpoint of what Americans expect from the performance of their economy, persistence in the present anti-inflation policy until prices are brought under control will undoubtedly prove to be wiser than an overly hasty reversal of policies that run the risk of prolonging inflationary psychology throughout the 1970's. Therefore, the banking industry continues to support strongly those of the Federal Government's present policies aimed at stemming the inflationary tide, while at the same time pointing out that Federal expenditure control and a long-run reform of the way in which expenditure levels are determined is an absolute necessity for a financial system that will meet the needs of the 1970's.

The Prospect for Interest Rates

Americans in all walks of life are naturally concerned about the prospects for interest rates this year and later in the 1970's. Many of them are well aware of the upsetting effects of the high cost of credit upon their personal and business activities and look forward to rates that prevailed in the early 1960's or before. As the year progresses, however, it may become increasingly clear that despite the slowing of the economy, a large volume of unsatisfied borrowing remains to be done. Although Treasury needs now are projected to be relatively modest, the increasing use of Federal agency financing outside the budget tends to be an adverse influence holding rates up. In addition, deferred needs for State and local financing, for housing and for rebuilding liquidity positions of firms may be expected to sustain credit demands well after some calming is observed in the economy. Furthermore, for the remainder of the 1970's it seems almost inevitable that public and private capital demands will be very high relative to the volume of savings. This means that there is little likelihood of a return to interest rate levels prevailing in the early 1960's.

It is easy to assume, as many do, that relaxation of credit policy as the economy decelerates will bring about low-interest rates. Yet, the period just passed has certainly shown that interest rates are more a function of the rate of inflation than the degree of ease or tightness of monetary policy. Accordingly, bankers feel that moderation in present interest rate levels awaits a convincing demonstration that the inflationary mood of the public has passed. In the longer run this desirable goal can be achieved by the realization of Federal expenditure control along with a monetary policy that tends to complement this anti-inflationary fiscal posture.

AMERICAN FARM BUREAU FEDERATION

We appreciate the opportunity to comment on the Economic Report of the President for 1970.

Farm Bureau is a general farm organization with 1,865,854 member families in 49 States and Puerto Rico. It is a voluntary, nongovernmental organization financed by membership dues and wholly controlled by its members. Our statement is based on policy resolutions that have been developed through a process which involves study, discussion, and decision by majority vote of Farm Bureau members or their elected representatives at local, county, State and national meetings.

Farm Bureau members are interested in the Economic Report because economic conditions and the economic policies followed by the Federal Government affect farm costs, farm prices, taxes and the purchasing power of farmers' dollars as well as the employment, income and purchasing power of nonfarm people. For example, the inflation of recent years has contributed to a farm price-cost squeeze by raising farm costs faster than farm prices. The index of prices received by farmers rose 29 points, from 248 in 1965 to 277 in 1969. In the same period the index of prices paid, interest, taxes, and wage rates rose 52 points, from 321 to 373.

We will confine our comments to the sections of the Economic Report which deal with agriculture and inflation.

Agriculture

We are disappointed with the Economic Report's treatment of agriculture. This section of the report is deficient in that it indicates a lack of understanding of the urgent need for a fundamental change in the direction of agricultural policy.

On page 104 the Economic Report refers to agriculture as an important sector of the economy where regulation has been used in an attempt to make market performance more satisfactory.

A more accurate statement would be that agriculture is a outstanding example of an industry where the Government has intervened to prevent the market system from functioning.

Under past and present farm programs the Federal Government has at various times fixed prices by establishing commodity loan rates without regard to the market, restricted acreage on the basis of past history, dumped Government-owned stocks to hold down prices in years of short crops, subsidized exports, imposed quotas on imports, paid farmers for not producing and used income payments to offset the adverse effects of Government actions on market prices.

The Economic Report (p. 106) quite properly says that, "Farm policies on field crops should give greater emphasis to market forces and thus reduce direct governmental participation in the marketplace." It fails, however, to recognize that Government payments interface with the operation of market forces. On the contrary, it argues that, "direct income payments, properly applied, offer a more efficient way to support farm income than high price supports." The issue is not direct payments versus high price supports. The issue is: "What can and should the Government do to improve opportunity for farmers with due consideration for the interests of consumers and taxpayers?"

The disadvantages of high price support are well known. High price supports encourage excessive production; this leads to surpluses, export subsidies, import controls, acreage restrictions, and a capitalization of program benefits which forces new producers to buy the right to participate in the program.

Payments share many of the disadvantages of high price support programs. In addition, they make farm income dependent on congressional appropriations. An incentive price will encourage production and force the Government to impose production controls regardless of whether it is made effective by a loan, a payment, or a combination of the two. The control of production is just as difficult and just as damaging to the market system under a payment program as under high price supports. The tendency for program benefits to be capitalized is the same under payments as under price supports.

Contrary to the claims of the proponents the payment approach does not avoid interference with foreign trade. Programs that hold prices above the market level lead to export subsidies; a direct payment on an export crop is a disguised export subsidy. In either case the result is to reduce our national capacity to bargain for greater access to foreign markets.

Major provisions of the Food and Agriculture Act of 1965 are adverse to the interests of farmers, consumers and taxpayers. We are convinced that farmers would do better under a market-oriented program than under either high price supports or direct payments; however, the transition to a market-oriented approach should be spread over a period of years to allow farmers time to adjust.

Specifically, we recommend that the Food and Agriculture Act of 1965 be amended to (1) phase out annual diversion programs and direct payments for feed grains, wheat and cotton, (2) establish a permanent program of price support loans for these commodities based on average market prices for a recent period, (3) expand the retirement of cropland under long-term contracts with emphasis on whole farms, and (4) provide special transitional assistance, including adjustment payments and retraining, for low-income farmers.

In contrast to the act of 1965, this approach would solve the problems confronting the producers of feed grains, wheat and cotton and permit a gradual reduction in Government expenditures for agriculture, without limitations on payments to individuals which would be unfair to many commercial farmers.

Inflation

In our opinion the President and the Council of Economic Advisers should be commended for recognizing that inflation is the most important economic problem confronting this country at the present time. The extent to which inflation has been building up is illustrated by the following data which show recent annual changes in the consumer price index:

INDEX OF CONSUMER PRICES, 1965–69

	Index for year (1957–59=100)	Change from previous year	Percentage change
1965	109.9	+1.8	+1.7
1966	113.1	+3.2	+2.9
1967	116.3	+3.2	+2.8
1968	121.2	+4.9	+4.2
1969	127.7	+6.5	+5.4

The upward trend in price which reflects a downward trend in the value of the dollar, clearly has reached the point where it is having a highly disturbing effect on our national economy.

Our views with respect to the policies that should be followed in the present situation are set forth in the following extract from Farm Bureau Policies for 1970:

GOVERNMENT SPENDING AND INFLATION

Inflation is a serious threat to economic stability. Excessive federal government spending is the basic cause of our current problem of inflation. Deficit spending by the federal government and policies which expand the supply of money and credit faster than production clearly lead to inflation. Both Congress and the Executive Branch of government must face up to this fact and bring expenditures into balance with income at tax rates which are not oppressive.

Over-expansion of the money supply to finance recent federal deficits has resulted in the need for the Federal Reserve Board continually to increase the discount rate to banks in an effort to reduce the inflationary economic impact.

Efforts of the Federal Reserve Board to restrain inflationary increases in private credit should not be offset by increases in direct government lending.

We encourage an all-out effort to make the public aware of these basic economic facts so that they will be in a position to cause the Congress and the Executive Branch of government to end excessive inflation and bring about a stable growth based on increased productivity.

FEDERAL RESERVE BOARD

We favor continuation of the independent Federal Reserve Board as an essential tool to bring about a balanced economy.

Agriculture should have representation on the Board.

PROTECTION OF THE DOLLAR

Because stability of the purchasing power of the dollar, as well as the maintenance of high employment, is essential to the economic well-being of the nation, we recommend amendment of the Employment Act of 1946 to provide equal emphasis on the maintenance of the value of the dollar.

ECONOMIC CONTROLS

We continue to oppose direct price and wage controls.

We also oppose indirect controls, such as efforts to influence private decisions by guidelines, retaliatory actions, or dumping of stockpiled commodities. Such measures deal with symptoms rather than causes of inflation.

Existing law should be amended to permit the Treasury to pay competitive interest rates on long-term government bonds.

INCOME TAXES

Tax policy should be designed to encourage private initiative, help stabilize the dollar, promote employment and economic growth, and equitably distribute the tax burden.

Steps to cut less essential expenditures should have priority over continuation of the surtax.

It should be clear by now that a policy of encouraging inflation in order to promote economic growth is unwise, and in the long run self-defeating because inflation leads to maladjustments that eventually have to be corrected. The objective of Government policy on matters that affect the course of the national economy should be to achieve both economic growth and a relatively stable price level. We are convinced that this is an attainable objective, and that it represents the best available approach to the desirable goal of maintaining high employment with rising productivity on a continuing basis.

In our opinion the inflationary pressures now evident in the economy make it essential that Congress and the administration cooperate in efforts to hold down Federal spending and thus avoid a return to large Federal deficits.

While economists disagree on the relative roles of budget deficits and monetary expansion as causes of inflation, we think the Economic Report put this disagreement in proper perspective when it said—

Many uncertainties exist about the relative power of fiscal and monetary actions taken separately. There is much less doubt about the power of fiscal and monetary actions taken together. (Page 23 of the Economic Report.)

As a practical matter, it must be recognized that monetary policy cannot be considered to be completely independent of fiscal policy. For example, we think it important to avoid large deficits in inflationary situations because deficits that cannot be financed out of current savings inevitably require an expansion of the money supply.

The rise in interest rates which has occurred in recent years is a natural result of inflationary pressures. Inflation increases the demand for—and consequently the cost of—credit by causing people to think that it will be possible to repay borrowed money with cheaper dollars. Consequently, as the Economic Report notes on page 68—

Interest rates will tend to rise when business is booming and inflation is present or expected; they will tend to decline in the opposite circumstances.

We agree with the statement on page 68 of the Economic Report that—

The possibility of using debt management as an instrument of stabilization policy has been severely inhibited by the 4¼-percent interest rate ceiling on Government bonds.

This ceiling has not reduced the cost of money to the Government; it has merely forced the Government to confine its borrowing to the sale of short-term obligations which are not subject to the ceiling.

In conclusion we would like to stress the importance of recognizing that it will take time to work out of our present economic difficulties. Our present inflation is the result of several years of inflationary policies; and we should not expect corrective measures to have instantaneous results. Much of the current upward pressure on prices and wages is a result of the inflation that has already taken place; however, this pressure will gradually abate if we avoid the temptation to revert to inflationary policies. The steps needed to bring inflation under control are not painless, but they are essential to our future economic wellbeing.

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

By NATHANIEL GOLDFINGER, *Director, Department of Research*

The Nation is faced by both an economic slump and rapidly rising prices, after more than a year of the administration's policy of severe economic restraint, imposed in the name of combating inflation.

There is danger of continuing economic slack, even after the present decline has halted—as indicated in the projections of the President's Council of Economic Advisers for 1971, as well as for 1970.

Residential construction is now in a deepening recession, which started in February 1969. Industrial production is in a declining trend since last August. Sales of autos and other consumer hard-goods are moving down. Layoffs and cutbacks in working hours are spreading in numerous industries. Unemployment is increasing. Industry is operating at less than 82 percent of productive capacity; new plants and equipment are being installed at a rapid pace, while industrial production is declining and the operating rate is continuing to head down. But the rise in consumer prices accelerated from 4.2 percent in 1968 to 5.4 percent in 1969, as a whole, and a yearly rate of approximately 7.2 percent in the past 3 months.

The squeeze on the economy tightened during the course of 1969. The Nation's money supply hardly increased at all between May and December; interest rates skyrocketed to peaks never before reached in the memory of living Americans; Federal construction projects were cut.

The real volume of total national production declined slightly in the fourth quarter of 1969 and the President's Council of Economic Advisers forecasts little, if any, rise of real national output in the first half of 1970, with merely a small improvement in the second-half and a modestly slower rise in the price level.

However, the spread of downward trends in many parts of the economy indicates that even this rather pessimistic statement of the administration's official forecast may be overly optimistic. Declining sales in the coming weeks may set off further cutbacks of production, if business decides to reduce inventories rapidly.

Increasing slack, with cuts in working hours and workers' weekly earnings, layoffs and a lack of sufficient job opportunities for a growing labor force are the inevitable results of the administration's economic squeeze. In January, unemployment soared from 3.5 percent of the labor force to 3.9 percent—the largest month-to-month increase in 9 years—and the factory workweek dropped to its lowest level in 2 years.

Government spokesmen camouflage the impact of the Government's economic restraint by speaking of percentages rather than of people.

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The burden on the increasing number of jobless workers and their families will be tremendous.

A rise in unemployment from 2.8 million or 3.5 percent of the labor force in 1969 to 4.5 percent would mean about 800,000 additional unemployed. A rise to 5 percent would add approximately 1,200,000 to the ranks of the jobless. Moreover, the actual rise of unemployment in the coming months may be even greater.

Much of the weight of this burden of rising unemployment will fall on blue collar workers, particularly those with the least work-experience, the least skill and education, especially Negroes, members of other minorities and young people. Government and private programs to encourage employment of the hard-core jobless, especially minority-group workers, are being undermined and threatened with destruction.

The serious consequences of the severe squeeze on the economy are more widespread than just the impact on workers' jobs and earnings.

In its recent report, the President's Council of Economic Advisers states: "One must consult records for the Civil War and earlier to find comparable interest rates. And the steepness of the advance, on long-term as well as short-term securities, may well have been unprecedented."

Skyrocketing interest rates are raising costs and prices all along the line from the farmer and manufacturer to the wholesaler, retailer and the consumer—adding considerably to upward price pressures, in the guise of fighting inflation. Soaring interest rates are also increasing the costs of Government. Moreover, they are building in high costs and prices for years to come.

The recent rise in the interest rate ceiling on FHA and VA mortgages from 7½ to 8½ percent is merely one example of how the consumer is being saddled for years in the future. On a 30-year, $20,000 mortgage, that rise in the mortgage rate increases monthly payments on principal and interest by about 10 percent—to be paid each and every month for 30 years.

Over the 30-year life of the mortgage, that increase alone comes to approximately $5,000—more than the total wages and fringe benefits of the construction workers who built that house. In fact, that $20,000 mortgage costs the homeowner a total of $55,362, in payments on principal and interest, before he can call his home his own.

Interest charges are the major component in monthly occupancy costs to the homeowner or renter. High interest rates for homebuilders, compounded by high mortgage rates, have already priced most American families out of the market for homes and new apartments. Decent housing is being put out of the reach of even middle-income working people.

As interest rates soar, homebuilders postpone construction. State, county, and municipal governments put off building hospitals, roads, and public buildings. Small- and medium-sized businesses—and State and local governments—get hit by the increased costs.

The discriminatory nature of the Government's economic squeeze can be seen very clearly, in its singularly devastating impact on homebuilding, which has been hit first and hardest. Housing starts dropped from an annual rate of 1.7 million in the first quarter of 1969 to 1.2 million in January—a decline of 30 percent—and are continuing down.

The Nation's urgent need for housing—and the national goal of 26 million new and rehabilitated housing units in 10 years, established by the Housing and Urban Development Act of 1968—are being set back for the second consecutive year. A serious housing shortage is building up and inner-city areas continue to decay.

The administration's policy of severe economic restraint has unfairly hit selected economic sectors and groups that are being compelled to shoulder most of the burden—homebuilding, smaller businesses, States, and local governments and blue- collar workers, particularly those who are most vulnerable to unemployment, with the least skill, education and work experience.

But the severely restrictive policy, with the highest interest rates in 100 years or more, has had little effect, thus far, on the activities of most big corporations—with their huge profits and depreciation allowances, as well as their lines of credit at the banks. So business investment in new plants and machines continues to rise rapidly—the only major source of inflationary demand-pressure in the past year and one-half—while other sectors of the economy are hit.

The administration's blunderbuss policy can finally affect the activities of the big corporations by pulling down the house—by so depressing the incomes of workers, farmers, and smaller businesses that the sales and profits of the big corporations are finally affected.

An immediate change in national economic policy is needed. The dangerous squeeze on the economy should be eased, considerably, without delay. Selective measures, aimed at restraining the specific causes of inflationary pressures, should be adopted. Homebuilding—particularly low- and middle-income housing—should be provided with immediate Federal assistance.

The time is long overdue for the Federal Government to cease sole dependence on aggregate economic policies and measures. Aggregate analysis, policies and measures are much too simplistic for a huge, complex and rapidly changing economy in a nation of continental size—structural changes and problems are bypassed, essential social needs like decent housing and rebuilding the cities are sacrificed, social equity and income distribution are ignored.

America can no longer rely, solely, on aggregate fiscal and monetary analysis that was originally developed in the 1930's and 1940's—before the onset of rapid and radical changes in technology, economic structures, urban growth, and race relations. The social and economic consequences of national economic policies—on the job opportunities of blue-collar workers, for example, on meeting such high-priority social needs as housing and the rebuilding of urban areas and on the distribution of income—can no longer be ignored in a simplistic focus on aggregate national averages that conceal and distort almost as much as they reveal about the well-being of the people.

An emphasis in national economic policy on selective approaches—pinpointed to get at specific problems and to achieve specific social and economic priorities—is needed.

Since the present inflation is largely based on the profit inflation of the 1960's, with demand pressures from a one-sector capital goods boom, specific measures should be taken to curb this major problem. The repeal of the 7-percent tax credit for business investment in equipment, adopted in 1969, is one step in this direction. Additional selective measures are needed.

Bank loans to business for plant and equipment outlays, which soared last year, should be directly restrained by the Federal Reserve System—to restrain the only inflationary demand-pressure in the economy.

Government action is required to curb the sharply accelerated pace of business mergers, which has been producing a greatly increased concentration of economic power in the hands of a narrowing group of giant companies and banks with substantial shelters from market conditions and with price-administering ability in spreading, key parts of the economy.

A comprehensive congressional review is needed of the Nation's monetary machinery and policies—to achieve much-needed reform to meet the requirements of the 1970's.

The specific causes of such sharp consumer price pressures as physicians' fees, hospital charges, auto and property insurance rates and housing costs should be examined for the development of practical, selective Government measures to dampen these pressures on the cost of living.

Expanded manpower training programs—buttressed by a modernized and effective vocational educational system and nationwide public employment service—as well as specific measures to reduce specific production bottlenecks, when they appear, are essential.

As defense expenditures are reduced, the Government should use every possible means to assist returning veterans, affected defense workers and their communities, to adjust to civilian employment and pursuits.

Such policies and measures to attain full employment and relative stability of the price level should be supplemented by a large-scale federally financed program to create public-service jobs—in Federal, State, and local government agencies and in private, nonprofit institutions—for the unemployed and seriously under-employed, in providing much-needed public services in urban and rural areas.

To the extent that regular private and public economic channels fail to achieve full employment, the Government must become the employer of last resort. In a work-oriented culture, in the 1970's, the Government can do no less than to create the necessary number of jobs, linked with training and supportive services, to fulfill such needed public services as in parks, recreational areas, schools, hospitals and similar public institutions—to achieve and sustain full employment.

Homebuilding is in dire need of immediate assistance. The Federal Government should provide direct loans for the creation of low- and moderate-income housing. Congress should direct the Federal Reserve to buy up to $5 billion of Government-guaranteed housing obligations. A portion of the GI life insurance fund should be earmarked for veterans' mortgage loans at reasonable interest rates. Congress should require that a portion of trust accounts, including bank trust accounts and pension funds, should be invested in Government-guaranteed mortgages to qualify for tax-exemption.

Moreover, the AFL–CIO Executive Council stated again on February 19, 1970, as on numerous occasions in the past 4 years: If the President determines that the situation warrants extraordinary overall stabilization measures, the AFL–CIO will cooperate, so long as such restraints are equitably placed on all costs and incomes—including all prices, profits, dividends, rents and executive compensation, as well as employees' wages and salaries. We are prepared to sacrifice as much as anyone else, so long as there is equality of sacrifice.

A reduction of price pressures can—and must—be achieved without a growing army of unemployed. The forward advance of the American economy must be permitted to continue. The commitment of the Federal Government, under the Employment Act of 1946—to promote maximum production, employment, and purchasing power—must be maintained, as a foundation for the well-being of the American people.

The Employment and Income Gains of the 1960's Are Threatened

Gains in employment and incomes are not the sole indication of well-being as the experience of the 1960's revealed. But they are a necessary foundation for the improved well-being of the people, particularly in a work-oriented society.

The long period of sustained economic growth, that got underway in early 1961, brought substantial gains in employment and incomes to the overwhelming majority of Americans, although a disproportionately large share of the gains of the long economic expansion went to business and wealthy families.

These gains in employment began to be undermined during 1969, as the economic squeeze affected employment in a spreading number of industries.

As production and sales turned up from the recession of 1960–61, employers restored full work-weeks and recalled workers who had been laid off. With continuing economic expansion, employers in most industries hired additional workers. Toward the end of 1963, the economic expansion accelerated and increases in employment picked up steam.

Employment declines, which had spread through several major economic sectors during most of the 1950's, were limited in the 1960's essentially to farming, the railroads, and mining. This loss was more than offset by substantial employment gains in other industries and occupations, where demand for goods and services increased faster than output per man-hour.

As a result, employment increased faster than the labor force. While the civilian labor force increased 9.1 million in 1960–69, total employment rose 10.1 million. The number of unemployed fell to 2.8 million or 3.6 percent of the labor force in 1968. The rapid expansion of sales and production had created jobs for a fast-growing labor force, in a period of rising productivity and spreading automation—and, at the same time, reduced unemployment.

Not only did sales and production expand at a sufficient pace in the 1960's to boost job opportunities, but the Federal Government embarked on several new programs to aid the unemployed and new entrants into the labor force—particularly youth and members of minority groups, the least skilled and the most disadvantaged. A Federal manpower program was begun to upgrade the skills and basic education of the unemployed and underemployed. The Neighborhood Youth Corps provided part-time jobs for in-school and out-of-school youth. The Job Corps provided basic education and training for small numbers of disadvantaged youth people. There were the beginnings of a needed overhaul of the Nation's vocational education systems. Federal aid for elementary and secondary schools was established for the first time. The Civil Rights Act of 1964 barred discrimination in employment.

Though sometimes hesitant and usually underfunded, these new programs—within the framework of expanding job opportunities—helped to bring employment gains to many of the long-term unemployed and unskilled members of minority groups.

The expansion of job opportunities, increases in wages and salaries, and the spread of second wage earners in many families brought median family income—the mid-point of all family incomes—from $5,620 in 1960, to $8,632 in 1968, the most recent date for available information—a gain in buying power of about 30 percent after accounting for increased living costs.

The gains in employment and incomes in the 1960's were particularly marked among Negroes and members of other minority groups, who started from very high unemployment levels and low incomes. Serious problems of unemployment, part-time jobs and low incomes among Negroes and other minorities remained. But the long economic expansion, combined with Government assistance made it possible for most nonwhites to get a foothold, or at least a toehold, on the job-and-income-ladder.

As the general rise of sales and production proceeded, after the beginning of 1961, Negro workers with seniority and skills were recalled or hired. By 1964, the economic expansion picked up steam, and Negro employment began to move up rapidly.

Between 1960 and 1968, nonwhite employment increased 1.3 million or 19 percent—faster than the 15-percent rise of total employment. With this sharp rise of employment, accompanied by increased educational attainment and upgrading, substantial employment gains were made in clerical jobs, medical and health services, teaching, semiskilled factory jobs and in the skilled crafts.

Unemployment among nonwhites in the labor force dropped from 10.2 percent in 1960 to 6.7 percent in 1968—a substantial decline, which still left a high rate of joblessness.

The unemployment decline among nonwhites was sharpest among adult men, 20 years of age and older. In 1968, according to Labor Department reports, there were 179,000 unemployed nonwhite adult men—down from 413,000 in 1960. The unemployment rate for nonwhite adult men fell from 9.6 percent in 1960 to 3.9 percent in 1968.

These employment improvements, backed up by advances in education and skills, brought great gains in Negro family incomes. The median income of nonwhite families rose from $3,233 in 1960, to $5,590 in 1968, the most recent available information—up from 55 percent of the median income of white families in 1960, to over 62 percent in 1968. A substantial gap in family incomes remained, but it was narrowing.

Largely left out of this advance were unskilled nonwhites, generally, and unskilled youth, in particular—those with little, if any, education, vocational training, and regular work experience. The unemployment rate among the rapidly growing number of nonwhite teenagers was 25 percent in 1968—slightly worse than in 1960.

Commenting on these trends, the noted Negro economist, Gov. Andrew F. Brimmer of the Federal Reserve System stated in June 1969:

So far in the decade of the 1960's, Negroes have benefited relatively more than the population as a whole from the vigorous expansion of the national economy. However, increased occupational mobility and significant strides in education have also played vital roles.

Reflecting these favorable trends, the income differentials between blacks and whites have narrowed appreciably in the last few years, with the greatest relative gains by Negroes being among those with the highest levels of education. Simultaneously, however, within the Negro community, two different classes are becoming increasingly evident as the best prepared are moving ahead rapidly while the least prepared are lagging behind.

Among the total population, too, the remaining unemployment problems, in 1968, and early 1969, were mainly concentrated among those with the least skill, work-experience, education and training—particularly among teenagers, unskilled laborers, and Negroes. Unfortunately, this group that remains outside of the economy's mainstream is larger than the Labor Department's unemployment statistics indicate, since there is considerable low-wage under-employment and hidden unemployment among the poor, particularly the Negro poor.

Solution of these persistent problems requires a foundation of rapidly expanding job opportunities for a labor force that is increasing by about 1.5 million persons per year, as well as for the unemployed. For the youth, who will be entering the labor force in the coming year—and for those who have been left out of the employment and income gains of the 1960's—the main route into the economic mainstream is education, manpower skills, and jobs at decent wages.

A halt or reversal of the economic expansion of the 1960's would not merely put an end to the welcome advances in employment and incomes of recent years. It would increase unemployment—with layoffs of workers, particularly those who were most recently hired. It would also mean increasing unemployment for new entrants into the labor force. And those workers with the least skill and work-experience—nonwhites and young people—would be hit hardest.

Employment gains continued into 1969. But by the spring, summer, and fall, the squeeze on the economy began to affect job opportunities of construction workers and many other blue-collar workers in private employment. By the October–December quarter of the year, layoffs were developing and employment gains were essentially concentrated in State and local government jobs and in the services, which include private nonprofit institutions.

Moreover, in January 1970, layoffs spread and the jobless rate shot up.

The job gains of the 1960's were undermined during the course of 1969. By early 1970, these gains were being reversed, with increasing layoffs and cutbacks in working hours in many industries and occupations.

The Continuing Urban Crisis

The urban crisis continued to pull and tug at the fabric of American society in 1969. America continued to face a complex of social problems that are related to rapid and radical changes in technology, urban population growth, and race relations, as well as the 350-year history of Negro slavery, segregation and discrimination, and the rising trend of unemployment and underemployment during most of the 1950's and early 1960's.

The population continued to increase rapidly in the 1960's, although at a somewhat slower pace than in the previous 15 years. The population grew by over 2½ million a year. Moreover, the number of people in rural areas continued to decline, with the drop of farm employment and migration to metropolitan areas. America's urban areas continued to grow at a faster rate than even the rapid expansion of the Nation's population.

At the same time, middle- and upper-income families continued to move from the cities to the suburbs, within the metropolitan areas. This movement opened up older housing in the cities. But, combined with the movement of industry to the suburbs and countryside, it reduced the tax base of the cities, when the demands on their financial resources have risen sharply for welfare, education, housing, and public facilities. The central cities have become increasingly the residential areas of the very rich, the poor, and the near-poor—with a sharp decline of middle- and upper-income families.

Moreover, the change of industrial location has compounded the problems of inadequate mass transportation facilities for low-income city dwellers to get to the new areas of employment growth. And most suburban areas have discriminatory racial practices, as well as an absence of low-cost housing.

Many of those who have migrated from rural areas to the cities have been Negroes from the rural South, who brought with them a history of segregated and inadequate education, health-care and vocational training and, frequently, a suspicion of Government authorities. From 1940 to 1950, the net migration of Negroes out of the South—to the cities of the North and West—was 1.6 million. In the next decade, the net migration was almost as great. This historic migration continued in 1960–68, but at a much slower pace—the net migration of Negroes out of the South was over 700,000 in those 8 years.

The cities were not prepared for this continuing migration of the 1950's and 1960's. For the urban poor, there was hardly any new construction of low-priced housing in the post-World War II years and there was very little such construction in the previous 20 years, following the end of the home construction boom in 1925.

The residential construction of the post-World War II years largely ignored the housing needs of the bottom half of the Nation's income distribution—in a period of rapid urban growth and the historic migration of the Negro population out of the rural South. So the poor and near-poor—particularly among Negroes and other minorities—were increasingly concentrated in very old, and frequently decaying, housing in the central cities.

In the Nation, as a whole, the prevelance of poverty and near-poverty declined rapidly in the 1960's, with the gains in employment and incomes. From about 40 million persons below the Government-defined poverty level in 1960, or about 22 percent of the total population, the number declined to an estimated 25.4 million, or about 13 percent of the population in 1968. The Government-defined poverty threshold in 1968, was an income of about $3,550 for a family of four. This dramatic reduction still left a sizable poor segment of the population, with an additional group of near-poor.

While an estimated 17.4 million poor whites, in 1968, were more than twice the number of poor nonwhites, only 10 percent of all whites were poor—in contrast to one-third of all nonwhites. This, too represented a substantial improvement from 1960, when 18 percent of whites and 55 percent of nonwhites were below the Government-defined poverty level. But there were still many low-income people. And the Government-defined poor, as well as the near-poor—particularly among Negroes—were increasingly concentrated in the central cities of the Nation.

As a result of this continuing process in the 1960's, the hard-core city slum areas continued to deteriorate. Many people with jobs, some skills, and regular family incomes have been moving out. They have been replaced in the decaying areas by new migrants—adding to the remaining lower-income families, the jobless, the aged, the chronically ill, and fatherless families.

The number of urban nonwhite families, living outside of census-defined poverty areas, increased 100 percent from 1960 to 1967—from 700,000 to 1.4 million families. This represented an increase from 28 percent of the 2½ million urban, nonwhite families in 1960, to 44 percent of the 3.2 million urban nonwhite families in 1967.

Nevertheless, with the continuing migration from rural areas to the cities and persisting, hard-core poverty problems, the number of nonwhite urban families in poverty areas of the cities hardly declined at all—leaving 1.8 million. While many Negro families improved their incomes and living standards—and moved out of city poverty slum areas—the urban ghetto slum communities remained crowded, deteriorating, and with an increased concentration of social problems.

Of the estimated 25.4 million poor, by the Government-defined standards, over half are in families headed by a person in the labor force—a low-wage, part-time, or unemployed worker. Approximately one-third of all the poor are in families whose breadwinner is employed throughout the year. A major cause of poverty, therefore, is directly linked to low wages, part-time work, inadequate skills and education, and unemployment.

About 20 percent of the poor are 65 years of age and older. For them, the key causes of poverty include the generally inadequate level of social security benefits and a lack of adequate public and private pension benefit credits, built up during their working lives.

Approximately 30 percent of the poor are in families headed by women or where the male head-of-household is disabled or chronically ill. Forty-three percent of persons in families, headed by women, are poor and the percentage of such fatherless families, headed by women, has been increasing—from 8.7 percent of white families in 1960 to 8.9 percent in 1968, and from 22.4 percent of nonwhite families in 1960 to 26.4 percent in 1968.

Major causes of the poverty of people in families whose male head is dead, disabled, chronically ill, or absent for other reasons is the Nation's woefully inadequate public welfare system, a lack of proper day-care facilities for the children of working mothers, an archaic workmen's compensation system, inadequate supportive services and personal guidance for the poor.

There are no instant solutions for this complex of problems that are at the root of America's urban crisis and persistent poverty among a significant portion of the population. The causes are nationwide in scope. No city or State government or private group, working in isolation, can solve these problems.

Nationwide, Federal programs are needed—planned measures over the next decade or two. Complacency can lead to national disaster. Continuing, rapid forward strides are essential to strengthen the Nation's social structure.

Basic to solving these problems in America's work-oriented society is a national economy that is growing rapidly enough to provide job opportunities for all persons who are able to work and seeking employment. Under such conditions—linked with an expanded manpower training program—the vast majority of workers will be employed in the private economy or in regular Federal, State, or local government jobs.

For those who remain unemployed or seriously underemployed—because of a lack of skills, training, education, and work experience—a federally financed public-service employment program is needed. The Government should be the employer of last resort.

The protection of the Fair Labor Standards Act should be extended to all workers. And the legal minimum wage should be raised to $2 an hour.

The work-related unemployment insurance and workmen's compensation systems should be improved and updated, with adequate Federal standards—to provide workers and their families with much more adequate protection against loss of income due to unemployment or work-related injury, illness, or death.

Social security benefit levels should be raised substantially and the minimum monthly benefit should be increased to $100—with the gradual introduction of Federal financial contributions, in addition to those made by employees and employers.

Public welfare assistance must be thoroughly restructured and federalized. The program should be based on need alone, with uniform Federal standards of eligibility and payments, federally administered, and finanred by the Federal Government. Welfare payments should be supplemented by supportive services and personal guidance. Where family circumstances and qualifications permit, welfare recipients should be encouraged by proper guidance, day-care centers, and financial incentives to obtain part-time or full-time jobs at no less than the Federal minimum wage.

A comprehensive national health insurance system is urgently needed.

Residential construction and rehabilitation should be stepped up sharply to meet the housing needs of the rapidly growing and increasingly urban population—and to meet the housing goal, established by Congress, of 26 million new and rehabilitated dwelling units in 10 years. The housing legislation of 1965–68 should be fully funded and put into effect. Private housing starts, which were at a yearly rate of 1½ million in 1969, should be boosted sharply, particularly low- and moderate-income housing. Public housing starts, which were only 33,-400 in 1969, should be accelerated considerably. Open housing, in suburbs and new towns, as well as in the cities, is an essential part of a national effort to solve the urban crisis.

Accelerated construction of public facilities—such as water and sewage systems, mass transit, schools, hospitals, day-care centers, play-grounds, clean air and water facilities—is essential to rebuild America's metropolitan areas.

Full and fair opportunities for all citizens including minorities, are established by Federal laws. They should be effectively enforced.

For the vast majority of Negroes and other minorities, the route into America's mainstream is jobs at decent wages, education, manpower skills and decent housing. Sound Government and private efforts to assist Negroes and other disadvantaged minorities to establish business enterprises, through capital formation and technical assistance, should be provided. However, in a society where 90 percent of those at work are wage and salary earners, only a small number of people can move into the mainstream through self-employment and small business. Moreover, racially separatist economic schemes offer no hope for the advance of the overwhelming majority of disadvantaged minorities. Consistent commitment to the principles of integration and equal opportunity, accompanied by jobs-education-skills-housing measures, are essential.

The opportunity of quality education for all, to the maximum of personal capacity, requires closing the educational gap between privileged and underprivileged students, by special aids to teachers and schools in slum areas and by full use of school buildings for job training, adult education and community center activities. Full funding of Federal-aid-to-education legislation is essential. In addition, vocational education should be geared to the actual needs of the modern job market.

Relief of rural poverty, primarily concentrated in the southern and southwestern States is needed.

Economic planning—under Federal leadership, and including each State and metropolitan area—should include the development, coordination and maintenance of an inventory of needs for housing, public facilities and services to provide the basis for adequate funding of planned programs to meet the needs of a rapidly growing urban population, while also providing a sound foundation for an expanding private economy. Such inventories of needs in each category should also be used as yardsticks for the yearly measurement of tangible progress toward meeting the objectives.

Preservation of a free society requires adequately funded, planned programs, with year-to-year progress, to meet the needs of the population in a period of rapid and radical changes in technology, urban growth and race relations. The Federal Government must provide the national leadership, national performance standards, and key resources to sustain the needed effort.

America cannot afford to ignore the need for continuing progress toward solving the urban crisis in the 1970's and toward bringing, into the society's mainstream, those who are at its outer fringes.

The Deteriorating Position of the United States in World Trade

The U.S. position in world trade deteriorated in the 1960's, with adverse impacts on American workers, communities and industries.

The U.S. share of world exports has been declining throughout the period since World War II—particularly the share of exports of manufactured goods.

While U.S. exports continued to increase—although at a slower pace than most other industrial countries—imports into the United States, particularly of manufactured goods, increased very sharply during most of the 1960's.

In every year since 1894, the United States has sold more to foreign nations than it has bought. But by 1968 and 1969, this surplus of merchandise exports over imports almost disappeared.

The reported surplus dropped sharply from an average yearly rate of about $5 billion in 1960–63 and $7.1 billion in 1964 to merely $800 million in 1968 and an estimated $1.3 billion in 1969. Excluding shipments under AID and Public Law 480 programs, there was a merchandise-trade deficit in the neighborhood of $1.5 billion in 1968 and probably a small deficit in 1969.

Foreign trade accounts for only a small portion of the total U.S. economy. Merchandise exports are only about 3½–4 percent of the gross national product and imports account for a roughly similar percent of total national production. But exports are important to a number of specific industries. And imports have an important impact on some specific industries and product-lines.

The adverse impact of the deteriorating U.S. trade position is particularly harsh on affected workers and their communities. Shutdowns of plants or departments usually result in the loss to workers of seniority and seniority-related benefits and, sometimes, the job-loss means that the special work-skills, developed in a specific plant, cannot be applied elsewhere. Moreover, workers and their families cannot easily move from one town to another and, when they do, they incur the expense of moving, as well as the loss of friends, schools, church and social relationships that have been developed over many years. An affected community, particularly a small town, can experience a shrinking tax base, losses for merchants and professionals, and the waste of public facilities. In contrast, invested money in a business can be moved around and equipment can be sold and shipped.

Major causes of the deterioration of the U.S. position in world trade have been new developments in the postwar period that accelerated in the 1960's. Among these developments have been the spread of managed national economies, with direct and indirect Government barriers to imports and aid to exports; the internationalization of technology; the skyrocketing rise of investments by U.S. companies in foreign subsidiaries; and the spread of U.S.-based multinational corporations.

Such changes have made old "free trade" concepts and their "protectionist" opposites outdated and increasingly irrelevant. Yet U.S. Government policy has failed, for the most part, to face up to these new developments. As a result, U.S. Government policy in the area of foreign trade is more applicable to the world of the late 1940's and 1950's than the 1970's.

A substantial change in U.S.-trade policy is needed—for the orderly expansion of world trade, on a reciprocal basis, and the improvement of the U.S.-trade position, in the interest of the American people.

In conclusion, I am appending excerpts from the report of the Economic Policy Committee to the AFL–CIO executive council, entitled "Wage Negotiations in 1970":

Workers and trade unions are seriously concerned with the inflation that has plagued the American economy in the past few years. Rising prices erode workers' buying power and many workers have experienced declines in real wages. The average nonsupervisory employee has had no advance in the buying power of his weekly after-tax earnings in 4 years, while profits, in the 1960's, skyrocketed and executive compensation moved up sharply.

Under these conditions, workers have no other recourse than to seek substantial wage gains in collective bargaining—to offset the effects of previous price increases and to try to achieve some gain in buying power.

The cost of living in 1969 was up 5.4 percent, following a 4.2 percent rise in 1968 and a 2.8 percent increase in 1967. These increases in living costs have been washing out the buying power of much of workers' wage gains.

Despite outcries in the news media about the size of collective bargaining settlements in 1969—and there were some large ones—Secretary of Labor George Shultz reported to the AFL–CIO convention, in October, that the median wage increase, in the first year of contracts negotiated earlier in the year, was "a little under 2 percent for 1969," after accounting for the rise of consumer prices. For 1969 as a whole, the median real increase in wages and fringe benefits in the first year of settlements reached in 1969, was only 2.8 percent, after accounting for the 5.4 percent rise in the consumer price index.

Moreover, many workers are covered by 2- or 3-year contracts that were negotiated in 1967 or 1968. Some of these long-term agreements, unfortunately, provided deferred wage increases that were less than the rise of living costs in the past 2 years and workers, covered by such contracts, have had declines in the buying power of their hourly wages.

The Labor Department reports that, in December, the gross weekly earnings of the average nonsupervisory worker in private nonfarm employment—over 47 million workers—were $117.25. For a worker with three dependents, this came to weekly take-home pay of $102.01, after deduction of Federal taxes.

The buying power of this weekly take-home pay of the Nation's rank-and-file worker, in December, as well as in 1969 as a whole, was slightly less than in 1968. It was also slightly less than in 1965, 4 years ago. Large groups of nonsupervisory workers have had little, if any, increase in the buying power of their take-home pay in the past 4 years.

The Labor Department also reports that it now costs over $10,000 to maintain a modest, but adequate, standard of living—with few luxuries—for a family of four in urban areas. That comes to about $194 a week for a full-time worker, 52 weeks in the year.

Even the Labor Department's lower family budget, with some amenities and no luxuries, now costs about $6,600 for a family of four in urban areas—approximately $127 a week for 52 weeks to maintain a low standard of living.

These trends are important factors confronting workers and unions in wage negotiations in 1970.

In collective bargaining, trade unions seek to offset previous increases in living costs and to gain some improvement in buying power and living standards. The prior increase in living costs is an important factor in collective bargaining.

In the 1960's, the record shows that the accelerated rise in living costs came first, long before the push for larger wage settlements. In fact, between 1960 and 1965, increases in wages and fringe benefits in manufacturing industries were less than the rise of industrial productivity. Unit labor costs of industrial goods moved down 1.6 percent. But wholesale industrial prices went up 1.7 percent. Profit margins on each item widened and, with the expansion of sales, total profits of industrial companies skyrocketed.

In that same period, unit labor costs in the total private economy increased only modestly. But consumer prices rose 6.6 percent—more than twice as fast as the small rise of unit labor costs. As a result, profit margins throughout the private economy, widened. Widening profit margins and increasing sales brought soaring profits to business.

It was not until 1966–67, after the stepped-up pace of rising living costs got under way in 1965, that the size of collective-bargaining settlements also began to move up. Unit labor costs began to increase and business raised prices at an accelerated pace, in an attempt to maintain or even widen profit margins.

Until 1965, when living costs rose 1–1½ percent a year, the median collective bargaining settlement was under 4 percent, according to Labor Department reports. Wage and fringe benefit increases of over 5 percent in the 1960's did not become widespread until 1967 and 1968, long after the sharper rise in living costs began in 1965. By 1968, after 3 years of more rapidly rising prices, the median settlement was 6 percent over the life of the agreement and 6.6

percent in the first year. In 1969, it was 7.4 percent per year and 8.2 percent in the first year of the contract.

The present inflation is largely a profit inflation. A key part of the inflation problem of recent years has been corporate profits. These profits have been a major factor in the rising price level, as business has sought to maintain or increase large profit margins. Moreover, these soaring profits have been fueling the fires of the inflationary boom in business investment in plants and machines—the only part of the economy in which demand has been rising rapidly in the past year and one-half, while all other economic sectors have been leveling off, rising modestly or declining.

Corporate profits shot up sharply in the 1960's, much faster than wages and salaries.

In the first half of 1969, corporate profits after taxes were up 93 percent from 1960.

But the after-tax personal income of all Americans was up on 76 percent—about one-fifth less than profits. And that includes the effects of a large increase in employment, as well as the income gains of individuals.

The after-tax weekly earnings of the average nonsupervisory worker were up only 34 percent—three-fifths less than profits. In terms of buying power, the gain was only 10 percent.

The record of price, profit and wage trends led Peter L. Bernstein, president of Bernstein-Macauley Inc., a New York investment counseling firm, to state in the Wall Street Journal of August 5, 1968: "the pattern is clear enough. Instead of labor costs pushing prices up, what we see instead is a sort of profit push."

And as the noted Yale University economist, James Tobin, declared: "There's no question that excessive labor costs and fuel to inflation. But if you want to put first things first, have a look at the role of profits."

However, business is trying to protect its profit levels by raising prices at an accelerated rate. In the second half of 1969, total profits dipped slightly, as industrial production moved down and the sales of many businesses leveled off or declined, under the impact of the administration's severe squeeze on the economy.

The top managers of big business have also been amply protecting their own large incomes, through salary boosts, bonuses and stock options. In a recent study of corporate executive pay, the New York management consulting firm, McKinsey & Co., reported, according to the Wall Street Journal of November 14, 1969, that "the average chief executive's compensation jumped 9.8 percent in 1968." Increases ranged as high as 18.8 percent in motor vehicles and equipment and 17.6 percent in paper and allied products.

"Business executives generally agree that the higher rate of compensation is continuing in 1969," after last year's 9.8-percent average boost, the Wall Street Journal stated.

The source of these top-drawer compensation hikes has been the soaring profits of big business. According to the Wall Street Journal's account, "Mr. Foote of McKinsey notes that for some of the industries that boosted executive compensation the most, 1968 was a year of fat profits. Thus, bonus plans tied to profitability paid out handsomely, thereby boosting the compensation to key men by large amounts."

But there have been no outcries from Government spokesmen or the news media about the size of such pay boosts, which amount to more than the total yearly earnings of most workers.

The administration has failed to put first things first, in its economic measures. The administration's policy of a severe squeeze on the economy—with very tight money, the highest interest rates in 100 years and cuts in public construction—have hit homebuilding, smaller businesses, State and local governments, workers in many industries and consumers. But it has, thus far, had little effect on the big corporations—with their huge internal flows of cash and lines of credit at the banks. As a result, the boom of business investment in plants and machines continues, while other parts of the economy are being hit.

Moreover, the administration's tough restraint on the economy is not directed at the areas of sharpest increases in consumer prices—such as auto insurance, housing, health care and hospitalization.

Tight money, high interest rates and reductions of Federal appropriations for essential Government programs slow down the entire economy, depress residential construction and result in rising unemployment. In addition, the soaring rise of interest rates, itself, contributes to the rise of prices . . .

However, the soaring price of money has boosted bank profits. The Commercial and Financial Chronicle of January 15, 1970 reported, "it is estimated that of the 25 major commercial banks, earnings were up approximately 12½ percent in 1969.

Confronted by these developments in recent years, the AFL–CIO has urged the Government to combat inflation through selective measures, specifically aimed at the profit inflation, the business investment boom and other trouble spots, rather than a severe squeeze on the economy as a whole—with its discriminatory impacts on homebuilding and other sectors of the economy.

Furthermore, as the AFL–CIO has stated on numerous occasions since early 1966: "If the President determines that the situation warrants extraordinary overall stabilization measures, the AFL–CIO will cooperate, so long as such restraints are equitably placed on all costs and incomes—including all prices, profits, dividends, rents and executive compensation, as well as employees' wages and salaries. We are prepared to sacrifice as much as anyone else, so long as there is equality of sacrifice."

However, the squeeze on the economy continues and prices continue to rise at a fast pace.

At the bargaining table, there is no other recourse than to seek substantial gains—to offset increased living costs and to try to achieve an advance in living standards.

AMERICAN LIFE CONVENTION AND THE LIFE INSURANCE ASSOCIATION OF AMERICA

This statement is submitted on behalf of the American Life Convention and the Life Insurance Association of America, two trade associations with a combined membership of 358 life insurance companies which account for 92 percent of the legal reserve life insurance in force in the United States. The total assets of the life insurance business aggregate $198 billion, which represents the savings that have been entrusted to us by millions of policyholders. The protection of the economic value of these savings is of vital concern to our business. We appreciate the invitation of the Joint Economic Committee to express our views on the economic issues which confront the Nation, as part of the committee's hearings on the Economic Report of the President.

Policies To Control Inflation

Fiscal and monetary policies during the past year have worked in harmony to restrain economic growth and to curb the pace of price inflation. The effectiveness of these policies is demonstrated by the flattening out of gross national product (expressed in constant dollars) during the last quarter of 1969, and by the slower rate of price inflation, which declined from a 5.4 percent annual rate in the third quarter of 1969 to a 4.7 percent rate in the final quarter. Nevertheless, these results are only a first step in the direction of the ultimate goal of noninflationary, sustainable economic growth. At this critical juncture, it is essential that policies of restraint are kept in force long enough to stifle inflationary forces and to dissipate widespread expectations of further inflation ahead.

Inflationary trends in 1968 and 1969 resulted from the combined forces of excessive demands which produced a demand-pull on prices, reinforced by upward wage and cost pressures which produced a cost-push effect on price levels. The leveling trend of real output indicates that demand-pull pressures have largely disappeared because of fiscal and monetary restraints on total spending. However, these restraints are still needed in the present environment to hold back cost-push forces that continue to exert upward pressures on price levels. More time will also be needed to correct the deep-seated inflation psychology, which has stimulated anticipatory demand in such areas as the capital goods sector and has added to credit demands in the financial market.

In the present setting, it is vital that Government policies in 1970 continue to press in the direction of restraint, in order to avoid a resumption of an intolerable rate of price inflation and a reinforcement of inflationary expectations.

Economic Outlook for 1970

The Council of Economic Advisers, in its annual report for 1970, projected gross national product for this year at $985 billion, midway within a possible range from $980 to $990 billion. We are somewhat skeptical of the degree of recovery seen by the Council for the second half of the year, but the overall forecast is well-founded and consistent with the outlook as seen by many well-informed private economists. Our principal reservation is on the Council's anticipated rate of inflation for the final quarter of this year. The Council has indicated that the inflation rate in the fourth quarter of 1970 might be about 3 to 3.5 percent, but this forecast appears to be on the optimistic side. It is our judgment that present policies of restraint, in the face of strong underlying pressures on wage rates and other cost factors, may succeed in bringing down the inflation rate to only 4 percent in the final quarter.

Regardless of the exact outcome, it is clear that an inflation rate as high as 3.5 or 4 percent by the end of 1970 still would fall short of the goal of reasonable price stability. Inflation at these rates would be more than double the annual rate of price advance between 1959 and 1965, a period generally viewed as one of price stability. Unless inflationary expectations are dissipated by clear and decisive progress in bringing down the inflation rate well below 4 percent, business and personal decisions as to the amount and form of saving and spending will continue to be distorted by the fear of a long-term inflationary trend.

Accordingly, we believe that the fight against inflation must be considered as a matter for persistent Government action, and not set aside at the first early signs that progress is being made. The underlying attitudes and economic decisions which lead to inflation cannot be altered or reversed within a few short weeks or months. The Nation's economic policies must be aimed not merely at the remaining months of 1970, but toward the economic climate of 1971 and beyond.

Fears have been expressed that present policies of fiscal and monetary restraint might turn the economy into a severe downturn or recession in business activity and employment. Without question, this possibility deserves careful and continuing scrutiny in the formation of economic policy. It should be recognized, however, that the fundamental demands for goods and services in our economy remain strong. Within both the public and private sectors, the aspirations for greater spending remain high. In the unexpected event that a sizable business downturn should begin to develop, stimulative measures are readily available to both the Congress and the monetary authorities which would rapidly reverse the downward trend.

As the annual report of the Council points out, one consequence of continued restraint and a slower rate of real growth may be a somewhat higher rate of unemployment than we have seen in recent months, as individual sectors of the economy adjust to smaller markets and lessened demands for their products. As recently reported, the current rate of unemployment stands at 3.9 percent, even after several months of level output in real terms. The Council has indicated that a deflationary gap between potential output and actual output during the balance of this year may be accompanied by modest monthly increases in the unemployment rate, with an average unemployment figure of perhaps 4.3 percent for the year. To smooth the adjustment in production and job patterns, and to avoid hardships for individual families affected, every effort should be made to utilize job-training and manpower programs which will develop better skills and improve worker mobility during this transition period. In our efforts to correct an overheated economy which has been characterized by abnormally low unemployment rates, we must not neglect the need to moderate the impact on those who suffer a temporary interruption in employment during the transition to stable economic growth. The annual report of the Council describes several measures that will be considered by the Congress toward this end.

In gaging the adverse impact of anti-inflation policies on employment levels, we must also bear in mind the onerous effects of inflation upon the economic position of lower income families and disadvantaged groups within our economy. In spite of general prosperity, there are many who find themselves barely able to obtain a minimum level of food, clothing, and shelter. The prices they must pay for consumer goods have increased by more than 10 percent during the past 2 years alone. Many families and individuals are without means of raising their meager incomes to compensate for the effects of inflated prices. These groups have been victimized most by past inflation and are threatened most by continued inflation which would decrease the purchasing power of their limited incomes.

Annual Budget Message

In the President's annual budget message covering the fiscal year 1971, total Federal spending is projected at $201 billion, an increase of almost $3 billion over fiscal 1970. In our view, this $201 billion spending estimate represents the maximum level of Federal Government outlays that can safely be permitted in our present inflationary climate, and it should be a primary objective of the Congress to keep total spending within these bounds. With projected budget receipts of $202 billion, a narrow budget surplus of just over $1 billion is indicated for fiscal 1971. We believe that the preservation of a balanced or surplus budget in fiscal 1971 is of critical importance, to avoid generating renewed inflationary pressures from the Federal sector.

There have been widespread doubts as to the ability of the Federal Government to hold down expenditures in fiscal 1971 to the levels projected in the President's budget message. Recent experience with spending ceilings under the fiscal 1970 budget gives little reassurance on this question. We cannot emphasize too strongly the importance of limiting total government expenditures to the level set forth in the President's budget request. In our opinion, the Congress should be prepared to extend the 5-percent surcharge on personal and corporate income taxes beyond June 30, if total Federal spending is permitted to rise above the $201 billion level now projected in the budget message. Only in this way would it be possible to achieve the budgetary surplus or balance so vitally needed to limit the inflationary pressures such additional spending would impose on the economy.

A second reason for maintaining a budgetary surplus in fiscal 1970 relates to credit markets, and particularly to the residential mortgage market. To the extent that the Federal Government is a net borrower because of a budgetary deficit, this attracts funds away from other uses, including savings that would otherwise flow into savings deposits with thrift institutions that supply the mortgage market. When the Federal Government and its agencies issue debt securities at higher yields than the deposit rates paid by savings institutions, the mortgage market suffers from the competing demand for funds. On the other hand, a budget surplus allows the Federal Government to repay its debt and thereby supply funds to the credit markets. With the severe shortage of housing credit that presently exists, the Federal Government should avoid drawing funds away from the mortgage market through a budgetary deficit, but seek instead to assist the flow of savings into mortgages by maintaining a budget surplus.

Federal Reserve Monetary Policy

The Federal Reserve System deserves commendation for its stalwart adherence to a restrictive monetary policy over the past several months, in the face of pressures for a relaxation of credit restraint. Restrictive monetary policy has limited the credit-based demands on economic resources, and has been a prime factor in the decline in the rate of inflation in recent months. Moreover, the present degree of monetary restraint has been attained without producing a money crisis or market panic, which in the past has sometimes occurred in financial markets under stress.

In our opinion, the time may be near at hand when a moderate and gradual relaxation in the degree of monetary restraint may be appropriate to the changing economic climate. Such relaxation, however, should be conditioned on (*a*) visible evidence of further progress in reducing the rate of inflation, and (*b*) continuation of fiscal restraint through a balanced or surplus Federal budget. We feel strongly that a sudden or rapid shift toward active ease in monetary policy should be avoided. Such action would dangerously strengthen inflationary expectations and confirm a widespread belief among many businessmen that anti-inflationary policies will not be pursued to the point of needed adjustments in business planning or production schedules. Many businessmen, it is widely recognized, have been looking beyond the present period of restraint to the other side of the valley when downward pressures on the economy will be lifted, when demand will be stimulated by a freer flow of credit, and when growing markets will permit prices to be increased.

The persistence of a restrictive monetary policy has helped to persuade many businessmen that they cannot count on unending inflation and that they must adjust their business planning accordingly. These new attitudes must be fostered and strengthened if inflationary expectations are to disappear. Accordingly, any moves toward a moderation of monetary restraint should be gradual and tentative, with due regard to visible progress toward deceleration of the inflation rate.

Longer Run Outlook for 1970–75

A major innovation of the annual report of the CEA this year is a 5-year projection of gross national product, measured against the claims on total output from the public and private sectors. The

Council deserves commendation for this valuable approach to the question of national priorities and the capacity of our economy to satisfy the many demands on total output. As President Nixon has stated in his Economic Report: "We have learned that 1-year planning leads to almost as much confusion as no planning at all, and that there is a need to increase public awareness of long-range trends and the consequences for future years of decisions taken now."

The Council's analysis provides a concrete demonstration of a fundamental fact of economic life, in the Council's words, that "The total of satisfied claims cannot exceed the available output." In its projections, the Council shows that "existing, visible, and strongly supported claims already exhaust the national output for some years ahead." Not until 1973 does a narrow margin emerge between projected claims and potential output, to permit additional claims on total output to be considered.

For simplicity, the Council's projections have been made in constant prices; that is, without making allowance for a possible inflation trend during the years 1970–75. Another assumption in calculating potential output has been an assumed unemployment rate of 3.8 percent. The question arises as to whether the 3.8 percent unemployment assumption is compatible with constant prices, since this level of unemployment has been associated in the past with strong upward pressures on wages and price indexes. A more widely accepted assumption to express full employment would be a 4-percent rate of unemployment, which would produce a smaller growth in potential output than is shown in the Council's projections. On this more realistic basis, total output available in 1975 might be lower than the Council has shown, and the narrow margin of output available for unspecified claims in 1975 would also be lower.

While the Council has projected claims on available GNP in constant prices, a reworking of the projections with allowance for various rates of inflation would doubtless produce much different results. One of the adverse economic effects of inflation is that it falls with uneven force upon different sectors and groups in the economy. Thus, inflation can upset or distort the order of priorities among competing claims on total output. For example, dollars projected to flow into residential construction over a 5-year period will produce far fewer housing units than expected, if inflation forces up construction costs and home prices. Similarly, inflated prices of consumer goods and services can alter drastically the real value of personal expenditures projected over 5 years, when the distorting effects of inflation are taken into account.

The Council's long-range forecosts of claims on GNP point up the fundamental need to bring inflation under control so that national priorities and competing claims can be planned or considered in a more orderly way without a reshuffling of such priorities through the uneven impact of inflation.

Conclusion

The long-range objective of our Nation's economic policies should be to encourage balanced growth and efficient production, which can only be achieved in an environment of reasonable price stability.

Fiscal and monetary policies, working to restrain excessive demands in an overheated economy, have demonstrated their effectiveness in reducing the rate of inflation over the past several months. Still, we are a long way from winning the battle against inflation and it should be clear that persistent and skillful policies of continued restraint will be needed throughout 1970 and possibly into 1971. Toward this end, we would urge the Congress to make every effort to achieve a budgetary balance or surplus in fiscal year 1971. Total Federal spending should be kept within the bounds projected in the Annual Budget Message or, if this does not prove possible, an extension of the 5-percent income tax surcharge should be enacted to produce offsetting revenue gains. Any relaxation in monetary restraint should be gradual and tentative, conditioned upon clear signs of a deceleration of the inflation rate and the maintenance of a Federal budgetary surplus. The impact of antiinflationary policies upon employment levels should be cushioned by increased job training and manpower programs along with other measures to relieve hardship and provide a smoother transition to stable economic growth.

The stakes are high in the fight against inflation. Those hit hardest by inflation are often least able to defend themselves—the elderly, the disadvantaged, the poor. Inflationary expectations have contributed to the highest interest rates in this century and have disrupted credit flows in the financial markets, to the disadvantage particularly of the residential mortgage market. If inflation is brought under control by determined Government policies, we can look forward to a longer range outlook of more balanced and sustainable growth. If inflation proceeds unchecked, we face an uncertain future of disrupted credit flows, distorted spending and saving decisions, and an uneven loss of purchasing power among the various groups in our economy.

CHAMBER OF COMMERCE OF THE UNITED STATES

By DR. CARL H. MADDEN [1]

The Chamber of Commerce of the United States welcomes the opportunity to comment on the "Economic Report of the President," and the "Annual Report of the Council of Economic Advisers."

THE NEW DECADE: THE QUALITY SEVENTIES

A new decade is a good time to consider, as the reports do, some longer range issues and problems. As a nation, we have the vital potential to act together to invent the future rather than, by preoccupation with short-view issues, to end up its victim. The reports acknowledge our ability to choose.

The 1960's was an era well put behind us. Most people said good riddance to it. It was an era that ended with continuing world turmoil, inflation, social tension and violence, alienation and anomie. In the 1960's we learned in disturbing ways that Americans could find themselves getting rich faster but enjoying it less.

Economic policy in the 1960's was often a response in terms of the historic past—mainly of unemployment, stemming from the depressed 1930's and the postwar adjustment years. From getting the economy moving again, the 1960's took us through the new economics (in fact, the old economics of the 1930's, as its practitioners kept warning). When practised in a political climate of belief in our economic omnipotence, the new economics of the guns-and-butter policy left an unhappy legacy. It was a legacy of unrealized full-employment budget surpluses, escalating Government deficits, and accelerating inflation. It was a legacy of the credibility gap between intent and performance in governmental programs. It was a legacy of disturbing new insight into the potential destructiveness of full-blast production and consumption.

The 1970's is likely to be a decade of concern with quality. Adequate quantity and our ability to produce it are likely to be (perhaps unwisely) taken for granted. The pressing concerns will be not merely more but also better jobs, products, services, social services, institutions, and environment as the Nation searches for social and economic tranquility.

The 1970's is likely to be a watershed for economic and social policy. The knowledge revolution we are living through challenges existing concepts and institutions. The new knowledge produces impressive opportunities for social and economic policy. It also produces a new pessimism that questions whether mankind can manage his affairs without self-destruction.

The pessimism of the 1970's is reflected in the extreme distortion of U.S. institutions by the new left, the extreme avoidance of change in

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the new right, and the extreme withdrawal from involvement among the ghetto youth and in the post-hippy commune. These three responses—of distortion, avoidance, and withdrawal—are classic textbook human responses to powerlessness amid rapid change.

The acute disturbance of perhaps 20 percent of our youth by the forces of social change produced by the revolution of knowledge has its counterpart in what some observers see as the chaos, pessimism, and paralysis of will in the dominant adult society. Thus, Philip Hauser, in his 1969 presidential address to the American Sociological Association, said: "Contemporary society, whether observed globally, nationally, or locally, is realistically characterized as 'the chaotic society' and best understood as 'the anachronistic society.' " Our chaos, as Hauser sees it, stems from our diversity of people which multiplies tensions, our urbanism which crowds them into more frequent interacting contacts, and our doomsday technology of nuclear, biochemical, and pollutant weapons.

The development of what Prof. Rene Dubos of Rockefeller University describes as "the new pessimism" is a social datum for economic policymakers to consider, whether they agree with it, or accept it, or not. So acute an observer as Dubos writes: "As the year 2000 approaches, an epidemic of sinister prediction is spreading all over the world, as happened among Christians during the period preceding the year 1000."

So the presidential call for "a new realism" in his economic report is surely timely. His call suggests that, lest important and influential creative minds among us—both young and old—abandon the pursuit of reason in men's affairs, the task of policymakers in the 1970's is to demonstrate anew the efficacy of reason. The spread of "the new pessimism" lends weight to the President's observation in the economic report that "there is a need to increase public awareness of long-range trends and the consequences for future years of decisions taken now."

It can be argued that the impact of the knowledge revolution on social and economic policymaking is only beginning. If so, in the 1970's our society will have to learn far better than ever before to respect, organize, and use social and economic knowledge. Society will have to learn to bring its resources systematically to bear in social affairs the way we now use our resources systematically in scientific and technological applications.

A great philosopher, Alfred North Whitehead, perceived that the greatest invention of the 19th century was the invention of the method of invention. We have an analogous lesson to learn beginning in the last third of the 20th century about social and economic affairs.

It is not simple to develop throughout society a belief in and will to apply the spirit and method of scientific inquiry and procedure in social and economic affairs. The process is cultural and involves broadening the general level of understanding. It is not a matter of shifting analysis and inquiry to government but, rather, of increasing standards of information and analysis throughout our open and pluralistic society. It is not a matter, either of concluding that a systematic effort is all that is needed to solve social and economic problems by analogy to our systematic organization of, for example, the space effort to get a man on the moon.

Lying behind the moon shot were literally centuries of struggle to develop the traditions and spirit of scientific enterprise in industrial affairs. In social and economic affairs, such a tradition is not yet so firmly established, partly because the data of social and economic affairs involve the passion and prejudice, the ignorance and perversity, of human emotions. Yet, our vision as a society of the possibilities for institutional change and invention needed to develop systematic models and approaches, imbued with human understanding, to social and economic issues remains tragically clouded and truncated compared with our belief in, acceptance of, and enthusiasm for systematic approaches to problems of industrial technology.

Too few resources are invested in well-designed adequate data bases for social and economic decisions involving billions of dollars. Too few industrial or academic laboratories exist to study manpower, crime, or welfare policies or the nature and dynamics of urban growth. There are scattered signs that moves in these directions are getting underway. But much remains to be done by industry, by universities, other economic sectors, and government at all levels, in order to achieve the scale needed to act intelligently.

As part of the national effort to bring knowledge to bear on social and economic problems, problems of scale and of public participation need to be resolved. Many present research efforts in social sciences are wasted because they are badly designed, on too small a scale, and tailored to fit grants and resources rather than to fit the scope and nature of problems. Public participation—as urban renewal and freeway designers are discovering—is required if knowledge is to be accurate in reflecting people's preferences and social facts.

In the 1970's, ordinary people will want to be better informed and to participate more in social and economic policy analysis and formulation. The press reports today that ghetto residents and others, including college students, feel alienated from these processes. Thus, we see challenges to our existing methods of communicating, such as the April 22 teach-in throughout the Nation on environmental issues.

Alienation very likely is a function of two factors that have risen to the fore during this century: Population growth and density and the expanded and changed role of government.

A large and urbanized population means that the individual has a lesser voice in societal decisions. Thus, if an individual is one among 10 voters, his vote is 10 percent of the total; if he is one among 1 million voters, his political influence as a voter clearly is diminished. As the role of government is expanded, decisions are politicalized. Even with a small population this means that decisionmaking is transferred from the individual to the government. But when population increases greatly and many more decisions are politicalized, the role of the individual in decisionmaking—and his power and importance—all are very sharply diminished indeed. It seems probable that the growing sense of alienation and anomie are directly derivative from the population explosion and concentration and the government explosion and concentration.

The teach-in and its methods at their best in large part can represent learning—but different from the classroom method. Likewise, in the 1970's existing ways of communicating social and economic problems may come under pressure to change. Communications media—particularly TV—could become increasingly powerful purveyors of organized knowledge. A good example of what TV can do is the hour-long, prime-time program last fall on inflation, sponsored by a leading business firm, and carried by a major network. Other examples in the 1950's came from the work of Edward R. Murrow. The Joint Economic Committee, already active in economic education, can play a broader role in helping people to get informed and active in national economic and social policymaking.

Old Concerns, New Directions

One hard lesson of the 1960's was the national rediscovery of relative scarcity in the guns-and-butter experience. The Nation, faced with a 4-year excess of money claims on its resources that has pushed prices higher, is in process of reexamining goals and priorities, and hence its policies and programs.

We are called an affluent society, yet we are not nearly so affluent as some have appeared to believe. The last decade once again dispelled the recurring myth that we can afford, at once, everything we desire. We are learning again that we must choose among desired alternatives because our resources are limited relative to our desired uses of them.

CONCERN WITH ECOLOGY

A new dimension of resource scarcity is implicit in the recent widespread concern about ecology. Enormous costs must be incurred to prevent further environmental deterioration and to conserve the earth's physical capital of air, water, and surface earth. Put differently, we have not included all costs in our reckoning of national income. There is growing recognition that we have been overstating our national income because we have not accounted for the deterioration of our environment.

Environmental pollution in important cases appears to be not an incidental byproduct of industrialism and population growth, but an intrinsic property of the very technology used to increase productivity. Examples abound. The use of inorganic fertilizers that produce nitrogen and phosphorous runoff results in the fertilization of water bodies, multiplying algae and fouling the water, and so on.

Environmental pollution thus represents an enormous but uncalculated social cost stemming from industrial and consumer technology and arising in important part from its intrinsic properties. In some cases, the possibility exists—as in the dependence on inorganic fertilizers or persistent insecticides—that the environment is so altered as to force continued dependence on pollutant agents for the existing standard of living because biological systems previously supportive are destroyed. For example, inorganic fertilizers used much more intensively could possibly destroy soil micro-organisms which now sustain soil fertility.

Concern with ecology reflects an intrinsic property of a dynamic, learning society. The revolution of knowledge requires renewal of institutions and concepts so that they conform to new knowledge. The imperative, indeed, of knowledge is that it be reflected in institutional behavior. Recognition of ecological (systems) effects of individual business moves to increase productivity, requires new governmental framework rules that make social costs—hitherto uncalculated—explicit and that treat those costs in systematic ways.

Government, through policy study and analysis by bodies such as the Joint Economic Committee, can exercise leadership in a reassessment of attitudes toward the natural world on which our technology intrudes. The fact is that technology has made us more—not less—dependent on as yet unaltered nature because, barring severe reductions in living standards and population, our dependence on technology is irreversible. And barring hysterical public responses, recognition of ecological dangers can lead to effective measures in dealing with this newly recognized dimension of scarcity.

Government, through adequate policy analysis, can design framework rules which alter concepts of cost, productivity, profit, and risk to reflect systematic accounting for environmental effects. Government has alternative approaches to consider. It can set standards of purity (weighing benefit against cost for various desired levels), set pretesting rules for ecological effects of products, tax pollution or subsidize abatement, provide financial and other incentives to development of waste disposal industries, finance research into substitute technologies, and so on.

Each policy alternative develops consequences for the economic system. Setting standards, for example, leaves individual economic units free to respond in alternative, competitive ways and internalizes costs in the price of products. Polluters and their clients would bear the costs of meeting the standards, rather than shifting them to the public at large. There are strong arguments that internalizing and privatizing costs by setting performance standards would involve the least distortion of markets, provide incentives to choose the most efficient means of meeting the standards, assure future flexibility in varying the means as conditions change, and most closely approximate the requirement of equity.

Taxation and subsidy measures essentially are cost-sharing rather than antipollution devices. Taxation penalizes existing plants in older industrial regions and favors new plants having abatement facilities built in. Subsidy of abatement has generally reverse effects, favoring older plants and penalizing newer, pollution-free plants. Since river systems are distributed geographically in nonrandom fashion, payments to local governments along streambeds subsidize them against urban areas removed from water. Federal financing of antipollution efforts by States and localities redistributes tax revenues. Federal research on antipollution devices reduces risks in some industries (the risk of discovery costs) as against others.

In a learning society living through an explosion of knowledge, it takes time and resources to develop policy which conforms to scientific method, reflects equity, and is tolerably understandable. The banning of cyclamates is an example. Food processing on a commercial scale is barely 75 years old. The methods of epidemiology and biochemical testing for cancer from continued ingestion of carcinogenic substances are barely 20 years old.

The President's program on the environment, in his message to Congress of February 10, proposes a broad program. It includes Federal standards and penalties for their violation, financial aid to local government, incentives for research and development, and incentives for waste disposal. Establishment of a Council on Environmental Quality was provided for by the National Environmental Policy Act of 1969, which was signed by the President on January 1, 1970. The Joint Economic Committee, given its broad mandate to study the workings of the economy, should have a keen interest in measures of environmental control and their impact on costs, productivity, prices, the distribution of income, and the enhancement of the free enterprise system.

The issue of ecology illustrates important considerations for the Joint Economic Committee. In the 1970's, the committee is likely to find itself studying more issues that relate the impact of new knowledge to the concepts and institutions of our economic system. Policy analysis will take more time and resources. Decision rules in alternative policy recommendations should reflect scientific understanding. There is great need for better data bases and for more systematic research in social sciences underlying such alternative rules. There is need and desire for more public understanding and participation in the policy-making process.

RESOURCES AND GOALS

The prospects for growth of the U.S. economy in the 1970's are bright. Even so, the prospect for added goals, such as ecology, is as sure or surer. In the 1970's the Nation enters a period of searching for new means of expressing choices as to the allocation of growing but still relatively scarce resources at our command among competing, desirable ends.

The search for new methods of choice is widening, and it is significant to business and government. The growth of futurism illustrates the search. It stems from writings of de Juvenal, Gabor, and others; and from the development of methodology at the Rand Institute, the Harvard Business School, Dartmouth, and elsewhere. Futurism can be interpreted as using concepts of Whiteheadian process philosophy and modern decision-theory to examine what Whitehead called "the infinite possibilities that inhere in the future." Futurism rejects the method of limiting future possibilities that is implicit in projecting past trends, like arrows, ahead. Futurism, in a happy phrase, emphasizes that mankind has choices about the future—that mankind can in part "invent the future."

The intellectual thrust of futurism is to examine utopian possibilities systematically, in order to escape the straitjacket of past myopias. Concern with futurism leads to interesting efforts to seek out speculative knowledge. It leads to systematic methods suggestive that some technological change can be forecasted. It leads to concern with "alternative scenarios" for the future, employing utopian imagination as tools of thought. Such methods already find employment in long-range planning of progressive business firms intent on innovation. Their results are studied by other business firms concerned with the changing business environment. And nonprofit institutes are at work exploring implications of such societal forecasting. Though heuristic, futurism stimulates imagination and constructive anticipation, but at the same time it can fit resources and competing goals into an orderly framework of alternatives for public consideration and understanding.

In this context, the "1970 Annual Report of the Council of Economic Advisers" makes a valuable contribution. Although hardly futuristic, its innovative discussion and projection of available resources and competing claims for them emphasizes the need for setting priorities. Though uses of output are unspecified, the analysis contributes to public consideration of goals and priorities. These 5-year calculations of GNP potential, of claims against it, and of Federal expenditures on national income account, should become regular features of the annual reports.

In the same context, also important is the work of the Presidents' National Goals Research Staff. Announced July 12, 1969, the staff is responsible to forecast future developments, assess long-range consequences of social trends, measure probable future impact of alternative courses of action, and estimate actual ranges of social choice available to the Nation. The Goals Research Staff report, set for July 4, 1970—looking forward to the 200th anniversary of the United States—should be the subject of careful congressional study and hearings.

The advantages are clear of broadening the public understanding of long-range trends and the future consequences of present decisions. What may not be so clear is the limitation necessarily inherent in any effort to delineate future possibilities. While some technology can be forecast, genuine novelty appears to exist in the processes of reality. Futurism as a guide and discipline of imagination, and as a template for alternative possibilities, may well become a valuable tool of thought for developing new methods of broad choicemaking on national priorities in a free society.

The outlines of method seem clear, in the Council's annual report, for improving Federal decisions. The report argues for: (1) Studying long-range trends and identifying alternative goals; (2) evaluating Government organization for making long-range policy decisions; (3) evaluating costs and benefits of existing and proposed programs; (4) evaluating results of existing programs; (5) considering the time pattern of results and discounting future benefits; and thus (6) formulating the larger choices in allocating the national output.

The new methods of the Council bears a close relationship to the excellent study of the Joint Economic Committee's Subcommittee on Economy in Government. In its report of February 9, 1970, "Economic Analysis and Efficiency in Government," the subcommittee makes important recommendations contributing toward the deepening application of economic principles to the organization and operation of the Federal Government. The report shows throughout a valid and important concern for appropriate staffing of the Congress so that it can make a larger contribution to more sophisticated policy analysis and program evaluation.

In the reexamination of national goals and priorities, changing wants and preferences are playing an important role. Indeed, such changes remind us that the methods of futurism are more easily applied to technological and economic than to esthetic, ethical, and social change. Changes in wants and preferences also remind us that futurism is far from value free even in its most antiseptic formulations. The greatest risk of "surprise free" scenarios is, to be sure, surprises.

Full employment, economic growth and stability, remain important—indeed, vital—economic policy objectives. There are indications, however, that these goals are inadequate, taken by themselves, even as shibboleths, for the coming decade. Qualitative aspects of our economic life are, instead, of growing concern to specialists in many fields and the public in general, for whom accepted economic goals are taken for granted.

Concern with the quality of life is reflected in a myriad of issues beyond those of air, land, and water pollution. The knowledge revolution produces challenges to renew institutions in fields of education, medical care, and consumer products; in agriculture and rural development; and elsewhere.

Thus, improving the institutional machinery of medical care, education and labor markets is a key concern. Improving job opportunities and rewards, upgrading the quality of the work force—these are as important issues for the generation of the 1970's as was Government action to provide jobs for the 1930's. Alarm about chronic inflation has supplanted concern with depressed economic activity.

Public concern about the uses of growth is also finding increased expression as an economic goal. Economic growth, now confidently expected from year to year, is seen as providing incremental resources to upgrade the quality of the environment, at times even at the expense of present consumer quantity standards, without sustaining an absolute reduction in per capita income. It is reasonable to suppose that a larger proportion of the growth increment will be diverted into measures to effect quality improvements. At the same time, population growth and patterns of land use will come in for much closer study and direction. Efforts will be made to direct growth from expanding metropolitan centers to less congested hinterlands and regions in an effort to reduce pressures of numbers and complexity and to strengthen economies of smaller places.

Increased emphasis on the quality of life and on structural aspects of the economy and of institutions suggests the need for more resources to be devoted to regional and urban studies, as well as to studies of the efficiencies of institutions. In the face of poorly informed but well-intentioned calls for "reversing the flow of people to the cities," there is a significant body of economic and social knowledge concerning the geographical structure of the United States and of other advanced economies. Politics which ignores such basic structural features will suffer the cruel fate of ineffectiveness and waste of resources and eventual public revulsion.

Studies should be made of the national economy's geographic structure. Evidence suggests that ours is a nation comprised of a system of metropolitan communities composed of central city, suburb, exurb, and hinterland. The influence on the distribution-per-unit area of many forms of economic activity of metropolitan centers extends as far as up to 200 miles away. Throughout the Nation's history, urban places—over long periods of time—show a definite pattern in their geographic distribution. For one thing, urban places are arranged in each region in a hierarchy or pyramid of size and numbers, with a regional center, then increasing numbers of places of decreasing size in spiderweb pattern out from the center. Urban places decrease in average size depending on their distance from 200 or so leading metropolitan centers (SMSA's), the average size declining outwards of 45 miles or so from the centers. And, although the press headlines "our crowded cities," the average space per person for urban dwellers has been increasing during this century.

A large body of evidence suggests that the United States can be usefully viewed as a hierarchial system of metropolitan communities, with statistically significant relationships between sizes and distances between urban places of various sizes. Further, study of the developing eastern megalopolis stretching from north of Boston to south of Washington shows that arbitrary distinctions between "urban" and "rural" populations are obsolete and misleading.

Finally, migration patterns within the system of metropolitan communities reflect statistical regularities associated with the rise in productivity of our economy and the rise in income of migrants. Even today, migration is often viewed as massive, mostly from rural to urban, and mostly black. There is a belief migrants are poorly educated, likely to end up jobless, and on welfare. But these beliefs are factually incorrect. Most moves of migrants are for short distances; net nonwhite migration is in fact quite small; most long-distance migrants are better educated than nonmigrants; most migrants are young; Negroes are less likely to move out of county than whites; most nonwhite, male migrants are likely to be employed soon after migration; and most poor migrants from rural to urban places experience an increase in income, the increase being bigger on average, the bigger the urban place of destination.

These empirical observations about our system of metropolitan communities are only examples of long-term structural features characteristic of most developed economies. They are part of the study of human ecology, and they need understanding as a basis for policy proposals and analysis. Otherwise, proposals advanced in ignorance, such as would promise to scatter new towns at random like seeds across the landscape, or would promise every bypassed and isolated hamlet a renaissance, are likely to create disappointed hopes and further disillusionment with government programs.

Currently, the United States lacks anything which could be called an urban policy, although the historic move toward urbanism is more than a century old. Elements of governmental policy toward urban development are scattered, inconsistent, duplicative, and confused. Creation of the President's Urban Affairs Council is a first move. However, the key to effective policy in economic development depends on appropriate concepts, as illustrated by the brilliant concepts of the Agriculture Department in the move to diversify agriculture in the South during the 1930's. Appropriate concepts, in turn, depend upon careful assembly and reduction of existing study and data into a coherent explanatory model which possesses fecundity of implication and usefulness in reducing information overloads. This principle is at the heart of the process of theorizing in all the sciences.

In considering urban policy, the Nation by and large lacks the benefit of any system of thought analogous to the concepts which have shaped consideration of national income and output. Government has shown little appreciation of the need for such understanding as part of the cultural process. "Solutions" to urban problems have tended to be simple in concept and piecemeal in character. Yet, as students of complex systems such as Jay W. Forrester point out, when dealing with complex systems, simple and piecemeal solutions are not only apt to be wrong; they are apt to be perverse. As Forrester observes in his study, "Urban Dynamics" (p. 9): "Choosing an inffective or detrimental policy for coping with a complex system is not a matter of random choice. The intuitive process will select the wrong solution much more often than not."

The United States lacks not only appropriate concepts in governmental urban policymaking; it lacks a systematic and orderly data base for observing the changing developments in metropolitan communities. Newspaper and TV journalistic accounts analyzing metropolitan developments remain the chief source of public understanding. While at time brilliant and enlightening, because of richness of detail, journalistic treatment as a rule is not designed to impart a systematic understanding of urban or metropolitan structure.

Efforts to develop a system of social indicators which might clarify issues of the social benefits and costs of public and private social decisions reveal glaring defects in our information on social phenomena such as health care, disease incidence, crime, migration, education, and many other phenomena. We have not attempted seriously to make even crude use of concepts of human ecology as guides in giving configuration to data bases. This is not so much that scholars have not studied these matters. It seems to be because we do not realize as a society the value or significance of devoting resources to organizing such knowledge in order to make social and economic decisions of both public and private institutions more effective. Institution after institution—professional, industrial, voluntary, and governmental—seem to lack standards for requiring that hard knowledge be brought to bear in urban policy analysis and decision.

Meanwhile, human ecology remains as important to understand and disseminate to the public as biological ecology. Social cost-benefit analyses of life in urban places of various sizes are usually misstated and are certainly not well understood. Scholars living in great metropolitan centers and employed by distinguished research institutions publish sentimental essays about the need to "reverse the migration flow to our overcrowded cities" without apparently adequate knowledge of their subject. Meanwhile, the resources of research talent and national energies needed to develop systematic understanding of human ecology are lacking.

The rising interest in the future and in our capacity to influence its characteristics by taking thought of it heralds changes in attitude of great import to the economy and to public and private decisionmakers. Business organizations such as the National Chamber are paying much closer attention to anticipating future trends and dissemimating information about their meaning for today's choices. Major business firms are engaging more deeply in long-range probing into future developments. These same firms are more systematically examining the anticipated future business environment.

The shift in emphasis from the present to the future—as a means of making today's choices more effective—implies a fundamental, though not much noted, change in people's time horizons. Concern of pessimists that civilized mankind have a future, and of others about the quality of that future which mankind may have, reminds us that the efficient allocation of resources includes the dimension of time.

Changes in our time preferences, in turn, lead to changes in our discounting of present as opposed to future values in our economic value-stream. For example, concern with ecology means weighting certain kinds of investments (yielding future value-streams) more heavily in a scale of preferences than present consumption. A major shift in time preferences, if it is in act occurring, as significant long-range implications or business marketing, in its broadest sense, and for national governmental policy affecting the balance between consumption and investment. As another example, recent discussion of some concept of optimum population size for the Nation and the world reflects possible profound shifts in people's time preferences. In such ways, then, the growing interest in the quality of the future environment and in the possible conditions of future civilized life can be interpreted as favorable. This interpretation is based on the prospect that mankind remains capable of exercising reason, courage, will, imagination, and human wisdom to avoid catastrophe by reform of anachronistic behavior. Renewed interest in the future may imply a significant shift in the values and tastes of people—an element of novelty in human affairs of deep significance to business and government and worthy of their careful study and understanding.

Economic Problems of Changing Goals

Three dominant economic problems closely relate to the increasing concern with quality, the new methods of choice-making, and the changing values and preferences likely to mark the 1970's. These problems emphasize the need, reflected in the Economic Report of the President, for increased attention to the larger strategies of stable long-term advance. The first is the fact of relative scarcity; the second is the problem of secular inflationary bias; the third is the role of Government in the economy.

CHOICE, INFLATION AND GOVERNMENT

A misplaced emphasis on U.S. affluence during the 1960's led to vague notions about the new "age of abundance." The "old" economics of scarcity, it was said, had been repealed in favor of a "new" economics of abundance and income guarantee. These ideas coincided with an explosive increase of Federal spending during the decade, commonly attributed mainly to defense expenditures or to the war in Vietnam.

The Federal budgetary increase was in fact preponderantly caused by civilian programs. A decade ago, President Eisenhower's Commission on National Goals placed a high priority on social objectives. It recommended that increased attention and funds be allocated to health, education, welfare, urban renewal, farm policy, and economic growth. During the 1960's social and environmental programs tripled in size, rising far more rapidly than defense expenditures.

By 1970, spending for human resources dominated our public budgets. The spending upsurge responded to real economic and social difficulties, but despite some improvements, these difficulties remain. The upsurge yielded the inflationary guns-and-butter policy. And it created growing skepticism about the effectiveness of Government action. Abrupt attempts to draw resources quickly into specific sectors, as in medicare and medicaid, made specific prices shoot upwards as demand skyrocketed and outpaced supply.

The accelerating inflation refuted in painful pocketbook terms the loose rhetoric of the decade about affluence and abundance as real income of workers lagged. People came to sense that much new Government spending stemmed from depression-born ideas of stagnation, projected into a postwar era of worldwide capital shortage. Government did stimulate economic growth. But as inflation began to curb growth and productivity gains after 1965, Government—far from creating abundance—appropriated through deficits and through the cruel tax of inflation resources that the public saw frittered away in a maze of duplicating, overlapping, paper-clogged grant programs.

The lesson in all this for the 1970's is to avoid confusing confidently expected economic growth with the rhetorical overkill of "affluence" and "abundance." There is little doubt that Americans can anticipate a growth potential during the 1970's of 4.3 percent annually, as argued by the Council of Economic Advisers. The central thrust of the new budget, when taken with the Council's analysis of the uses of growth, is the continuing need for choice. Even a nation as affluent and technologically superior as this one must make hard choices among desirable goals of what to have more of and what to have less of. Even if employment and growth, the preoccupations of the past 30 years, are tolerably resolved, the Nation must still match resources and priorities.

Inflation has been a central fact of worldwide experience since the 1940's. A steady erosion of currencies has marked the world upsurge in output, trade, and investment. During 1958–68, currency shrinkage annually averaged 2–5 percent in industrial countries and 10–60 percent in underdeveloped countries.

At home, structural changes since the 1940's have tilted the economy toward inflation. These include steady growth, the shift to services, and the move to the welfare state. Steady growth has evoked annual money wage increases. Rising money wages, though, have to be validated by productivity advances or, being about 80 percent of costs directly or indirectly, they produce cost-push pressures. The shift of jobs to labor-intensive services, including Government, makes for lower national productivity gains than in farming or manufacturing where productivity advances are greater. And the rapid move to the welfare state imparts a built-in increase to Government spending. Unlike European welfare states, though, the United States also devotes sizable resources to a complex and far-reaching defense structure.

Monopoly pricing by restricting output and employment imparts an inflationary bias to the economy. As a rule, though, monopoly is likely to be transitory without affirmative Government action to support it. A dynamic economy needs flexible prices, including wage rates, so that it can make the continuous adjustments needed as people's tastes and spending patterns change and as industries rise and fall in consequence. The more inflexible prices are, the greater will be the output and employment adjustments to changed consumer spending.

Competition in the markets for resources, including labor, is just as important as in markets for products. If wage rates are forced upwards in some industry—or generally—by monopoly unionism, cost-price relationships get distorted, and output and employment in that industry—or generally—will shrink. There is a temptation for policymakers to inflate the money stock and raise the general level of prices to offset the unemployment effects of monopoly. The result is, monopoly introduces into the economy, first, a restrictive bias on output and employment and, second, a later inflationary bias.

Some people think that the achievement of our goals will demand such a degree of concerted social perspective and effort that Government must be heavily involved. A number of people take another view, opposing the expansion of Government programs. Some say we are starving the public sector amid private affluence; others say we are creating governmental control of economic life.

Government allocates, directly and indirectly, over one-third of our annual output, buying one-fifth directly and redistributing another 10th or so. And although—as some people assert—Americans may choose some trivialities at the expense of primary needs, many families suffer from an "illusion of affluence."

To be sure, by 1980 more than half of all families in the United States could have an annual income in today's dollars of $10,000 or more, compared to one-fourth in this group now. But the fact is today that only 54 percent of families in the United States can afford the officially defined "low moderate" life standard. Since this life standard depends on steady receipt of income, mostly wages and salaries, unless wealth is more widely distributed, many families—whether those professors who are affluent realize it or not—will continue to suffer from genuine feelings of insecurity.

Government reorganization and structural reform are urgent needs. Many people wonder whether they themselves could not spend some of the dollars they are paying in taxes more wisely than Government does. Nearly everyone agrees with Arthur F. Burns that something deep-seated is wrong with a governmental system which offers a maze of over 600 categorical programs of Federal grants to local officials, or that may require over 30 major Federal agency steps—including review by a 15-man advisory committee and headquarters approval—to secure a Federal grant of $1,000.

Even collective wants can often be satisfied without the expansion of Government as a force in economic and social life. The primary contest is between the competing and interrelated needs of society. Only secondarily does the question arise as to how much Government involvement there should be. And collective needs do not necessarily require enlargement of the public sector. On the contrary, the politicizing of decisionmaking and program-making steadily erodes the role of the individual in the Nation's social life.

Soundly conceived Government policy recognizes many possible degrees and types of Government involvement in supplying collective needs. Government may supply information, conduct studies or experiments, set public standards, make loans or grants, create quasi-public institutions to become self-financing, contract-out for needed goods or services, design policies to give incentives or exact penalties in the market place, and so on. Government policy which—as suggested by the Economic Report of the President—clarifies the interacting choices by examining the interrelated system of resource-priority issues, is genuinely innovative and significant for the new economy of choice. It lays the groundwork for limiting Government by constructing a basis for enlightened choice of the role that Americans want the public sector to play in their lives during the 1970's.

Responsive Economic Policy

The major test of short run economic policy is to get inflation under control. In the longer run, the more complex test of policy will be to mediate successfully between the desire for quality and the desire for quantity. Successful policy will advance productivity, promote competition, and stimulate stable growth in order to foster voluntary enterprise and initiative among business and other groups, promote urban and rural development, and illuminate the larger choices of the Nation in coming years.

MONETARY AND FISCAL POLICY

The 1970 report reflects a major, historic shift in policy approach away from the mix of the 1960's. The report rejects the exaggerated role of fiscal policy, both the ability to manipulate it and the gains from doing so. From the doctrine that combined an active fiscal policy with an accommodating and passive monetary policy, the 1970 report moves to a doctrine that gives monetary policy the greater role in steadying the economy.

The approach to monetary policy is more even-handed than the stop-go monetary policy of the 1960's. The 1970 report holds that the crucial variable influencing the economy is the rate of growth of the money supply. And the report makes clear that a steady monetary growth will replace the past monetary policy of stop-go.

The new doctrine accords with empirical study of monetary history and with the recent facts of experience. Statistical analysis of the historical record, 1870–1970—in the studies, first, of Clark Warburton and then of Milton Friedman—show that changes in the money supply are significantly correlated with changes in economic activity. Forming the basis of a "new quantity theory" of money, the studies show that the business cycle is largely a "dance of the dollar," in Irving Fisher's words, rather than that the dollar is largely a dance of the cycle. Recent facts of experience, during the 1965–70 period, with "fine tuning" in fiscal policy, on the other hand, has been perverse. The delay from 1966 to 1968 in enacting the income tax surcharge cast grave doubt on the ability to manipulate fiscal policy. The incorrect analysis in 1968 of the effects of the tax increase—the incorrect diagnosis of "fiscal overkill"—led to accelerating the inflation from 1968 to 1969, rather than damping it.

Undue emphasis on monetary policy, like undue emphasis on fiscal policy should, however, be avoided. Leaders of the "Monetarist" school of thought are at pains to point out that monetary growth explains only part—though a major part—of changes in economic activity. They would surely recognize that the firmest resolve to maintain monetary growth on an even keel can be dissipated by governmental tax-expenditure policies that overtax enterprise or run continuous deficits which shift resources to Government. The relative role of monetary and fiscal policy under the new doctrine is the basic issue for study by the Joint Economic Committee. The President's

Economic Report (p. 3) rightly draws the lesson that "the Government itself is often the cause of wide swings in the economy." Money does matter. But so does its use. The Annual Report of the Council of Economic Advisers recognizes that sound monetary and fiscal policy are inseparable. Thus, steady monetary growth requires an accommodating fiscal policy. Sustained Government deficits force the monetizing of Federal debt and shift resources from private to public allocation and control, to the detriment of the weakest sectors of the credit markets, usually new housing and new business enterprise.

The fiscal policy of State and local governments is in danger of being overlooked in the 1970's. The money supply is crucial to the general price level; but the all-government (Federal, State, and local) taxation-expenditure function is crucial to the money supply. One out of 3 dollars of government spending in the national income and product accounts is that of State and local governments, and the proportion is likely to grow in the 1970's. In the 1930's, as Douglass North has pointed out, surpluses in State and local finance offset Federal deficits in all but 2 years. All-government fiscal policy analysis is needed.

Federal fiscal policy for 1970 and 1971 relies on thin budget surpluses of $1.6 billion in fiscal 1970 and $1.3 billion in fiscal 1971. Although these surpluses are commendable in intent, they are wholly inadequate in logic and substance. They are too little and too "iffy." Needed now, given the determination to control inflation, are all-government budget surpluses of 5 to 10 billion dollars. True enough, the fiscal 1971 budget keeps dollar outlays down despite inflation; it shifts basic priorities from defense to human resources; it restrains defense-multiplier spending. True enough, a thin surplus is no invitation to the expenditure-minded in Congress.

Even so, the fiscal 1970 and 1971 budgets illustrate the pressures of the welfare state and the explosion of demands on Government in the 1970's. These budgets echo with the impending likelihood of added Government spending that will require Congress and the Nation to address the issue of further tax increases. These budgets should be red flags to Congress that it shares heavily in the responsibility to reform the Government structure, to eliminate outmoded programs, and to make fiscal room for the new demands of the 1970's. Otherwise, the thin surpluses will dissolve into deficits that will put pressure on the Federal Reserve to increase the money supply unduly. It is significant commentary on the fiscal mood of the United States that in a period of full employment and price rises of 5–6 percent, only a surplus of $1.6 billion—and that surplus hypothetical—can be achieved in a $200 billion dollar Federal budget.

APPLYING POLICY TO INFLATION

At issue now is the "game plan" to control inflation in 1970–71. First, there is the question of recession. There is doubt about how to define a recession, particularly when mild. The criteria of the National Bureau of Economic Research do not rely wholly on a single measure of economic activity but use broader measures of slowdown such as duration, amplitude of change, and the scope of involvement of economic sectors. Thus, as this semiofficial arbiter of business cycles measures them, recessions involve more than a 2-quarter period of negative growth in real (constant-dollar) GNP.

Although most business economists recently have shaded their outlooks for 1970 downward, the Council's standard forecast remains within range of business economists' consensus. Disagreement exists between monetarists, generally expecting a recession, and expansionists, who doubt that business plan and equipment spending will be much curtailed from survey plans. Even so, the bulk of business economists anticipate either lateral movement, or slight decline in real output for the first and second quarters (possibly the third) with a moderate pickup in the third or fourth quarter; and they foresee a yearly total for GNP of \$975–\$985 billion. They also expect a slowing down of price rises through the year.

Whether there is a mild statistical recession in 1970 is less important to the American people than the determination to get inflation under control through the policy of gradualism. The more painful choice for the American people and the administration is the necessary "trade-off," sacrificing some buoyancy of the economy to combat inflation. The issue is whether it is more important to the future well-being of the United States to bring inflation decisively under control in 1970–71 than it is to keep unemployment from rising above 4 percent.

The historical record is clear that inflation can be controlled only by reducing excessive demand. To be sure, in the longer run, the dollar's purchasing power benefits from steady growth at high employment levels of plant and workers. Curbing demand in the short run will, however, stabilize the general price level without stopping relative price-cost adjustments needed for growth in desired ways. Furthermore, nearly all economists realize that monopolistic practices among both business and labor can exert continuing inflationary pressure on the economy only if Government allows aggregate money demand to grow enough to validate their claims to excessive wages and prices; otherwise, unemployment will result from monopoly wages and prices. Finally, although budget surpluses in fiscal 1970 and 1971 are thin, fiscal policy has been set within tolerable bounds to allow monetary authorities to curb excessive demand by slow growth of the money supply.

Curbing excessive demand is, however, uncomfortable and painful to both business and labor. For business, it may mean slowdown in sales, buildups in inventories, profits squeezes, lagging rises in costs, downward revisions in expansion plans, and for some business a combination of these effects, resulting in losses or failure. Small business, housing, and firms in stable and declining industries or cut off from credit markets are the most vulnerable. For labor, curbing excessive demand means some rise in unemployment in markets weakened by the differential impacts of lessened demand on business.

THE QUESTION OF DIRECT CONTROLS

General monetary and fiscal restraint are preferable to selective or direct controls because they interfere less with flexible response, relative price-cost adjustments, and market freedom. Direct wage-price controls deal only with symptoms; they suppress symptoms but neglect causes of inflation; they prevent relative cost-price adjustments; they favor established institutions over new or growing sectors; they require resources to administer; they penalize honesty; and they are enforceable only for short periods. Selective controls, though undesirable for similar reasons, may be useful, if not used as a substitute for general restraint, to choke off excesses. Selective credit controls on consumers or real estate are not needed, but currently could be considered with open-mindedness on business plant and equipment spending. Guidelines on wages and prices have not worked when needed; are hit-or-miss, hitting business but missing labor; set ceilings on wage gains that become floors for bargaining; discriminate against the highly visible; and thrust Government into a mass of complex operational detail that saps business and labor responsibility.

THE EXTENT OF UNEMPLOYED RESOURCES

The truth is that if the American public wants better price performance than now, it has to accept some extra unemployment and some sacrifice of real output and income for a temporary period. The question of unemployment should be examined here. Through 1969 the U.S. economy was, if anything, overemployed, and a rise in unemployment to average 4.5 to 5 percent in 1970 and 1971 is not as great a hardship on the American people as failing to control inflation now.

The analysis of unemployment in the 1970 report bears out such conclusions. In late 1969, the number out of work for 15 weeks or longer was down to just above 300,000 in a labor force of over 82 million, and it did not increase during the year. In a typical recent month, out of a total of 3 million unemployed, some were teenagers after their first jobs, some were housewives entering or reentering the labor force to gain "second incomes," some were manufacturing workers laid off temporarily and most receiving unemployment compensation, some had moved and were seeking jobs in their new location, and only a relatively few were jobless for 15 weeks or more.

In 1969, among average unemployment of 2.8 million, nearly 1.4 million (49 percent) either never worked before or were reentering the labor force, while 0.4 million (15 percent) left their jobs voluntarily. Almost 40 percent of the unemployed in 1969 were teenagers, many of whom (73 percent) were also in school. The joblessness of teenagers differs from that of adults. Over 30 percent of unemployed teenagers were in families with average incomes over $10,000 annually; about the same fraction were in families with less than $5,000 annual incomes. Among unemployed women, nearly half were married with husbands present, and more than half of the rest were teenagers. Although nonwhite unemployment rates are double that of whites, an additional 290,000 jobs for unemployed Negroes and other nonwhites in 1969 would have equalized the white-nonwhite unemployment rates.

Congress could reduce the impact of hardship through unemployment by passing proposals before it to set up a standby program for extended benefits during periods of high unemployment, job training, and other forms of alleviating job or income loss. Meanwhile, to bring nonwhite jobless levels down is likely to require longer term measures in the distribution of education, skill levels, job opportunities, and opportunities for admission to occupations and industries.

In short, the price in hardship for getting inflation under control in 1970 and 1971 can be estimated crudely as about half a million people who may suffer job losses of 5 weeks, plus perhaps 100,000 who may experience job loss (some with unemployment compensation) for 15 weeks or more. The fact that only 30 percent or less of our labor force is now in manufacturing and the bulk is now in the service industries is likely to significantly reduce the unemployment effect of measures of restraint. (This subject has received less study than it deserves.) And the fact that measures are being taken by the administration to improve the efficiency of labor markets, such as establishing Job Banks, should reduce the duration of unemployment.

THE DURATION OF THE ADJUSTMENT

A little noted aspect among businessmen of the administration's "game plan" is that it means, if followed, stretching out the adjustment period through 1970–71. While nearly everyone agrees that the degree of monetary restraint may need to be softened in the next month or so, not enough attention has been paid to the repeated assertions of administration officials that the economy is to run well below its potential output not only for this year but for 1971 as well. This means that money supply growth will remain below the 4–5 percent range considered appropriate for steady advance near potentials. It also has implications for evaluating the decline in interest rates or rise in stock prices to be anticipated during the renewal of moderate advance. Finally, if the administration sticks to its game plan, this slow return to potential has important implications for the profits squeeze and the wage-cost push which we must now face.

All in all, the administration game plan for controlling inflation appears reasonable and humane. With the all-important cooperation of Congress to avoid overshooting the spending targets in the fiscal 1970 and 1971 budgets, the anti-inflationary policy can work to bring price rises under control by 1971.

THE NEED FOR FISCAL REFORM

Given the lessons of the 1960's and the prospects for the 1970's, fiscal reform is imperative. The 1970 report reflects a recognition of the challenge to the Federal Government as an institution to reform its structure, respond to new goals, operate more in accord with economic principles, and embody new methods for permitting the American people to exercise rational choice within a new goal structure. The 1970 report points to the need, over a period of years, for the Federal Government to maintain average expenditures within full employment revenues. The report shows that the Government must face the fact that, despite expected economic growth, existing and proposed claims on output leave little room, without tax increases, for significant additions to Government expenditure programs before 1975.

THE NEW RATIONALE FOR BALANCED BUDGETS

In an economy of confidently expected increments to output from economic growth and high employment, existing in a world of inflationary pressures, there is no mystery about the cause of secular devaluation of the dollar. Federal deficits, debt monetization, and too-rapid increases in the money supply in such an economy give the answer. Nearly all accept today that the size of 1 year's surplus or deficit will and should vary with economic conditions. But, as the 1970 report clearly points out, the choice of a long run posture for fiscal policy determines the savings available to private business and housing investment. Chronic budget deficits and a tight money policy is a fiscal policy mix designed to enlarge Government's role in economic life at the expense of private business and housing. Long run budget surpluses provide the source for economic development and the enlargement of funds available for housing.

Urban and rural areas alike face mammoth demands for investment funds if the cities are to be renewed while population grows and is dispersed into suburbs, exurbs, and formerly rural regions. The recent inflation and credit restraint have badly affected the organiztaion of the housing industry. Inflation has raised labor and materials prices, and by boosting interest rates has restricted the flow of funds to housing. Credit restraint falls with special severity on housing because relatively small firms with narrow capital bases predominate in the industry. Meanwhile, the Nation lags behind its housing goals, however defined, despite the strength in output of mobile homes, whose omission from housing statistics understates housing output by 20–25 percent. National housing goals project an increase of more than 50 percent by 1975 of claims on GNP for residential construction, as shown in chapter 3 of the 1970 report.

The control of environmental pollution will require billions of dollars over the next several years. In addition to investment by business, industry, and households, there is an enormous deferred capital investment in community infrastructure for waste disposal that requires freeing both funds and resources. The means chosen of financing such investment crucially affect economic growth and equity. Financing methods, as discussed earlier, which set maximum pollution emission standards, give the maximum freedom of response but require real resources and private financing. User charges to cover user benefits avoid shifting private costs to the public at large. Modest personel and corporate income tax reductions, after Government revenues surpass expenditures, could soften the impact of such regulations.

Effective regulation, coupled with modest tax reductions, would preserve and even strengthen incentives for polluters to use the most efficient means of meeting social standards of performance. Setting performance standards—"rules of the game"—involves the least distortion of markets, gives the biggest incentive to choose efficient means to meet the standards, assures flexibility of changing the means as conditions and technology change, and places cost most closely in conformity with benefits expected, to approximate most closely the requirements of equity.

FISCAL POLICY AND ECONOMIC GROWTH

The "Quality Seventies" of new tastes and preferences, rising demands, and increased desire for public participation takes economic growth for granted. During the 1970's, whatever decision may be made for stabilizing growth in population by the 1990's, population is likely to grow by 30 million or so. Just to maintain full employment and existing real per capita income will require economic growth; to meet new needs while expanding per capita income will require still more growth. In order to support the growing scale of public consumption without reducing private consumption may require even faster productivity gains than in the past.

But economic growth is not automatic. It requires appropriate long range fiscal and monetary policies. An appropriate mix is Federal budget surpluses which permit easing credit restraints and shifting toward regularizing the rate of growth in the money supply to coincide with the growth potential of the economy. Budget surpluses in turn would then permit carefully planned long range tax reduction programs designed to stimulate investiments in high-technology fields and to modernize existing plant. Such a long range tax reduction program would reduce current barriers to investment in high risk enterprises. It would promote the growth of smaller firms by improving their access to capital. All these effects would contribute to more efficient production at lower costs and prices.

Economic growth is to be affected in the 1970's by the continuing shift of employment to the services rather than the goods producing industries. In the 1950's the United States became the first Nation to employ more than half its work force in the service industries, and by 1975 service employment will rise to about 65 percent of total employment. This shift to services means that labor-intensive industries are using a growing proportion of the labor force. Of itself, this trend would suggest a possible slowing down in the rate of economic growth. Hence, added capital investment to stimulate growth in manufacturing efficiencies is needed to accommodate the shift to services.

Also, much of the growth in service industries is in Government employment. In Government, productivity is measured, by definition, at zero; that is, Government services are calculated at the cost of employment—factor prices—rather than at the price in the market of the services. This produces the anomaly that the more it costs to produce a unit of Government services, the greater the apparent addition to national income. It does not, however, follow that because, say, education costs more, therefore we are getting more satisfaction from education. The plight of central city public schools, on the contrary, suggests to some people that it would be more desirable to contract out to private firms the task of educating and then to require that the firms meet standards of performance set by the public or lose the business to others who can perform.

A long-term policy by Congress and the President of a balanced Federal budget in a high-employment stable growth economy would have other advantages besides spurring economic growth. The policy of a balanced budget would be tangible evidence that Congress is sensitive to the plight of the middle class, squeezed between rising taxes and rising prices, especially of consumer services and housing. Steady surpluses strike at inflationary expectations among consumers, businessmen, and financial decisionmakers that increase the velocity of money. Steady surpluses would raise the future value of the dollar as discounted in the present, exerting downward pressures on interest rates and restoring vigor to fixed debt instruments in the capital markets. Meeting the needs of the future—in housing, in evironmental improvements, and in economic growth and development—would thereby be advanced.

THE NEED FOR EXPENDITURE REFORM

A budget surplus can be achieved only if effective control is established over expenditures. There is a great need at present for expenditure reform.

One device to help establish control over spending is zero-base budgeting. Each agency or department would be required to present its case for and justify its entire requested appropriation every year. This would assure annual review of every activity, including both existing and proposed programs. Rather than acting on the customary assumption that existing spending programs are necessary, the entire complex of proposed spending programs would be examined. The President's proposals to trim back some $2.1 billion from outmoded programs may be regarded as a hopeful initial step toward the adoption of zero-base budgeting.

Ceilings set by Congress on Federal expenditures is another promising device for expenditure reform. Such ceilings were adopted in fiscal years 1969 and 1970. A predetermined congressional limit on aggregate outlays could help to stimulate lively discussion and analysis of proposed spending programs. Such discussion would help to focus attention on resource availability and on priorities and choices, dampening at least some of the ardor for automatic increased spending. Since the total of individual appropriation measures may exceed the established spending ceiling, the President in effect would become responsible for cutting back individual programs in order to meet the legislative budget ceiling. This would permit holding down total spending to responsible levels while Congressmen responded to the pressures of their constituencies. Congress could of course override the President by new legislation in the event of compelling disagreement about priorities.

A much neglected factor of rapidly growing importance to inflationary pressures and national priorities is the expansion of State and local government expenditures. The major element in the expansion of Federal expenditures during the past decade has been civilian outlays, mainly for education and welfare programs. Education and welfare expenditures also exert a dominant influence in State and local government expenditures. In education, the time has arrived when quality rather than quantity should be stressed. Some analysts suggests that burgeoning State and local expenditures may balloon still more once Federal revenue-sharing is instituted. The credit for spending programs would reside with State and local officials, while the onus for taxation would fall upon the Federal administration and the Congress. Assuring efficient State and local spending is becoming increasingly important in the struggle to combat inflation. Monitoring State and local spending will become of still greater significance if Federal revenue sharing materializes.

THE NEED FOR TAX REFORM

Tax reform is needed to redress the balance between consumption and investment if productivity increases and economic growth are to provide the resources to meet the demands of the "Quality Seventies."

The balance between consumption and investment needs redressing. Last year's tax reform favors consumption at the expense of capital formation. This redirection of spending may be useful in the short run to cool an investment boom, but it could be damaging to prospects for the long run growth of the economy. The 1970 report seems to reflect some confusion on this point. It argues, from the long run decline in the ratio of capital stock to real output, that by 1975 real business fixed investment could fall to 11½ percent of real private output. However, the 1969 Tax Reform Act appears to shift spending toward consumption and away from other forms of spending; that is, capital formation broadly defined. The result could be, by 1975, an even smaller ratio of fixed investiment to real private output.

The balance between consumption and investment needs redressing because of the prospective capital shortage from changing time preference mentioned earlier. The issue is that of raising present satisfaction by shifting resources to provide for future enhancement of the quality of life. Therefore, business tax reform should provide for realistic depreciation reform. This would speed technological change that would raise manufacturing productivity to offset the productivity-reducing shift to services. It would also assure that the United States keeps pace with competition abroad. And it would recognize the need for raising productivity in the services industries by cost-cutting business investment.

The Nation's revenue system needs an extensive as well as an intensive review. Greater application of user fees offers promise at all levels of Government. User fees could be a significant source of revenues. User fees also would help to allocate and rationalize the use of Government services and facilities, provide guides to priorities, and contribute to conservation and the best use of our scarce resources. User fees that reflect market costs and prices can help relate costs to benefits, in effect providing cost-benefit analyses akin to those that are continuously made by competitive markets. Nonmarket cost-benefit analyses such as those widely trumpeted a few years ago have proved disappointing. Not only are they subject to vast errors, they also are of limited value because of the ease with which the results can be manipulated by the analyst who assigns estimated quantities and values. User fees in line with market costs and prices subject Government services to the test of consumer preferences.

MEASURING ECONOMIC POLICY EFFECTS

The 1970 report is commendably sensitive to the importance of maintaining a high level of employment. Its perception of the problem balances the need for even-handed fiscal and monetary policies against the need for structural measures that overcome personal and institutional barriers to employment.

The depression of the 1930's sensitized an entire generation to the hardship and deprivation that widespread and long-lasting unemployment could impose on millions of people through no fault or lack of their own.

As a result, the gross unemployment rate (GUR) has served for decades as a major indicator of the state of the economy, a signal to trigger expansionary monetary and fiscal policies. The GUR was satisfactory for this purpose during the decade of the 1930's when unemployment of resources was general and substantial. But when unemployment is at marginal levels, use of the GUR as a signal for expansionary policies imparts an inflationary bias to our set of policy-determining criteria. For example, normal frictional unemployment is included in the GUR just as if it were comparable to the massive unemployment that characterized the 1930's. The GUR also includes, with equal weight and without distinction, the unemployment of a teenage dependent and that of a head of household responsible for himself and perhaps several dependents. About 60 percent of the presently unemployed are dependents. Some 40 percent of the presently unemployed are aged 16 to 21.

Further, less than half (only about 40 percent) of the unemployed are people who have lost their jobs through no fault of their own, the traditional view of the unemployed. Nor does the GUR distinguish between short-term and long-term unemployment. Further, too, recent current population survey data show that of 12.3 million men outside the labor force (neither employed nor unemployed), most were under age 20 and likely to be in school or were above age 60 and retired. The GUR is computed as a percentage of civilian rather than total labor force. The use of the smaller bases is inherently misleading since it overstates the impact of unemployment on the labor force. Its use thereby provides a fillip to an already inflationary-biased measure of unemployment.

Cultural lag has left the GUR preeminent, when the need is for a more refined and socially significant measure. A measure is needed that is more germane to the determination of appropriate monetary and fiscal policies. Some possibilities are: The unemployment rate for married men, the rate for heads of households unemployed 5 weeks, or the percentage of the total labor force that is employed or has been employed within, say 5 weeks. However we decide to measure employment relationships, it is clear that reforms are needed to iron out the inflationary bias of the gross unemployment rate. It has outlived whatever usefulness it may have had in the 1930's.

The Emerging World Economy

The United States has a profound national interest in the new world economy of the 1970's. Startling changes will speed up and make relatively cheaper international transportation and communication and will improve management scope and technique. Worldwide satellite TV; newer, faster, and bigger jet airplanes; and new computer methodology for business and finance will combine to revolutionize world economic activity. The impact of these developments will require rethinking conventional concepts of the balance of payments, exchange rates, the role of reserves, the significance of international trade and investment, and the problem of resource transfers from one country to another.

THE AMERICAN INVESTMENT REVOLUTION

The familiar phenomenon of American investment abroad has brought since World War II what one expert observer describes as "the most significant economic revolution since the Industrial Revolution." The growth since then of American-type multinational corporations has been widespread, with a concomitant spread of new methods of management, marketing, and production that are basically internationalized in character. U.S. direct investment abroad by 1969 at book value was $70 billion, compared with $12 billion 20 years ago, and considerably understated compared to market value today. The output of multinational corporations—the sales revenue of American subsidiaries and affiliates abroad—is now in the neighborhood of $200 billion per year. This is equivalent to 20 percent of our domestic production; it is over five times our exports of $37 billion. The growth rate for 18 years in new direct U.S. foreign investment has been 10 percent per year, compared with a 6–7 percent trend rate growth in U.S. exports.

Total U.S. investment abroad—including portfolio and other private investment, plus investments by the Export-Import Bank and U.S. participation in official international financial institutions such as the World Bank—is of an order of about $140 billion at book value. This compares with a total for such investment of $32 billion in 1950. It is little wonder that the international payments system designed 25 years ago at Bretton Woods has felt the greatest pressures in an area—international capital flows—with which it was perhaps least designed to cope. The new world economy of the multinational corporation, United States and other, now amounts to 10 percent of the aggregate output of the noncommunist economies of the world.

Indeed, the output of multinational corporations now exceeds that of all national markets other than those of the United States and Russia. The outlook for the growth of multinational production remains in excess of the trend rate of growth of our exports. The growth of the multinational corporation is consistent with our continued export growth partly because U.S. direct investment abroad induces exports from this country and partly because the Americanization of production bases abroad also induces other U.S. exports of complementary products.

The benefits of the American investment revolution are consistent with the rationale behind the British neoclassical arguments for free trade and investment. Mutually beneficial trade, it was argued, raises standards of living by providing people with more goods at a given real cost, by raising productivity, and by increasing economic efficiency through competition. Capital importing countries see the benefits of increasing the supply of their financial and other resources; of the transfer of technology, construed broadly to include organization methods, management skills to create new opportunities for other domestic business. Thus, it is broadly correct that U.S. direct foreign investment and management—as argued by Servan-Schreiber—have brought to many countries intensified competition, higher levels of efficiency, and higher levels of productivity. And so, it remains valid to support the case for freer trade and investment because of the results they produce.

EFFECTS OF THE NEW WORLD ECONOMY

The growth of the multinational corporation, with headquarters both in the United States and in other countries, has crucial significance for the orderly development of the world economy in the 1970's. This new institution, whose output in one estimate could reach

$1 trillion in today's prices by 1980 and whose growth rate projected to 2000 would imply an output of $4.5 trillion, has appeared in a world of intensifying nationalism. It appears as a significant vehicle for surmounting nationalistic barriers, transferring technology, and increasing wealth. Two-thirds of the output of such corporations currently is produced in industrialized countries. However, considering the urgent problem of world economic development in an era of population explosion, this internationalization of production and marketing could have the greatest significance to underdeveloped countries, given political stability.

The multinational corporation and the American investment revolution are important to developments in international capital markets. In recent years, the chronic U.S. balance of payments deficits produced the major resource of present international capital markets in the torrent of dollars they released. The restrictions on U.S. capital exports went far toward creating the Euro-dollar capital market, now exceeding $35 billion in size. Monumental and sudden flows of capital, while threatening the stability of the international monetary system in 1968 and 1969, have been surmounted. And the impact of credit restraint on U.S. banks has been cushioned by their access to the Euro-dollar market.

The new corporate managers have operated in a world of economic integration and currency convertibility created by finance ministers and central bankers with more assurance than their governments at times have found comfortable. One governmental response has been controls on capital inflows and outflows. Since the average rate of return on the $200 billion of multi-national corporate output is 5 percent, the policy of capital controls is immediately costly. This policy will be even costlier in the long run because it reduces the future benefits of greater economic integration and productivity of the new world economy. The United States should move promptly to reduce its own controls on capital outflows.

The provision of means for the growth of international reserves is a more constructive move. The decision to manage reserve creation through the Special Drawing Rights of the International Monetary Fund will allow reserve growth at least to keep pace with growing international trade. There is room, however, for valid doubt the SDR's will be sufficient to provide for the profound change in the structure of international payments flows that is likely to result from the growth of the world economy.

Indeed, a basic question for study and possible innovation is the impact of changes in the world economy on present concepts of the balance of payments. Is the conceptual basis of a balance of payments adequate to reflect the fundamental position of the dollar? Although by standard measurements, the U.S. payments deficit on a liquidity basis was at a record in 1969, the dollar was strong. How can we cast our international accounts to reflect at once our strong long-term investment position which the balance of payment concepts oversimplify as a shortage of cash? And should the constrictions of balance-of-payments thinking deter the United States from capital investment abroad, foreign aid, a high level of imports, or defense of the free world? This is a crucial conceptual question to be investigated by groups such as the Joint Economic Committee if the United States is to prevent its financial conventions from defining its national interest in narrow or irrelevant terms.

A second question arising from the growth of the world economy concerns the problems facilitating transfers of foreign aid and long-term investment. The transfer problem raised by the present size and operation of multi-national corporations is certainly as significant as the problem after World War I concerning German reparations. The logic of transfer theory as propounded about the earlier problem is clear. It is that if such a sum as 5 percent of $200 billion is to be repatriated, either the United States would have to accept a current annual import surplus in that amount, cancel the payment, or expand capital outflows further.

The transfer problem raises the fundamental question of what is to be the economic position of the United States in the 1970's vis-a-vis the rest of the world. There is a need for considerable study of this fundamental question of economic policy, which is linked to the question of the international monetary adjustment process. To be sure, the United States should exert every effort to expand its exports, in order to bear the costs of carrying out a foreign policy appropriate to its position in the world. However, it is in fact possible that preoccupation with a neomercantilist drive to subsidize exports, protect domestic production from import competition, and achieve payments balance through an artifically attained trade surplus could frustrate long-term U.S. goals for expanding world trade and investment. As noted above, such a configuration of the balance of payments could also frustrate the transfer of real resources via repatriation of earnings abroad.

Thus, it becomes necessary to examine the hypothesis that the rise of the new world economy is irreversible because of technological advance; that the world is entering a period of prolonged growth in foreign direct investment. If so, then it may become increasingly likely that many countries produce in foreign markets, with increasing corporate interpenetration, not necessarily as a substitute but is a supplement to exports. Given the problem of capital transfers, this may mean that the balance of payments configuration of certain capital exporting countries will become different from one relying on a balance of trade surplus to finance capital exports.

Such a development would, in turn, require improvement in adjustment mechanisms such as increased harmonization of national economic policies affecting trade and investment or more effective arrangements for exchange rate adjustments.

In thinking about the policy implications of the growth of the world economy, the following considerations may be important:

1. Either the industrialized countries must continue heavy capital outflows to offset growing receipt of earnings from existing investment, accept a heavy excess of imports on current account, or forego the benefit of the earnings through serious disruptions in foreign exchange markets subjected to heavy financial flows not corresponding to transfers of real resources.

2. Either the industrialized countries will provide real resources for capital formation to underdeveloped countries—through special allotments of SDR's or other means—or these countries will increase the statistical risk of political instability, radical social and economic change, and international disruption.

3. Either the United States will tolerate increasing flows of foreign capital through foreign-based multi-national corporations, as rates of return become more equalized by increasing economic interdependence, or the United States will increase the statistical risk of disruptions in world trade and investment initiated by other industrialized countries.

Many problems remain to be resolved as the international corporation becomes more widespread. To the underdeveloped country, such a corporation is new and faces problems of cultural adjustment which may require new institutional means for cooperation between a foreign business corporation and its host government. The scale of development possible through, for example, the "nu-plex," a combination nuclear power-industrial-agricultural complex, requires long range commitment to planning resource development both by the involved country and corporations. However, a quarter century ago few if any could have forecast that the international corporation was to become the prime mover for capital formation in the postwar world. Over the next quarter century, world output must somehow rise sufficiently to transcend the environmental barriers of the less developed countries under the implacable pressure of population growth. Certainly, this is unlikely to happen through the repetition by these countries of the stages of growth that have led in three centuries to the present success of developed countries in assimilating the industrial revolution. Meanwhile, the high growth rate of internationalized production seems to offer a realistic hope for world economic progress that should be examined with utmost seriousness and dispatch in formulating the economic development policy of the United States for the 1970's.

COMMITTEE FOR ECONOMIC DEVELOPMENT

By EMILIO G. COLLADO, *Chairman, Research and Policy Committee*

The Research and Policy Committee of the Committee for Economic Development appreciates this opportunity to comment on the Economic Report of the President and the annual report of the Council of Economic Advisers. These reports, together with their annual reviews by the Joint Economic Committee, have been of invaluable assistance in furthering public understanding of the key economic issues which face the nation and in improving the formulation and conduct of economic policies. It is a source of real satisfaction to us that the Research and Policy Committee has had an uninterrupted record of presenting annual statements on these reports to the Joint Economic Committee ever since the review was established.

This year there are two special reasons why we are pleased to transmit our views to your committee. The first is that two of the present members of the Council of Economic Advisers have had a long and close association with the Committee for Economic Development prior to joining the Council—Chairman McCracken as a member of CED's Research Advisory Board of Dr. Stein as its former vice president and chief economist. Second, the program committee of our research and policy committee only last December issued a statement on "A Stabilizating Fiscal and Monetary Policy for 1970" that is directly relevant to many of the key issues discussed in the Council's report and provides a particularly convenient starting point for evaluating the report's recommendations.

The program committee's statement indicated that the broad principles for fiscal and monetary policy CED has developed over the past quarter century should be of major assistance in choosing the proper policy course for 1970. The main elements of these principles were summarized as follows:

> The impact of the budget should vary with the conditions of the economy as a whole, being more expansive when the economy is depressed and more restrictive when the economy is booming or inflationary.
>
> The overall impact that the budget exerts upon the economy should not, when combined with appropriate monetary and other policies, be so restrictive as to make attainment of high employment ordinarily unlikely or be so expansive as to lead to persistent inflation.
>
> To achieve these objectives, the Federal Government should normally set its expenditure programs and tax rates at levels that would yield a moderate budget surplus on a national income and product account (NIA) basis under conditions of high employment and price stability.
>
> The "high employment budget" position attained in this manner should be one which permits an adequate flow of funds to the

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private credit markets and to the markets for State and local securities, avoiding excessive tightness of monetary policy and helping to promote sound economic growth.

If demand conditions deviate significantly from those on which the stabilizing budget is based, flexible adjustments should be made in monetary policy and, if need be, in tax rates.

On the basis of these general principles and of other policy prescriptions developed in policy statements of the research and policy committee—notably the January 1969 statement on "Fiscal and Monetary Policy for Steady Economic Growth"—CED's Program Committee arrived at the following broad conclusions with respect to the proper course of policy in 1970:

First, despite the uncertainties in the outlook for overall demand, the central focus of the policy strategy for 1970 should be on the containment of inflation. Toward this end, fiscal and monetary policies, in combination, should aim at an aggregate level of money demand in 1970 that does not excessively strain productive capacity and that is conducive to an early return of steady, noninflationary economic growth at relatively high levels of employment.

Second, a proper fiscal-monetary mix in 1970 and in fiscal year 1971 calls for a high employment budget surplus of between $6 billion and $9 billion on NIA basis. Assuming no marked change in the volume of Government net lending, this would imply a similar—or only slightly smaller-high employment surplus on a unified budget basis. The proposed surplus "should permit a gradual easing of monetary policy compatible with holding total demand to the desired level."

Third, every effort should be made to eliminate both military and civilian budget expenditures that are nonessential and to reduce or postpone outlaws of lesser essentiality. In this connection, we recommended that current efforts by the Congress and the administration to improve the decisionmaking process governing military spending be intensified. In addition, the statement called for slowing down the space program, for sizable cuts in the present large-scale subsidies for agriculture, and for deferment of lesser priority construction projects. At the same time, we stressed the need for substantially greater efforts to deal with the urgent problems of the cities, poverty and welfare, racial discrimination, education, housing, and health care—efforts which will for the most part entail expanded Federal programs and expenditures—and indicated that it would be a tragic mistake if the Nation failed to take meaningful forward steps in these areas.

Fourth, to assure that the budget would have an appropriately stabilizing effect and to allow it to deal with our most pressing domestic needs, the surtax should be continued at a 5-percent rate not just until June 30, 1970, but at least for the full calendar year 1970. The statement also indicated that the Congress should call upon the President to undertake a special review of Federal fiscal needs in the latter part of 1970 and to make a formal recommendation at that time as to whether the surtax should be extended further.

Fifth, in the event the actual course of the economy should deviate significantly from the intended path, policy responses can and should be prompt. There should be no attempt to resist a reduction or elimination of an actual surplus if economic activity is really sagging. Moreover, the authorities should be alert to the possible need for making flexible adaptations in monetary policy to unfolding economic developments during the year.

Looking ahead toward the longer term, finally, we stressed the importance of (*a*) providing adequate incentives for productive investment and sound economic growth (such as the now repealed investment credit); (*b*) supplementing proper management of total demand through fiscal and monetary policy with more public and private exploration of structural and institutional improvements that can combat inflation; (*c*) integrating decisions about tax reforms that involve net revenue losses with a broader assessment of priorities for the allocation of national resources; (*d*) devoting the larger part of the Federal revenues that might be made available by a major phasing down of hostilities in Vietnam to alleviating the problems of the cities, of race, and of poverty, and (*e*) providing for better integrated and more flexible budget and fiscal policy procedures.

The Stabilization Strategy for 1970 and Fiscal Year 1971

It should be apparent from the preceding summary of our December 1969 statement that we are in very substantial agreement with the basic thrust of the President's Economic Report as well as with many of the more detailed analyses and recommendations that appear in the annual report of the Council of Economic Advisers. We particularly welcome the stress in the two reports on the continued vital importance of coping with the problem of inflation; on the desirability of a budgetary surplus; and on the need for a significant change in the fiscal-monetary "mix" that will permit a sufficient easing of monetary restraint to allow a substantially enlarged flow of funds to housing, State, and local governments, and other sectors on which the present tight monetary policy is exerting an exceptionally severe and uneven impact. At the same time, however, we have considerable doubts that the specific fiscal measures proposed in the reports and in the President's budget will be fully adequate to cope with the twin tasks of stabilizing the economy and providing for our most pressing domestic needs.

The Council's assessment of the likely and desirable course of total demand and real economic activity in 1970 appears to be generally reasonable. The uncertainties in the outlook remain unusually great, and there may therefore be a special need for prompt and flexible policy responses if actual developments should prove to be significantly different from the present forecast. For the moment, however, the Council's projections would seem to afford an appropriate basis for policy formulation. A definite cooling off of the economy is needed to brake the momentum of upward price pressures and of inflationary psychology, and this requires a temporary period of slower growth in real gross national product than would be desirable over the longer run. At the same time, the widening of the gap between potential output and total demand that is implied by this prescription must not be carried too far. In this connection, we are pleased to see that the approach taken in the report appears to be fully in line with the position we expressed in our December statement that we would be opposed to "a degree of demand restraint deliberately calculated to result in a definite recession or prolonged economic stagnation."

To achieve the appropriate degree of demand restraint, the President has proposed a budget for fiscal year 1971 that would yield a surplus of $1.3 billion on a unified basis and of $1.6 billion on an NIA basis. Regrettably, neither the Council's report nor the budget contain estimates of the anticipated budget results on a high employment basis, even though the Council's report appears to endorse the principle that it is the high employment surplus which should be used as a basis for fiscal policy planning. Since the Council estimates the average rate of unemployment in calendar year 1970 at 4.3 percent and since this rate could well run somewhat higher in fiscal year 1971, actual revenue collections in fiscal 1971 are likely to be appreciably less than those which would be yielded by a high employment economy. Hence, the high employment surplus implied by the President's budget would seem to be substantially higher than the actual surplus shown in the budget document. On our estimates, it appears to fall within the target range recommended by our program committee.

Nevertheless, it is not at all clear that the budget in fiscal year 1971 will in fact be adequate for meeting the policy challenges outlined earlier. Indeed, the prospects that this will be the case strike us as quite precarious, for several reasons:

First, the actual achievement of the budget estimates depends on an unusually large number of new legislative actions, deferment of prior actions, and other favorable developments. For example, the budget assumes a 6-month postponement of the Federal pay raise now scheduled for mid-1970 in line with the pay comparability principle; a sizable increase in user charges for highway and aviation services; a rise in the social security tax base without significant additional increases in social security benefits; and a further increase in postal rates. It also assumes reduction or elimination of a sizable number of programs that in the past have proved fairly resistant to change.

It is, of course, true that the President's budget constitutes his financial plan for the coming year and that this should appropriately include whatever special legislative actions he considers desirable. However, when fulfillment of the plan depends on congressional acceptance of a wide variety of such proposals—some of them quite controversial—it would be prudent and desirable to plan a budget surplus large enough to allow for an adequate margin of safety in the event that some of the estimates should prove to be unattainable. This is particularly important in view of the fact that, on the basis of the performance in recent years, the prospects for holding total outlays within original estimates do not appear particularly reassuring. The current budget indicates, for example, that fiscal year 1970 outlays for so-called uncontrollable programs are now expected to be $4.3 billion higher than the President had estimated last April.

Second, while we are strongly in favor of appropriate economies in Government expenditures wherever this is feasible, we are concerned that the budget may not make adequate provisions for the financing of some of our most pressing social needs. Funds for education, for example, are scheduled to rise by only about $100 million in fiscal 1971. Since it already appears that actual outlays in fiscal 1970 may exceed the budget estimates by a sizable margin—even on the basis of the President's own amended proposals—the 1971 budget estimate for education may well amount to a net cutback in such outlays. Serious questions can also be raised about the adequacy of funds proposed for other vital areas, such as welfare reform, health care, and urban transportation.

It is also noteworthy that the impact of the projected surplus on financial markets may not prove as favorable as may appear at first sight. The budget provides for the creation or expansion of various programs that depend on Government-sponsored or guaranteed credits (which for the most part are not directly reflected in the budget) and for some simultaneous reductions in direct Government lending activities (which are fully reflected in the unified budget). The total of federally sponsored and guaranteed borrowing from the public is expected to rise by approximately $5 billion in fiscal year 1971. To the extent that these various transactions tend to exert an expansionary impact on credit demands and resource use in the economy, the projected budgetary surplus is likely to have substantially less effect in facilitating an easing in private credit markets than might otherwise have been expected.

In the light of the various considerations I have outlined, it seems very possible that the Congress and the administration will after several months further study have to come to the conclusion that assurance of an appropriate high employment budget surplus and of adequate funding of programs of high social priority requires a very substantial increase in revenue availabilities above current budget estimates. In view of this possibility, and assuming no marked economic deterioration from expected levels, we believe that our proposal for a further temporary extension of the 5-percent surtax beyond June 30, 1970, deserves continued serious consideration. The case for such an extension would be especially strong under the circumstances because the tax is already on the books and clearly presents a particularly expeditious and practical means of providing the additional revenue needed.

Whatever the final decision of the Congress on these matters may be, it is evident that there will be a critical need over the coming year to approach spending and revenue decisions in an integrated and decisive fashion. Improvement of congressional procedures to permit such an approach, along lines indicated in our January 1969 policy statement on "Fiscal and Monetary Policies for Steady Economic Growth" is highly desirable.

It is also very important that the policy measures adopted will be properly responsive to evolving developments in the economy. We agree with the Council's observation that care must be taken lest the Government's fiscal actions themselves serve as a destabilizing element. This, in fact, is one of the reasons why we have been critical of the proposed elmination of the surcharge. At the same time, however, it is essential to keep in mind that the main concern of demand management policy must be with the stability of the economy as a whole, and to recognize that achievement of this goal requires the flexible use of fiscal and monetary police tools whenever appropriate.

Improving Markets, Strengthening Efficiency, and Containing Costs

Will proper management of total demand, together with the various other types of policy measure outlined in the Council's report, be enough to bring inflation under reasonable control within the foreseeable future and in the context of a high employment economy? The answer to this question will be of crucial importance in judging the adequacy of economic policies over the next several years.

The Council's report is clearly optimistic on this score. Its long-term projections apparently assume that reasonable price stability will be maintained from 1972 on and that this will be compatible with a rate of growth of real GNP in 1972 and 1973 that would substantially exceed the growth of potential output in order to bring the economy back to a high employment path.

The Council stresses that the transition to a stable condition of high employment without inflation can only be achieved with persistent attention and effort. In this connection, it very commendably devotes considerable attention to a wide range of specific efforts that will be required. We particularly welcome the report's stress on the need for measures to improve the competitiveness and flexibility of product markets, including those for agricultural as well as industrial products; to place greater reliance on economic incentives and market mechanisms even in regulated industries; and to strengthen manpower and training programs as well as the general functioning of labor markets. It is also must appropriate that the Council devotes particular attention to the special problems of the construction industry—which has been confronted by exceptionally severe inflationary pressures—and examines in some detail the possibilities for improving productivity in the industry, reducing costs, and overcoming bottlenecks in skilled manpower.

Nevertheless, we have some question as to whether the various measures cited in the report will in fact be sufficient to cope with the inflationary problems that are likely to remain after excessive demand pressures have been brought under control. In this connection, we are particularly concerned with the report's relative neglect of the vital role that sound private investment in new capacity and modernization can play in increasing the economy's efficiency and potential, in offsetting inflationary cost pressures, and in improving our international competitive position.

We have indicated in the past that the provision of tax and other types of incentives for such growth-producing investment should constitute an integral part in our overall economic strategy and in the battle against inflation. It is for this reason that we regret the recent complete repeal of the investment tax credit. The report states that, without further explanation, "the national priorities in the 1970's did not require or justify this special incentive." We do not find this statement convincing. In our view, productive private investment will need to play a key role in achieving the goals of the 1970's, and the provision of adequate incentives for such investment should remain a major element in our arsenal of economic weapons. Hence, we consider it highly important that the Congress and the administration give renewed consideration to possible means of providing such incentives.

There is also a question whether still other structural and institutional improvements may be required to cope with inflationary cost pressures. The desirability of such improvements would become especially great if a sharp upward movement in wage and other costs should continue well after overall demand has been brought under reasonable control.

Long-Term Economic Growth and Priorities in the Uses of National Output

An innovation in this year's Economic Report is a chapter that projects, for 5 years ahead, the potential claims on available gross national product that can be foreseen on the basis of existing trends in the private sector and of already initiated or proposed governmental programs. The purpose of this exercise, and of the parallel analysis in the President's budget, is to sharpen public understanding of how limited are future resource availabilities in relation to already-visible claims. It also highlights the need for a longer range strategy for determining broad priorities in the uses of national output.

In our view, the administration is to be greatly commended for introducing this new approach. It is a necessary first step toward the more comprehensive approach to the formulation of national objectives and priorities than was outlined in our January 1966 policy statement on "Budgeting for National Objectives." In that statement, we specifically recommended that "at the beginning of each Presidential term, a redefinition be undertaken of broad goals, objectives, and priorities for governmental actions during the coming decade."

On the assumption that presently visible claims would be fully exercised, the Council's report sees virtually no room for satisfying additional resource claims prior to 1974 and 1975. Even in 1975, the resources potentially available to satisfy additional claims are estimated at only $12 billion in real terms. It is abundantly clear, therefore, that if the major social and environmental challenges that face us are to be met, growth in public and private expenditures in other, less essential areas will have to be substantially curtailed.

An especially useful feature of the Council's report is its analysis of the relation between the requirements of the private sector and the Federal budget. The report makes clear that over the longer term, sizable high employment surpluses in the Federal budget are likely to be required if there is to be an adequate flow of resources to the housing sector, to other private investment, and to State and local governments.

While there are various other elements of the report's long-term analysis that are of great interest, I should like to focus here on three aspects that deserve particular comment.

First, the report seems to give the impression—perhaps unintentionally—that policies to aid economic growth can have little effect in enlarging the future availability of national resources. Thus, on page 72, the report states that—

> * * * in the 1950's and early 1960's, many people were impressed with the possible contribution that a "small" increase in the annual rate of economic growth—from 3 or 4 percent to 5 or 6 percent—would make to providing the output available for every kind of purpose. "Faster growth" became the source from which all new claims on the national output would be met. But in time this was seen to be largely an illusion. The basic full employment growth path of an economy is not readily raised by any of the policy instruments that we now know about.

It is of course true that faster economic growth and policies to further such growth cannot be a substitute for facing up to our national priorities. But this does not alter the fact that achievement of a satisfactory rate of growth is exceedingly important for the health of our economy and for facilitating social as well as economic progress. Moreover, the importance of small changes in the rate of economic growth should not be minimized. Thus, our 1958 statement on "Economic Growth in the United States"—when updated and reissued as a program statement last October—indicated that—

* * * Even a seemingly moderate difference in this growth rate can make a sizable difference in living standards within a relatively brief period. A long-term rate of growth in disposable income of 3 percent could mean in 1995 an average family income, after personal taxes, of about $14,000. If the average annual growth rate of disposable income reaches 4 percent, this income would reach $18,000. On the other hand, if it should fall to 2 percent, average family income in 1995 would be in the neighborhood of $11,000. These are big differences—big enough to warrant the most careful attention of every citizen.

The above arithmetic has very direct relevance to the long-term projections in the Council's report. Thus, if the expected rate of GNP growth in 1975 were to be reduced by 1 percentage point the estimated resources available to meet additional claims ($12 billion) would be wiped out entirely.

It is in the light of such considerations that the Committee for Economic Development has since its inception stressed the importance of sound economic growth. As already indicated, we continue to believe that governmental policies which assist such growth—whether they involve encouragement of productive private investment or increased allocation of resources to education and other forms of human investment—must be an essential ingredient of our longer term national economic strategy.

I place particular stress on this point because, in the recent past, there has been a growing tendency in some circles to suggest that the mounting problems of coping with our environment require a virtual end to efforts to foster economic growth. We cannot accept this view. To be sure, better ways need to be found to assure that there is sufficient concern with the way in which the quality of the environment is affected by economic growth and to take adequate account of resource deterioration when we calculate net economic growth. But this should not divert our attention from the basic importance of encouraging such growth. In this connection, I strongly agree with the recent statement before this committee by Dr. Arthur F. Burns, Chairman of the Board of Governors of the Federal Reserve System, that "we cannot overlook the fact that the economic and social problems of this country will be more readily resolved if our resources are utilized in ways that maximize the long-term potential for economic expansion."

Second, while the report provides a helpful initial framework for the discussion of longer term priorities, it would be highly desirable in our view if some of the key national priority problems that affect the immediate years ahead could be brought into sharper focus. Moreover, in line with our statement on "Budgeting for National Objectives", we believe there is a need to obtain some explicit indications of the President's own view of what the long-term priority choices should be.

Some examples of what we have in mind can be cited. The Council lists "Federal Government purchases" as a major claim on national resources over the next 5 years. However, neither the Council's report nor the budget provide an indication of the share of military spending in that total, nor of the role of Vietnam-connected expenditures or of outlays on major new weapons systems now being proposed or initiated. We are fully aware of the many difficulties that the drawing of such distinctions might entail. At the same time, however, the distinctions involved relate to issues that are of key importance for decisions on national priorities in the years immediately ahead. Availability of a wider range of information that would improve an understanding of these issues would certainly be desirable.

In connection with nondefense expenditures, it is rather regrettable that the report does not contain a more specific evaluation of budgetary needs in various individual areas of high social priority, such as education, health, poverty, improving our urban areas, and lifting the quality of the environment. At the same time, there is a need to spell out more clearly the kinds of longer term budgetary savings that might be effected in such areas as agricultural price support programs, construction, and space activities. We hope that more specific analyses in these various areas can be developed by the Council and the Budget Bureau before long.

It is also noteworthy that the tax reform legislation recently passed by the Congress entails a net annual revenue loss of about $12 billion by 1975 (without the effect of repealing the investment credit). In current dollar terms, this serves to reduce the resources available for new initiatives by over one-third. We seriously doubt that such sizable tax reductions should take precedence over the kind of priority claims on national output cited earlier. We hope, therefore, that the Congress will carefully explore appropriate means of reducing this prospective net revenue loss.

Finally, we should like to comment on the Council's remarks regarding the usefulness of "budget-balancing discipline" over the longer run—not because of any disagreement with the Council's analysis but because there appears to be some risk that its stress on this principle could be misinterpreted. The Council indicates that in the long run—given agreement on the desired average size of the high employment budget surplus and after allowance for revenues generated by economic growth—Federal expenditure increases in one area will necessarily have to be matched by expenditure cuts in other areas, or by increased taxes.

In this sense, the budget-balancing principle can, indeed, be said to be valid. It is important to understand, however, what this principle does not mean. It does not mean that the broad stance of fiscal policy should be free from frequent review in the light of evolving economic condition; in our opinion, such a review is needed at least annually. Even the long-term target for the high employment budget surplus needs to be reassessed with reasonable frequency in the light of experience. Nor does the principle mean that the actual budget position should normally be in exact balance. The Council stresses that this position should properly vary with economic conditions. Deficits may be appropriate when aggregate demand is weak, while surpluses are likely to be required in periods of high employment and even higher surpluses are needed when demand is excessive.

We particularly want to stress the indicated need for budget surpluses at high employment—rather than mere budget balance—because there have been some recent suggestions that in the longer run, budget surpluses may in practice never be attainable. The initial appearance of such surpluses, it is argued, would simply give rise to higher Government spending. Those who hold this view apparently conclude that actual balance in the budget may in fact be the appropriate target under high employment conditions. But surely this is a counsel of defeat. The fact is that unless adequate surpluses are generated at high employment over the long terms, there may be no satisfactory way of channeling needed additional resources to housing, to private investment, and to the cities. This is, indeed, one of the major lessons that emerges from the Council's analysis.

International Economic Policies

The final chapter of the report presents a very useful and well-balanced analysis of international economic problems and policies. By and large, we share the views expressed in this chapter. I would, however, like to offer a few comments on topics to which CED has recently devoted special attention.

We were particularly pleased to see the Council's relatively extensive discussion of the problem of nontaiff barriers. Our conviction that reductions in these barriers are of key importance for the freer flow of world trade led to the issuance last September of a joint policy statement on "Nontariff Distortions of Trade" by CED and its counterpart organizations in six other industrial countries. We believe that the policy recommendations made in that statement deserve very careful consideration—including, in particular, the recommendations for curbing various types of quantitative trade restrictions; for closer scrutiny of border tax adjustments; and for improvements in the procedures for negotiating reductions in nontariff barriers.

In the area of foreign aid, we welcome the report's emphasis on increasing the reliance on multilateral development assistance; on improving the efficiency of aid through the ending of additionality requirements and a relaxation of aid tying; and on the recent establishment of an Overseas Private Investment Corporation that will administer government insurance and guarantees to private U.S. investors. All of these steps are in line with the views expressed by our Research and Policy Committee in its September 1969 statement on "Assisting Development in Low-Income Countries: Priorities for U.S. Government Policy."

We believe, however, that it is also particularly important to stress—as was done in our statement—that there is an urgent need to increase the total flow of external resources (both public and private) to the less-developed countries. To encourage a greater role for the private sector in this process, moreover, we continue to recommend a blanket exemption of U.S. investment in the developing countries from the program of balance-of-payments restrictions on capital outflows.

The report's treatment of international capital mobility, the balance-of-payments, and mechanisms for international adjustment is informative and constructive. Let me emphasize, even more than is done in the report, that the solution to the adjustment problem does not, in our view, lie in direct controls on the movement of capital or controls on other types of international transactions. Nor should it be expected that the principal part of the answer can be found in the adoption of one or another of the proposals for limited exchange flexibility that are discussed in the report. It is possible that such innovations can make a constructive contribution to the functioning of the international monetary systems, and this is a question that in our view deserves considerable further study. But the fundamental basis for proper payments adjustment must continue to rest on sound national economic policies. For the United States, in particular, the continuing need for strengthening its international trade balance makes it highly important that every effort is undertaken to assure an early restoration of price stability compatible with sound economic growth.

COMMUNICATIONS WORKERS OF AMERICA

Members of the Communications Workers of America are seriously concerned, at this point, over the condition of the economy. They are aggravated by the continuation of an inflation that now is threatening to wipe out their wage increases of the last 3 years. At the same time they are worried by the developing increase in unemployment, and Government anti-inflation policy which seems to be directed toward producing unemployment.

The Nixon economic policy is to employ fiscal and monetary restraint to cut back final demand in the economy. It is expected that as total demand is restrained, the ability of sellers of goods and services to raise prices will be impaired. Costs will continue to rise for a time, thus squeezing corporate profit margins and ultimately total profits. The decline in profits is expected to curb capital investment. Unemployment is expected to rise and the decline in general business activity is counted on to stiffen the backs of employers in wage bargaining and to moderate the wage demands of labor. Out of all this comes a dampening of inflationary pressures.

The administration appears to be opposed to using direct controls on wages and prices and the monetary authorities are unwilling to use selective credit controls. Complete reliance is being placed on general and impersonal fiscal and monetary tools to combat inflation as compared with direct or selective controls.

Of course, the official Government position is that these governmental policies are directed toward alleviating inflation, and not toward purposefully producing unemployment, albeit it is confessed that these policies may lead indirectly and inadvertently toward some unemployment.

The squeeze on the economy now is producing more than the expected results.

The real volume of total national product actually declined during the last quarter of last year and provided only a 2-percent increase for the entire year.

Housing starts dropped from an annual rate of 1.7 million in the first quarter of 1969 to 1.2 million in January 1970 and are continuing down. This represents a decline of 30 percent.

Retail sales went through January virtually unchanged after seasonal adjustments from December, and the year-to-year gain of only 2 percent means an actual decline in physical volume.

Auto sales dropped to 7.8 million in December and fell further in January to an annual rate of 7.2 million. This is the lowest sales rate since the mini-recession of early 1967.

The unemployment index climbed to 3.9 in January and has gone to 4.2 percent.

Admittedly, an inflationary situation such as we have been experiencing in the past 2 years requires that, somewhere in the economy, there should be some reduction in the level of aggregate monetary demand and spending. The real issue is just exactly how this reduction should be distributed. Should it be distributed on a catch-as-catch-can basis, or, should it be distributed in accordance with some overall, coherent plan that considers fundamental national priorities, basic national needs and the welfare of all of the people—rather than simply those who already are better off?

While most reasonable people would agree to the latter course, there seems to be considerable disagreement as to how that course should be pursued. We feel that implementation of this course should have involved several relatively clear-cut steps.

It is true that any evaluation of national priorities, as far as the Federal budget is concerned, could involve enormous expenditures of all sorts and that many of them would have to be trimmed in order to secure any realistic budget in line with revenues. We would assume, nevertheless, that the magnitude of proposed expenditures would be relatively commensurate with recognized national needs.

The shortage of housing is reaching crisis proportions. Some Federal relief is going to be necessary in the mortgage market. The country needs expanded public housing. We are still a long way from the elimination of poverty. We have air and water pollution problems. There are tremendous needs in education. Nevertheless, it appears that these priority items are to be dealt with in terms of several hundred million dollars while other items of Federal expenditure are to be dealt with in adjustments of billions of dollars. We do not feel that the projected Federal expenditure budget reflects the true national priorities. Moreover, we feel that expenditures have been tailored to a tax policy, while we may now be coming to a time when taxes may be more tailored to an expenditure policy. Such a change might provide considerable improvement in the determination of true national priorities.

Once these needs had been determined, it would appear that the next step would be a determination of the distribution of the revenue requirement. The revenue requirement itself could be expected, under the current economic conditions, to be set at a total level that would contemplate some budgetary surplus to counter-balance the excessive monetary demands of the private economy. The distribution of that revenue requirements might be only slightly affected by some variation in the total level.

The distribution of the Federal revenue requirement was dealt with this past year in the process of tax reform. The evidence is fairly clear that the Nation as a whole was ready for, and was looking forward to, considerable tax reform in the year 1969. Some tax reform was secured, but much of the efforts of the House of Representatives last summer were undone and much of the total effort was in the wrong direction as far as the current inflation is concerned.

As a result, we are left with inadequate tax reform with many continuing inequities in taxation and too many remaining loopholes for high-income and profit-earning income receivers. We are left with an inadequate budget and the consequent necessity of continuing an income tax surcharge which is a percentage of the tax and, therefore, compounds the remaining inequities not removed by tax reform. We are left with an inadequate budgetary surplus for the fiscal year 1971 in order to combat inflation, if we continue to have any amount of inflation at all. We are left in the position of having to undergo a general shotgun reduction of vital expenditures in order to otherwise reduce total spending in the economy, no matter how desirable those expenditures might be. And, finally as a resulting necessity, the major promotion of control of the inflationary pressures of the economy ultimately is consigned to a monetary policy whose scattergun character is such that it probably has not been capable of exercising effective control over inflation for some years.

After a year in which there seemed to be so much opportunity for genuine tax reform, and which held, therefore, the opportunity of a sound anti-inflationary fiscal policy, we are left with more inflation than in the previous year and the virtual promise of increased unemployment.

It is difficult to understand how this came to pass. We do feel, of course, that the administration did not, and could not, have its heart in full-scale tax reform. We feel that greater, more effective, leadership could have been brought to bear in securing the kind of tax reform that was needed. We still feel that further improvement in the tax structure offers the best course in the direction of regaining control over inflation. Tax policy provides the only means of placing deterrents on those sectors of the economy which may be said to be spurring on inflation as contrasted with those sectors of the economy that do not provide fuel for inflation.

We do not believe that the present level of tax reform is enough. While it cannot be denied that we now have a somewhat more reasonable distribution of the tax load, this only was secured at the expense of considerable less in Federal revenues for the effort to counteract inflation.

The taxation of capital gains is left substantially unaffected by the new law. The House bill had proposed that capital gains at death be taxed on the basis of cost rather than on the basis of the increase in value since death. Capital gains treatment of profit also was to be reserved to holdings extending beyond 1 year instead of 6 months. The new law left State and municipal bond interest still untaxed, In addition, depletion allowances were only slightly reduced instead of being substantially cut. These losses would have produced considerable Federal revenue.

The Federal income tax structure is still a far cry from American standards of fair play. The unfair manner in which federal taxes are raised seriously reduces the capacity of Federal tax policy to operate upon the problem of inflation or deflation.

In 1967, the Federal income taxes paid by millionaires averaged 25 percent of their total income. The preservation of the loopholes of capital gains and untaxed interest income will not increase their tax bills very much. The Federal tax structure is still rigged in favor of unearned income and against income from work.

While we may fully sympathize with the necessity for profits as an inducement to facilitate growth in the economy, in a period in which we have had to devote much of our resources to an expensive war, the unparalleled growth of profits over the last few years has actually threatened to shift income distribution away from the consumer purchasing power that has sustained those profits.

We warned about this situation in our testimony before this committee last year. While the problem of inflation in the overview is a problem of excess aggregate monetary demand, the "tradeoff" relationship found between inflation and unemployment that now is euphemistically referred to as the Phillips curve, we feel is shaped by the distribution of spending. In this context, I offered the following comments last year:

As the basis of high proportion of incomes, consumer expenditures are heavily dependent upon wages and salaries, in order that goods and services for profit can be "cleared from the shelves" without inordinate unanticipated increases in inventories. At the same time as purchasing power is maintained, it should not, of course, find a shortage of goods and thus produce inflation. If more purchasing power is channeled into time-consuming investment than is going to be provided from current savings, inflation will be the result. This condition has been the situation now for some years. Investment has proceeded apace in response to perhaps the wildest profit-boom in our history.

It is in this context that we have never been able to accept the veracity of a voluntary "income policy" comprehended in wage-price guideposts. A sacrificial wage policy will not keep profits up, if consumer expenditures fall below the level anticipated as necessary to "clear the market"; if the low wage increases merely leave incorrect anticipations of higher profits. We think the wage policies of Unions have helped sustain an expanding market by preserving the proportion of the national income going to wage and salary compensation.

The previous administration's council had urged labor to accept money wage increases of no greater than 5 percent and asked business to absorb increases in unit labor costs of up to 1 percent. They were willing to allow business profit margins, of course, of the comfortable level achieved in 1967 and 1968. We then further commented:

The profit margins of 1968 required a 2.6 percent increase in industrial prices. The corresponding increase in the consumer price index was 4.2 percent. If these increases are approached in 1969, it does not appear that an increase in money average earnings of 5 percent would increase *real* average earnings sufficiently to maintain the present distribution, as between wages and profits, of the national income, unless there were less than 3.3 percent increase in productivity—in which case the profit margin would not be retained anyway.

This is almost, in a word, exactly what happened. For personal consumption expenditures as a proportion of the gross national product have been slipped down, as a proportion of GNP, since 1961—from 64.6 percent in 1960 down to 62 percent in 1967, and 61.9 percent in 1968, to 61.8 percent in 1969. While investment expenditures as a proportion of the GNP has fluctuated somewhat between a low of 13.8 percent in 1961 and 16.2 percent in 1966, it moved back from 14.6 percent in 1967 and 1968, to 14.9 percent in 1969.

At the moment, productivity does appear to be at a standstill and profit margins undoubtedly have been cut some as the level of corporate profits finally slipped after the first part of the year in 1969. We feel that earlier excessive profits were the main cause of the investment boom and that tax reform directed toward increasing tax revenues from profits might have brought the economy better balance and might have mitigated the extent of the trade off between inflation and unemployment.

It now, in retrospect, is thoroughly understood that business investment expansion provided a major thrust for inflation during the past year. Swollen with profits from 1968 and with the added incentive of advance warnings that the investment tax credit might be cut off later in the year, business demand for plant and equipment was projected to increase by 14 percent over 1968 levels as the year 1969 began. It is a true commentary on the effectiveness of a shooting-from-the-hip monetary policy that the massive monetary restraints of 1969 restrained investment expenditures in 1969 to an increase of 12 percent over the 1968 level. By the Council of Economic Advisers' own report, this was only the eighth annual advance in a row, topping out the longest sustained increase in investment since World War I.

We think it is clearly the pressure of high profit-induced investment spending that has brought inflation to a head and has now brought such price increases as to force consumer resistance. The consequent relative decline in consumer purchases has thus pinched profits, and reduced business spending now is likely to take place quite apart from any effect of higher interest rates. In addition to the decline in profits, the index of industrial production has been slipping for the past 6 months, there has been a general weakening of retail sales, a slight increase in the unemployment rate and, of course, a sharp decline in housing starts from the level a year ago.

We have some difficulty in understanding how monetary policy can be brought to bear upon investment spending, anyway. It seems fairly clear that a major proportion of business investment is undertaken out of internal funds—depreciation accounts and otherwise. Economists have pointed out for years that more than half of each year's gross investment is financed from internal corporate resources. This investment, at least, is hardly subject to the deterrent of higher interest rates. And yet, the objective of higher interest rates must be to reduce investment spending.

Instead, higher interest rates have taken their full toll on more vulnerable sections of the economy in true indiscriminate, shotgun fashion, falling particularly heavily upon the residential housing market. While it is true that the year's 6.7 percent decline in private housing outlays may be said to have reduced spending and total demand, housing, tragically, is one of the Nation's greatest social needs.

During the year, private housing outlays decreased 6.7 percent from the first to the fourth quarter and constituted the major cause for decline in the rise of aggregate demand.

The present high-interest rates also are grievously impeding the capacity of States and municipalities to deal effectively with local problems of low-income housing, urban renewal, and transportation. State and local bond issues are increasingly expensive, and the necessity of keeping these issues competitive undoubtedly was one of the factors persuading Congress against taxation of State and municipal bond interest.

The other principle affect of high interest rates has been a complete disruption of capital market through complete disruption of the balance in the relative rates of return on money. The effects upon the stock market are well known and hardly require further comment.

These changes have, of course, produced some interesting side effects of an inflationary sort that further argue against continuation of the present course. Here, we can readily quote from the Economic Report of the President:

> The industrial composition of investment provides a clue to the strength of business investment. Over the past few years the demand for capital goods by electric and gas utilities and telephone companies has been exceptionally strong. In contrast to other groups, investment in these industries has increased

steadily and substantially each year * * *. High interest rates have not seriously deterred these industries from investment because they meet demands for service and because the regulatory authorities permit such cost increases to be reflected in higher rates.

Actual spending by these groups rose sharply in 1969, and in 1970 the State commissions now have a host of petitions before them for higher rates, many of which now are in effect. By March 1970, it has become clear that increases in rates in these industries are going to be major contributors to the price increases of 1970.

In our view, the third facet of administration policy, or lack thereof, the resulting, more or less, last ditch defense against inflation—the restraint on important domestic budgetary expenditures—borders on a national disaster. The cuts for medical research and education, in particular, seem ill advised. But, in spite of some moderate cuts in defense spending, little room has been left, otherwise, for any solution of the problems of urban areas, reduction of poverty, or the abolition of hunger within our country. In many respects, the solution of the problem of crime in the streets is the solution of the problems of the ghetto, poverty, and starvation.

In particular, the problem of housing is becoming more and more acute. The very least that should be done is a Federal interest subsidy to get increased housing out from under higher interest rates, yet, spokesmen for the administration insist that solution of the housing problem depends upon solution of the problem of inflation.

If the interest rate control of the Federal Reserve System is not subject to Government control because the FED is a semiprivate, autonomous corporation, the Federal Government, which created it, should at least pass the necessary legislation to subsidize housing. The reduction of inflation is sufficiently within the control of the Federal Government that it does not have to rest so large a share of the burden upon a single industry.

In summary, it seems evident for a number of reasons that the current monetary policy should be reversed rather considerably. It has none of the desirable effects it is reputed to have and the unfavorable effects, instead, are having a debilitating effect upon the economy.

The economy can still look to a more balanced tax structure as a basis for the fiscal policy that may prevent repetition of the mistakes of the past and may still allay some of the mistakes of the present. If the current inflation has run its course, we must not incur a rerun of the same features. At the same time, a more balanced income distribution, on the basis of a more equitable tax policy, must become the source of that improved level of consumption expenditures which will sustain full employment.

Many of the recently cut domestic budgetary expenditures should be restored, in order to avoid the inevitable social revolution that may be afoot otherwise.

The hard-core unemployed and underemployed still constitute a considerable problem. We feel a large-scale public service employment program is very desirable. Such a program could be combined with urban renewal.

We think this should be based upon a comprehensive and coordinated national inventory of needs for housing, community facilities, and public services. On the basis of similar State and metropolitan area inventories, the Federal Government should provide plans and programs which can be implemented through financial and technical grants-in-aid to States and cities as well as through direct Federal efforts. Our real national economic and social needs must become our first priorities.

We do not believe that Federal funds should be shared with the States, however, on a no strings basis. The Nation's best interests will not be served by undirected block grants which are not tailored to national goals and priorities and without Federal standards of performance. This will always be the case so long as the economies of some of our States are controlled lock, stock, and barrel by some of our largest economic interests.

The administration's scatter gun economic policies must be replaced by selective measures designed to operate upon the more specific causes of inflation. Removal of the 7-percent tax credit subsidy for business investment in new equipment was a desirable step in the recent tax law. New evidence of continued investment expansion in 1960, however, indicates that the phasing out of the credit contemplated in the new law was a mistake.

The specific causes of rising pressures on the cost of living should also be dealt with more directly where possible. We think the Federal Government has the means at its disposal to deal effectively with the problems of higher physicians' fees, hospital charges, and soaring auto and property insurance rates.

In implementing the Government's responsibilities under the Employment Act of 1946, we feel that it would be desirable for the Council of Economic Advisers to annually present its best estimates as to what level of consumer expenditures, Government expenditures, and investment expenditures the economy should have in order to move in the direction of the goal of full employment without inflation. These estimates should be coordinated with the Federal Government's inventory of pressing national priorities so that we have some national economic planning.

To improve upon this process, we would welcome the President's calling an economic conference each year, to be attended by representatives of major economic groups for exchanges of information and viewpoints. We think such a review of the Government's forecasts and policies for a coming year as well as review of the economic results of a preceding year, could greatly improve the economic policymaking process that our country so greatly needs in these times.

CONFERENCE ON ECONOMIC PROGRESS

By Leon H. Keyserling [1]

Let me express my deep appreciation of the opportunity accorded to me, from year to year, to comment upon the Economic Report of the President and the accompanying Annual Report of the Council of Economic Advisers.

Scope of My Analysis

This year, I shall depart considerably from the method which I have customarily followed. In earlier years, I have made rather detailed comments upon all important sections of the reports of the Presidents and the Council. But at this time, I deem it most important to focus upon what I regard to be the major thesis of current national economic programs and policies, a thesis of course at the heart of both the President's and the Council's reports.

This prevalent thesis is that the first and foremost task is to reduce the rate of price inflation; that, toward his end, economic growth, employment, and the service of our great domestic priorities should be temporarily sacrified to a considerable degree; and that, once this foremost task of reducing the rate of price inflation is accomplished, our other economic and social objectives as a Nation and a people may more easily be pursued with vigor and success.

I challenge this prevalent thesis almost in its entirety. I submit that it finds no support in empirical evidence. I believe that it puts the cart before the horse. I therefore urge that we immediately reexamine this prevalent thesis in the light of reason and experience, and fundamentally reconstruct basic national economic policies accordingly.

The balance of my statement will be devoted to my reasons for the conclusions I have just set forth, and toward recommendations of policy designed to alter the course of monetary and fiscal policy before the hour is even later than now.

The Failure of the Trade-Off to Materialize

The prevalent view is that there is a necessary "trade-off" between the objectives of maximum economic growth and maximum employment (goals of the Employment Act of 1946) and price stability, or at least between maximum use of our productive potentials and price stability. But no such "trade-off" has in fact occurred. The economic charge has been incurrd, but the price-stability benefits have not been delivered.

From 1966 forward, real economic growth has been progressively diminished to a minus figures, and, most recently, unemployment has risen sharply. Meanwhile, during these very same years, price inflation has been proceeding at an accelerating rate, above all in 1969 and at

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the start of 1970. Instead of any "trade-off" having occurred—putting aside for the moment what kind of "trade-off" is worthwhile—highly unfavorable results have been obtained on all fronts. And because the policies of (*a*) tight money and rising interest rates, and (*b*) a tight Federal budget and a Federal surplus (at least on paper) at the sacrifice of essential domestic priorities requiring more Federal spending, have been the two major means utilized to seek the "trade-off" which has failed to occur, the need for reconsideration and reconstruction of these policies is underscored.

It will not do to continue to insist that the "trade-off" has not yet occurred because the policies designed to effectuate it have not yet had time enough to take hold. The period from 1966 to early 1970 has been plenty long enough for policies to have shown substantial signs of effectiveness, if they were not wrong policies.

Aspect One of the Anti-Inflationary Policy: The Contrived Economic Slowdown

The fundamental thesis underlying recent and current efforts to restrain inflation is that the inflation has been due to an overheated economy. Unless one is to fall prey to the circular reasoning that an overheated economy is any economy in which prices are rising excessively, accompanied by the proposition that any economy in which prices are rising excessively is an overheated economy, it is necessary to start with a proper definition of what is really an overheated economy.

An overheated economy is one in which the pressures exerted by total spending or total demand at the current price level are in excess of reasonable production capabilities, thus forcing up prices instead of increasing real output, or doing some of both. Thus, starting from a base period in which there has been no excessive inflation for a meaningful period of years, an overheated economy is one where the growth rate in total spending exceeds the real growth rate potential of the economy as determined by productivity trends and trends in the civilian labor force, or those trends in the civilian labor force which would be induced by adequate real economic growth and adequate job opportunity. Clearly, at least from 1966 forward, the U.S. economy has not been overheated by this rational test, but, instead, has been progressively underutilized.

During 1960–66, the real growth rate of the economy averaged annually 5.1 percent. But it averaged only 3.4 percent during 1966–69. It was only 2.8 percent from 1968 to 1969, only 1.6 percent from fourth quarter 1968 to fourth quarter 1969, and at an annual rate of minus 0.4 percent from third to fourth quarter 1969. The only unresolved question as to first quarter 1970 is whether the real growth rate will turn out to be approximately zero, or even less than that. Most forecasts for 1970 as a whole indicate a real economic growth rate of 3 percent or less.[2]

The reasonable growth rate potential of the U.S. economy is best illustrated by the trends in productivity in the private economy (although some allowance should be made for the lower productivity growth rate in the public sector, due in large part to a product mix including relatively more services). In a long-term perspective, the

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[2] See chart 1 at end of text.

productivity growth rate in the private economy has tended clearly to accelerate substantially. It rose from an average annual rate of 0.5 percent during 1910–20 to 2.3–2.4 percent during 1920–40, and to 3.2 percent during 1940–55. The average annual growth rate in such productivity during 1955–60 was reduced to 2.4 percent by a very low average annual economic growth rate, stagnations, and recessions during this period, which cause serious underutilization of manpower in plants operating at very low capacity.

But during 1960–66, when the real growth rate of the economy, as earlier indicated, was 5.1 percent, the average annual productivity growth rate in the private economy was 3.7 percent (it was 4.1 percent during 1947–53). From 1966 to 1969, the annual average declined to only 2 percent, and from 1968 to 1969 was only 0.9 percent. These most recent deteriorations in the productivity growth rate have been clearly resultant from the excessively low real economic growth rate and large economic slack.

It follows that the average annual growth rate in the productivity potential, with the lower growth rate in the public sector counterbalanced by the acceleration in the private sector, must have been at least 3.7 percent from 1960 to date, or at least from 1969 forward. Coupling this with the normal growth rate in the civilian labor force, the optimum average annual real growth rate for the U.S. economy must be at least 5 percent after restoration of reasonably full resource use, and should be about 6 percent annually until such resource use is restored.[3]

The GNP production gap, measured by the difference between actual output and maximum output, has risen very substantially year by year from 1966 forward, being estimated by me as 7.4 percent in 1966 and 11.2 percent ($97 billion) in 1969. It is considerably higher now. I estimate the production gap at only 0.6 percent in 1953, and only 6 o percent in 1957.[4]

Aspect Two of the Anti-Inflationary Policy: The Contrived Rise in Unemployment

The dwindling real economic growth rate from 1966 to 1969 appears superficially not to have been translated into rising unemployment, as officially measured. Thus, full-time unemployment was reduced from 3.8 percent in 1966 to 3.5 percent in 1969. (For reasons stated above, this measurement neglects the underemployment of employed workers, and also neglects various other important factors. The true level of unemployment in 1969, taking into account not only full-time unemployment, but also the full-time equivalent of part-time unemployment, and the concealed unemployment in the form of those without work because of scarcity of job opportunity and therefore not participating in the civilian labor force and therefore not officially counted as unemployed, was 5.6 percent.)

Moreover, in early 1970, the impact of dwindling real economic growth upon unemployment became much clearer. Full-time unemployment, seasonally adjusted, rose to 3.9 percent in January 1970, and to 4.2 percent in February 1970, or 20 percent above December

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[3] See chart 2, and see again chart 1 at end of text.
[4] See chart 3 at end of text.

1969. This was the sharpest rise in many years. By now, the true level of unemployment must be at least in the neighborhood of 6 percent, and may well be considerably higher.

Highly qualified analysts forecast a further increase of up to 1.5 million in full-time unemployment during 1970, which would bring it above 5.4 percent of the civilian labor force, with a true level of unemployment close to 7.5 percent (it was 6.8 percent in 1961). Most important of all, unemployment has already concentrated heavily among vulnerable groups that a 54-percent rise in the rate of full-time unemployment (from 3.5 to 5.4 percent) might will lift the absolute amount of unemployment among these vulnerables to critical levels.

The Contrived Economic Slowdown Has Augmented Inflation

The trends since 1966 fortify mightily the thesis which I have advanced on many occasions during the past 15 years or longer: In sharp contrast to the prevalent thesis that a contrived slowdown in the rate of real economic growths and contrived increases in unemployment reduce the pace of price inflation, the empirical evidence is clear that the opposite is the case. On this subject, empirical observation of how the U.S. economy actually works must supplant outmoded theoretical formulations as to how it might be expected to work.

Before developing my position in detail, I hasten to add that very few positions of this type in the field of economics are definitively demonstrable 100 or 95 percent. While I am reasonably confident that my position in this matter is correct for purposes of practical economic policy, the burden of proof as to the degree of correctness of my position does not rest upon me. For if it is merely shown—as I certainly do show—that a contrived economic slowdown and contrived increases in unemployment are as likely to cause further price inflation as to cause the reverse, then there can be absolutely no doubt that the certain advantages of growth and employment should be the keynote of public policy, rather than stubborn reliance upon seeking relatively greater price stability even if this is obtained at greatly excessive costs in terms of lost output and unemployment.

Now, to move on with my empirical analysis: During 1952–55, the average annual real rate of growth in the U.S. economy was 3.5 percent, while the average annual increase was only 0.3 percent for consumer prices and 1.1 percent for industrial prices, while wholesale prices declined at an average annual rate of 0.2 percent. During 1955–58, when the average annual rate of real economic growth fell to only 0.8 percent, the average annual rate of increase was 2.6 percent for consumer prices and 2.5 percent for wholesale and industrial prices. During the shorter period 1956–58, when the average annual rate of real economic growth declined further to 0.2 percent, the average annual increase was 3.1 percent for consumer prices, 2.2 percent for wholesale prices, and 1.5 percent for industrial prices.

During 1958–60, when the average annual rate of real economic growth was 4.3 percent, the average annual increases were only 1.2 percent for consumer prices, 0.1 percent for wholesale prices, and 0.9 percent for industrial prices. And during 1960–66, when the average annual rate of real economic growth was 5.1 percent, the average annual increases were only 1.6 percent for consumer prices, 0.8 percent for wholesale prices, and 0.6 percent for industrial prices.

But during 1966–69, when the average annual rate of real economic growth declined to only 3.4 percent, the average annual increases were 4.1 percent for consumer prices, 2.2 percent for wholesale prices, and 2.5 percent for industrial prices. From 1968 to 1969, while the real rate of economic growth was only 2.8 percent, the increase was 5.4 percent for consumer prices, 4.0 percent for wholesale prices, and 3.4 percent for industrial prices. In late 1969 and early 1970, as the rate of real economic growth fell to zero or below zero, the process of price inflation accelerated.[5]

It may be argued that, while there is little or no positive correlation between the rate of real economic growth and the rate of price inflation, there is nonetheless a clear and positive correlation between the reduction of unemployment below certain levels (it is never made clear just what these levels are) and price inflation. But this argument is not justified by the empirical evidence.

During 1952–55, when virtual price stability was achieved, the average level of unemployment was very much lower than during 1955–58, when price inflation was relatively severe. During the shorter period 1956–58, unemployment averaged still higher, although price inflation became still more severe.

Remarkable price stability was achieved during 1960–66, when employment averaged about the same as during 1956–58 when price inflation was severe. Moreover, looking at trends within the periods averaged, unemployment rose from 4.1 percent in 1956 to 6.8 percent in 1958, while it fell from 5.5 in 1960 to 3.8 percent in 1966. Although price inflation was rampant during 1966–68, and especially in 1969 and early 1970, unemployment at 4.2 percent in February 1970 was much higher than the 3.8 percent rate in 1966 when inflationary price changes were far less severe, and rose about 20 percent from December 1969 to February 1970.[6]

The Spurious "Timelag" Argument

In view of this long record, it becomes increasingly ridiculous, if not disingenuous, to continue to insist that "timelags" explain these opposite trends in the economy and in prices, or to attempt to dispute my conclusions by contrived permutations in the years selected for the analysis. As a matter of fact, I have found no studies in depth by economists, inside or outside the Government, which have even attempted qualitatively and empirically to question my analysis or dispute my conclusions.

Some comments need to be made about the periods which I have selected for my demonstrations, in order to show why these selections are appropriate, rather than chosen to yield a particular result. In depicting the relationships between real economic growth and price trends, I have been guided in my choice of periods by the growth-rate developments without regard to the price trends, and then let the cards fall as they may with regard to the price trends during these same periods.

To illustrate the reasons for the period selections which I have thus made in the foregoing exercises compare real economic growth rates

[5] See chart 4, and also chart 13, at end of text, subsequently to be discussed in detail.
[6] See again charts 4, 5, and 13 at end of text, and 1970 Economic Report of the President.

with price trends, the period 1952–55 was selected because the real growth rate was 4.5 percent from 1952 to 1953; and, though there was a recession from 1953 to 1954, the real growth rate was 7.5 percent from 1954 to 1955, and price inflation was not great during any of these years. I have selected the periods 1955–58 and 1956–58 because the real economic growth rate was very low or negative in each year during these periods, declined from year-to-year, and culminated in an economic recession; meanwhile, price inflation averaged quite high.

I have selected the periods 1958–60 and 1960–66 because the real growth rate was very high during the first and last year of these two periods, averaged high throughout and was high except for 2 years; during these periods, there was very little price inflation. I have selected the period 1966–69 because the real economic growth rate declined very sharply during the first year within this period, averaged very low for the period as a whole, and culminated in an absolute recession during fourth quarter 1969 and first quarter 1970; during this period, in general, price inflation accelerated greatly. To be sure, the real growth rate was high from 1967 to 1968, but this aberration from the record for the period as a whole does not vitiate my demonstration. Indeed, on the "timelag" theory, prices should have declined (or at least evidenced a much less rapid rise) during 1967–68 in view of the very drastic economic slowdown during 1966–67, but instead prices continued to march upward very substantially.

This analysis is much too comprehensive, and extends over far too long a period, to explain the opposite movements with respect to real growth and prices by "timelags". Moreover, if one accepts the classical supply and demand explanation of price trends, there is no reason why the decline in prices should occur long after the economy begins to decline further and further below the reasonably full use of its resources, as during 1966—early 1970, or, on a narrower view, during 1968—early 1970. The only even superficially plausible explanation of the so-called "lag" would be that prices are administered and, therefore, react slowly. But to the extent that prices are administered, the whole classical theory breaks down. In fact it is just because prices are administered to so large an extent that I am able to explain the opposite trends in real economic growth and prices which undermine the classical theory.

But even if studies in depth by others (not yet made available, to my knowledge) were to modify the force of my conclusions, that is not the main point. I am even willing to concede that, if the recession deepens and lasts long enough, and if unemployment raises enough, there will be some substantial modulation of price inflation. But putting aside for the moment whether this would be worth the cost in the real loss and suffering caused by huge production gaps and excessive unemployment, the reasoning which supports the prevalent analysis would lead to the conclusion that prices will then start to rise again in accelerating fashion when the economy moves again toward more adequate economic growth, fuller resource use, and lower unemployment.

The crucial issue, therefore, is not whether striking devastating blows at the real performance of our economy can temporarily abate in due course the process of price inflation. The crucial point is this: In the longer run, these contrived upward and sideways and downward movements of the economy, this deliberate manufacture of gross instability, as well as the wayward and frequently about-faces in national economic policies in the name of "fine tuning," clearly net more price inflation in the longrun than would result from reasonably stable and reasonably consistent long-range economic policies directed always toward maximum economic growth and maximum employment.

I believe this conclusion to be absolutely clear. But even if it were not absolutely clear, it is clear enough to discredit those prevalent national economic policies which strike hammer blows at the real economy and risk further social disintegration in an ineffectual effort to restrain price inflation by the wrong means.

Tight Money and Rising Interest Rates are Highly Inflationary

Tight money and rising interest rates have both the avowed purpose and palpable consequence of attempting to restrain price infllation by stunting economic growth and adding to unemployment. It must follow, for the reason stated above, that the prevalent policy (with slight undulations) of tight money and rising interest rates during the past 15 years or longer has been in fact inflationary rather than anti-inflationary. Besides, this policy has inflicted immensely more real damage upon the economy than it would have been worth even if it had shown some mild signs of being effective in controlling inflation.

During 1955–69, the average annual growth in the non-federally held money supply was only 2.8 percent, and this contributed to a seriously deficient average annual real economic growth rate of only 3.7 percent. Meanwhile, the average annual increase in consumer prices was 2.3 percent.

During 1955–66, the growth rate in the money supply was reduced to 1.3 percent, and during 1956–57 was reduced to minum 0.7 percent. The annual rate of real economic growth during these years was only 1.8 and 1.4 percent, respectively. Meanwhile, the Consumer Price Index rose 1.5 and 3.5 percent, respectively. During 1957–58, despite a belated effort which expanded the money supply by 3.8 percent, the real growth rate of the economy was minus 1.1 percent, and yet consumer prices rose 2.8 percent.

During 1958–62, looking at each year separately, the money supply rose 0.6 percent, and consumer prices rose 0.8 percent; the money supply declined 0.6 percent and consumer prices rose 1.6 percent; the money supply rose 3.1 percent, and consumer prices rose 1.1 percent; and the money supply rose 1.4 percent, and consumer prices rose 1.2 percent. If these comparisons show anything much, they indicate a negative rather than a positive relationship between the trends in the money supply and the trends in prices.

During 1962–66, the average annual increase in the money supply was 4.2 percent, with brisk expansion in all years save 1965–66. The average annual real economic growth rate was 5.6 percent, and the average annual increase in consumer prices was only 1.8 percent.

For 1968 to 1969, the increse in the money supply was drastically reduced to 2.5 percent, the real growth rate of the economy was reduced to 2.8 percent, and consumer prices rose 5.4 percent. The drastic tightening of the money supply and the further lifting of interest rates within 1969, and on into 1970, brought the real economic growth rate down to zero or less than zero, while the annual rate of consumer price inflation rose to 6 percent or higher.[7]

Other End Effects of Tight Money and Rising Interest Rates: The Housing Crisis

In addition to crippling the economy and adding to unemployment, the ruinous monetary policy has had many other evil effects. It has fed the fat and starved the lean. It has misallocated resources in a manner which has increased the economic disequilibrium, thus torpedoing real economic growth and adding greatly to social injustice and discontent. It has had very slight effect upon the relatively excessive investment boom in plant and equipment which is financed primarily out of retained earnings and the price structure. But it is bringing ruination upon such vital industries as housing, and making it increasingly difficult for State and local governments, and even the Federal Government, to obtain adequate borrowed funds at bearable interest costs.

We hear on all sides that an average annual rate of housing starts of about 2.6 million, during the decade ahead, is essential to the decent housing of all our people, the rescue and restoration of our urban areas, and business investment and job opportunities sufficient to compensate for technological displacement in the mass production industries. Yet, the annual rate of private nonfarm housing starts declined from 1,845,000 in January 1969 to $1,245,000 in December 1969,[8] and declined further to 1,166,000 in January 1970, a decline of almost 40 percent from January 1969 to January 1970. Never, since the great depression, has any vital industry crashed so catastrophically.

My next four charts depict the shrinkage in housing and related commercial investment in ratio to GNP and to gross private investment; that, from 1961 to 1968, the average annual growth rate in real terms in investment in nonfarm residential structures was only 0.5 percent, compared with 5.2 percent for GNP and 7.5 percent for investment in new plant and equipment: that through 1977 (starting with the base year 1967), we need a real average annual growth rate of 11.2 percent in investment in residential structure, compared with a needed 5.3 percent growth rate in GNP; and that, by 1977, investment in residential structures should come to 34 percent of total fixed investment, compared with only 24.6 percent in 1968.[9] Our constant reaffirmation of these housing goals, and the enactment of much housing legislation to obtain them, become a travesty in the face of the policy of tight money and rising interest rates.

Impact of Rising Interest Rates Upon the Federal Budget, and Upon the War Against Poverty

Looking at the Federal budget, the outlays as of now in the form of interest on the public debt are from $8 to $9 billion higher annually than they would have been on a Federal debt of the same size if

[7] See chart 5 at end of text.
[8] See chart 6 at end of text.
[9] See charts 7, 8, 9, and 10 at end of text.

interest rates had been maintained at the 1952 level. This means, very simply, that the Federal surplus is $9 billion smaller, or the Federal deficit is correspondingly greater, than it would have been if the cost of these rising interest rates had not been foisted upon the Government and the taxpayer. Yet, we hear at one and the same time that rising interest rates combat inflation and that Federal deficits or inadequate Federal surpluses are the central cause of inflation.

I have made this further estimate: From 1953 through 1967, the excess interest costs imposed upon the American people (taking into account both private and public borrowings) totaled $106.6 billion. This has imposed, in the aggregate, an additional burden of almost $2,400 upon the average family of four, and almost $600 on a per capita basis. The related chart also indicates how the average annual excess interests costs of $7.1 billion during 1953–67 might have been used to reduce poverty.[10] Currently, I estimate that the excess interest costs are running at an annual rate of between $20 and $25 billion, even while we plead inability to afford the cost of our most pressing domestic and international priorities.

The foregoing demonstration indicates only a small fraction of the terrible costs of rising interest rates. For in addition to depriving the Federal budget of the availability of huge funds which might otherwise be used against poverty and on behalf of our other great domestic priorities, the policy of tight money and rising interest rates has cost us enormous forfeitures in product and employment opportunity, and correspondingly in Federal revenues at any given tax rates. As will be subsequently described in more detail, this inflationary monetary policy in the name of fighting inflation, along with other errors in fiscal policies founded in the same misconceptions, have caused us to forfeit, during 1953–68, more than $900 billion of total national product, measured in 1967 dollars. Taking into account the impact of a progressive tax system at various levels of economic activity, the forfeiture in terms of Federal revenues alone was in the neighborhood of $180 billion.

Why the Contrived Economic Slowdown and Rising Unemployment Are Also Inflationary

It has thus far been shown by empirical observation that tight money and rising interest rates, and excessive tightening of the Federal budget at the sacrifice of our great domestic priorities, are self-defeating by stunting economic growth and increasing idle plant and manpower, and in addition that these prevalent policies have actually increased price inflation. Let me now develop, on the basis of this empirical observation, a theoretical formulation to replace the prevalent theory, unsupported by empirical observation, that such policies reduce price inflation.

What are the basic reasons why the contrived slowdowns of the real economy and the contrived increases in unemployment are inflationary rather than anti-inflationary?

First, a large and influential portion of the U.S. economy is characterized by administered prices, rather than by prices determined by the so-called laws of supply and demand in a free market. When the

[10] See chart 11 at end of text.

volume of business is not expanding adequately or in accord with expectancy, many of those in the administered price sectors of the economy lift their prices more rapidly than they otherwise would, in the attempt to compensate for inadequate volume and to achieve investment and profit targets despite inadequate volume by higher returns per unit. This is borne out, not only by the price trends which I have already depicted above, but also by a wide range of studies which I have made of particular key industries during the past 15 years or longer.

Second, for reasons which I have already stated, inadequate economic growth and excess plant capacity reduce the actual rate of productivity gains in the private sector very far below the growth rate in the productivity potential which is approximately translated into actuality during periods of reasonably full resource use. This artificial reduction of the rate of growth in the productivity increases per unit labor costs. And whether these trends in labor costs have or have not justified substantial price increases (I have frequently demonstrated elsewhere that they usually have not justified price increases in view of profit margins, or have not justified price increases as large as those which actually occurred), these reduced productivity gains and increased labor costs per unit have in fact resulted in large price increases.

The proper remedy for this situation is not too bring the rate of real wage-rate gains down to the level of the artificially reduced productivity gains, which would compound the shortages in ultimate demand which are at the heart of the difficulty when these reductions in the productivity growth rate take place. The proper remedy is to maintain real wage-rate gains in accord with the growth rate in the productivity potential. This would help to lift the economy back toward adequate performance. And when there is such adequate performance, real wage-rate gains have tended to lag behind, rather than to run ahead of, gains in productivity.[11]

Third, a large and significant part of recent and current price inflation are in the fields of housing and medical care.

In housing, it must be manifest that the tragic decline in housing starts, in consequence of the prevalent policy of tight money and rising interest rates, and also in consequence of the gross failure to make adequate public investment in housing, has caused the costs to housing occupants, whether renters or owners, to go through the roof. In New York City today, the vacancy ratio is estimated at less than 1 percent, and the housing shortage throughout the country has reached a crisis stage. This is about as inflationary as anything could be.

With respect to medical care, the excessively rising costs are due substantially to inadequate facilities and personnel, and their bad distribution throughout the Nation. This, in turn, is due to a deficient long-range rate of public expenditures for these purposes, in the name of containing inflation.

Fourth, rising interest rates are inflationary per se and by definition. A rise in the price of steel is more inflationary than a rise in the price of avocados because steel enters into more products. Borrowed money enters into more products than any other commodity (human labor not being a commodity). And many of those who bear these rising

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[11] See chart 12 at end of text.

interest costs pass them on to others in the form of higher prices or rates. The utilities, which finance more largely through borrowings than any other major industry except housing, have seen their embedded debt costs increased tremendously because of rising interest rates. And so, necessarily, the utilities throughout the land are seeking rate increases which will be paid by the consumer.

If a workingman buys a $16,000 house, the excess interests costs, caused by the rising interest rates since 1952, will impose upon him over the life of the mortgage an additional charge equivalent to about 1 year of his income after taxes. And when he seeks to gain redress for this rising cost of living by asking a commensurate wage increase, it is called cost-push inflation, even though (as I have shown) the increases in real wage rates have tended to lag behind the increases in productivity gains.

My sophisticated economist friends tell me that my analysis is superficial, in that higher interest rates reduce borrowing, which in turn reduces business activity, and that this is anti-inflationary.

My first answer, which I have already given, is that the slowdown of the economy to stagnation or a negative rate of growth is inflationary rather than anti-inflationary.

My second answer, which I have already given, is that the rising interest rates do little to slow down the inflationary and excessive investment boom in plant and equipment, while they do slow down tragically those things which need to be expanded greatly on economic and social grounds.

My third answer is that, if rising interest rates are anti-inflationary because they slow down borrowings, then it would be anti-inflationary to encourage huge increases in the price of steel to the point where this would slow down the use of steel, or to encourage huge increases in the price of food to the point which would compel scores of millions of low- and lower middle-income families to reduce their food budgets, or to lift wages so rapidly that there would be huge decreases in the use of labor. These fair analogies disclose the preposterous nature of the claim that rising rates are anti-inflationary, because this is tantamount to arguing that all price increases are anti-inflationary if pushed far enough to translate a stagnation or a minimum recession into a general economic debacle.

Fifth, the sharp changes in business expectancies which result from contrived efforts to move the economy upward, sideward, and downward, in the effort to stop inflation, are in themselves inflationary. They are inflationary at both ends of the scale. Many administered prices are increased when Government policies evince the intent to lift the economy from stagnation or recession toward reasonable growth. And ironically but truly, many prices are raised in an effort to beat the gun, when Government policies evince the forward intention of slowing down the economy and reducing the growth rate in business volume.

Perspective on Price Inflation in the United States

Quite apart from the points I have thus far made, to the effect that the prevalent economic policies, both fiscal and monetary, are inflationary rather than anti-inflationary in their consequences, there is a further essential point to be made. This is that we have not had in the

United States, nor do we face any prospect of, a degree of price inflation sufficiently severe to justify making the control of inflation an obsession diverting us away from the pursuit of economic growth, priority development, social justice, and improved income distribution.

I trust that no one will regard my comments in this respect as being soft on inflation, especially in that I believe that the policies I recommend will be far less inflationary in the long run than the prevalent policies. My purpose at this point is merely to bring a more balanced weighing of objectives into the evolution of economic policies, by setting inflationary trends in a long-range and mature, rather than an alarmist and immature, perspective.

During the most recent 10-year period 1959–69, the average annual increase in the United States was 2.3 percent for consumer prices, 1.2 percent for wholesale prices, and 1.1 percent for industrial prices. This was really a better record than during the 20-year period 1949–69, when the average annual increase was 2.2 percent for consumer prices, 1.5 percent for wholesale prices, and 1.7 percent for industrial prices. During the 30-year period 1939–69, the average annual increase was 3.3 percent for consumer prices, 3.3 percent for wholesale prices, and 3 percent for industrial prices.

To be sure, the 30-year record was greatly affected by inflation after the great depression, and by some mistaken policies during World War II, and reconversion.

Nonetheless, there is nothing in these long-range trends to justify the substitution of the misdirected an unsuccessful anti-inflationary frenzy for a well-directed and successful dealing with price trends as they occur. Even the more rapid rate of price inflation during the most recent 4 years, while far too great and requiring more correct remedies than those which have been applied, is not essentially different from erratic and excessive upward price movements during short periods of years in the more distant past.

Comparisons with other countries reinforce this thesis. During 1959–69, while the average annual increases in consumer prices in the United States was 2.3 percent, it was 3.5 percent in the United Kingdom, 3.8 percent in France, 2.5 percent in Germany, 3.6 percent in Italy, 2.5 percent in Canada, and 5.3 percent in Japan. Even during the 5-year period 1964–69, while the average annual increase in consumer prices in the United States was 3.4 percent, it was 4.2 percent in the United Kingdom, 3.7 percent in France, 2.5 percent in Germany, 2.7 percent in Italy, 3.6 percent in Canada, and 5.2 percent in Japan.[12] In many other parts of the world, the rate of price inflation has been incomparably higher than in these relatively advanced industrial nations.

More important by far, even if one were to question my conclusion to the effect that a stable rate of optimum economic growth and minimum unemployment would net less inflation in the long run than the course we have been following, there is this towering issue: The real gains in national income and wealth, and in the distributive process, which result from sustained optimum growth and minimum unemployment, tremendously outweigh any hypothetically greater advances in the price level (although I do not in fact concede that such greater

[12] See chart 13 at end of text.

price advances would result) which would stem from more real growth and less unemployment.

Further, an appraisal of the consequences of price inflation—good or bad—cannot stop with looking at trends in prices alone. Prices in themselves are of little significance, apart for their effect upon the levels and allocation of economic activity, incomes, and benefits in terms of goods and services. A moderately rising, moderately stable, or moderately declining price level may be conducive to the best economic and social performance, or the reverse depending upon these allocations. A stable price price level is not, per se, a solvent of all problems. During 1922–29, we had a remarkably stable price level, except for falling farm prices. Yet, under this stable price level, the allocations of activity and incomes were so distorted that the great crash resulted.

A moderately rising price level, or even price rises of the size we have had during the most recent years, might be desirable if they were caused by programs and policies conducive to maximum real economic growth, maximum employment, the service of our great domestic priorities, and distributive justice. If the recent and current inflation had been caused by powerful programs to optimize growth and employment, elevate the real incomes of the poor and deprived, improve social security, and provide the housing, health, and educational facilities and services which our people need, there could not be valid objection to this amount of price increases. But the inflation of recent years, and currently, has been caused by programs and policies which have stunted growth, increased unemployment, distributed income regressively, imposed the harshest taxes upon those least able to bear them, and starved the servicing of our great domestic priorities. This type of price inflation is cruel and indefensible.

The Costs of Contrived Economic Deflation and Contrived Price Inflation

In order to depict how much the effort to fight inflation by methods which are in fact inflationary, and to erect the fight against inflation into an obsession which has blocked adequate attention to other values of transcendent importance, I turn now to the next phase of my analysis.

We have not sufficiently quantified how much the successive periods of upturns, stagnations, and recessions since 1953 have cost us. Measured in 1967 dollars, our failure to sustain the maximum employment, production, and purchasing power which is the objective of the Employment Act of 1946 caused us to forfeit more than $900 billion of total national production during 1953–68 as a whole, and to forfeit accordingly almost 39 million man-years of employment opportunity. If we should average during the years ahead a record no better than this, and the performance since 1966 augurs no better on the average, we will forfeit during the years 1969–77 inclusive almost $1.2 trillion of total national production, and also more than 31 million man-years of employment opportunity. Nobody concerned about the future of our country, especially in view of our alleged current inability to meet human needs adequately, can view this prospect with equanimity.[13]

[13] See chart 14 at end of text.

Let me stress this point in a somewhat different way. We now live in an economy producing about a trillion dollars worth of goods and services annually. Without complicating the problem by compounding, a 2-percent difference in the average annual real economic growth rate will yield a difference of 20 percent, or about $200 billion in the real size of our total national product 10 years hence. This comes to an average annual difference of about $100 billion. We must be aware that the average annual real growth rate of the U.S. economy was only 2.4 percent during 1953–60; that it was only 3.4 percent during 1966–69, and will be very much lower during 1966–70; and that the massive tax reductions in 1964 produced a great spurt for a short time, but in longer range perspective increased the disequilibrium by the irrational distribution of the tax-reduction allocations. Indeed, the real growth rate from 1966 forward would have been very much worse, but for the unexpected speedup in the Vietnam war. Under these circumstances, it is certainly conceivable that we might, during the decade ahead, have an average annual real economic growth rate 2 percent lower than the 5 percent or better which we must register to keep our resources fully employed, and to service more reasonably, without excessive domestic strain and conflict, our burgeoning domestic and our great international responsibilities.

It is unthinkable that we should, through deliberately contrived policies, blunt this great nonsecret weapon of the U.S. economy through an irrational obsession about the inflationary problem, which coincidentally is aggravating inflation because it is so filled with error.

Main Causes of the Deficient Economic Performance Accompanied by Contrived Price Inflation

The reasons for the deficient economic performance have become increasingly clear over the years, and on many occasions I have called attention to them in testimony before various congressional committees and elsewhere. Each substantial upward movement of the economy has evidenced a rate of growth of investment in the plant and equipment which add to our productive capabilities far in excess of the rate of growth in ultimate demand, in the form of total private consumption expenditures plus total public outlays at all levels for goods and services. When this imbalance has become sufficiently severe, there have been sharp cutbacks in such private investment. And these, combined with the more enduring deficiencies in ultimate demand, have caused the periods of stagnation and recession.

From 1961 to 1969, private consumer spending grew 44.5 percent, and government outlays for goods and services at all levels grew 49.1 percent, while private investment in plant and equipment grew 74.1 percent. From 1968 to 1969, private consumer spending grew only 3 percent, and government outlays only 0.9 percent, while private investment in plant and equipment grew 6.6 percent.[14] In early 1970, with the economy in recession, the unrestrained investment boom is rushing recklessly ahead, while every national policy is being directed toward restraint of ultimate demand in the form of private consumption and public outlays.

[14] See chart 15 at end of text.

The Magnitudes of the Tasks Ahead

From the base year 1968, employment needs to be up 7.3 percent by 1972, and 15.2 percent by 1977. The true level of unemployment needs to be down 2.1 million by 1972, and 2.2 million by 1977. Total national production, measure in fiscal 1969 dollars, needs to be up an estimated $229 billion by 1972, and more than $525 billion by 1977.[15]

I turn next to the basic changes required in national economic policies, if we are to reverse the unfavorable trends during recent years, whether measured by growth or by attention to our most pressing domestic priorities, or by the requirements for a sensible program to curb inflation.

Toward a Reconstructed Monetary Policy

First of all, for the reasons I have already stated fully, there needs to be at once a prompt and decisive change in national monetary policies. Toward this end, I recommend consideration of the following six-point program:

(1) Congress should require by legislation that the Federal Reserve assure an annual rate of expansion in the money supply roughly in accord with the goal for economic growth set forth annually in the President's Economic Report. This would help to keep interest rates within bounds; but many interest rates should be rolled back by legislation to 4 percent, and perhaps to 3 percent.

(2) Subject to various limitations set forth below, Congress by legislation should concentrate authority to regulate the money supply in the Federal Reserve Board, appointed by the President and confirmed by the Senate, instead of having this function shared with five additional members of the Federal Open Market Committee, drawn from private banks. The Open Market Committee should be abolished by legislation. Vital public functions should be publicly exercised;

(3) Congress should require by legislation that each Economic Report of the President deal in full with monetary problems and policies, and also contain a report from the Federal Reserve Board as to its objective and intentions for the year ahead, to achieve integration of monetary policy with other basic national economic policies;

(4) Toward further strengthening the President's hand, the 14-year terms of the members of the Federal Reserve Board should be reduced by legislation to 4 years; and the term of the Chairman should be made coextensive with that of the President, who should also have clear legislative authority to designate a new Chairman at any time from among Board members;

(5) Because aggregate enlargement or contraction of the money supply tends to strengthen the strong and weaken the weak, legislative action should move the Federal Reserve toward more selective monetary controls, taking into account national priorities and the goals of the Federal Government, as embodied in congressional and executive action;

[15] See chart 16 at end of text.

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(6) The Federal Reserve Board should be required by legislation, or by a joint congressional resolution, to submit to the Congress, within a period of 3 months, its own recommendations as to how interest rates may be substantially reduced by its own actions and/or by appropriate legislation, with emphasis upon selective limitations on interest rates in accord with national priorities.

Toward a Reconstructed Tax Policy

As already indicated, we also need drastic revisions in national fiscal policy both on the expenditure side and on the tax side. Attempting to balance the Federal budget at the expense of the national economy hurts the national economy, hurts the Federal budget itself in the long run, starves our national priorities, and fans inflation. I have already detailed why this is true.

On the tax side, there has been a plethora of errors in need of correction. Massively and egregiously during 1962–65, and to a considerable degree again in 1969, we undertook the wrong kind of tax reduction for the wrong individuals and business entities at the wrong time. Optimum economic growth will justify some further tax reduction in later years. But national dedication to repeated orgies of tax reduction makes it impossible to finance what our people and our Nation most need. And this evil is compounded, when the tax reduction is of a composition which increases the imbalances in the economy by excessive stimuli to private investment and inadequate attention to ultimate demand. Prior to the enactment of the massive tax reductions in 1964, I pointed out how ill-designed and regressive they were in detail, and our entire experience since then has fully demonstrated the validity of my original position. In my 1969 testimony before the Senate Finance Committee, I pointed out that, even with the repeal of the investment tax credit which I opposed from the time of its inception, the so-called tax reform legislation moved considerably further in the wrong direction. Although I am not detailing here the needed tax action, the first opportunity should be seized to revise the Federal tax structure in a highly progressive direction.[16]

Toward a Restorative Federal Spending Policy

In that we are suffering from inadequate rather than excessive total demand, and in that this deficiency is conspiring to augment inflationary pressures, we should abandon the prevalent policy based upon the idea that a very tight and restraining Federal budget, in terms of the relationship between estimated outlays and estimated tax revenues, is desirable under current and foreseeable conditions.

Even if we were in the position where greatly increased Federal outlays, to serve nonpostponable domestic priorities, offered the prospect of a sizable Federal deficit, the current economic situation and economic outlook call for that at this time. More of those economists who fully recognize this should have the courage to say so. In any event, it is by no means clear that a Federal budget directed toward full economic restoration would run a larger deficit in the long run than a Federal

[16] On this subject, see my study, "Taxation of Whom and for What," published by the Conference on Economic Progress, December 1969.

budget which joins in the contrived effort to stunt the economy and lift unemployment.

As an integral part of my long-range budgeting of goals for economic performance, both on the product and income side, I have year-by-year constructed a model Federal budget, and revised it in the light of observation. A salient feature of this model Federal budget is its indication that, while total Federal outlays should be lifted from $186 billion in fiscal 1969 to $280 billion by calendar 1970 (measurements in fiscal 1969 dollars), the ratio of the Federal budget to total national product would decline slightly in a U.S. economy growing at an optimum rate. In the long run, this does not import net tax increases.

My model Federal budget incorporates increases in outlays for national defense, space technology, and all international, from $89.5 billion in fiscal 1969 to $94.0 billion in calendar 1977. This is because I do not attempt to predetermine what the international situation will be. And even if this situtaion permits us safely to reduce national defense outlays drastically, my own strong conviction is that we should use these savings for international economic assistance to underdeveloped peoples in various parts of the world. This is the best program we could undertake to underpin the durable foundations for lasting worldwide peace. Even so, my model Federal budget shows that total Federal budget outlays in these categories would decline on a per capita basis from 1969 to 1977, and would decline from 10.11 percent to 6.73 percent of total national product in an adequately growing U.S. economy.

This model Federal budget projects an increase in outlays for all domestic programs from $96.5 billion in fiscal 1969 to $186 billion in calendar 1977, a rise from $475.84 to $812.93 on a per capita basis, and from 10.91 percent to 13.32 percent in ratio in GNP.

My specific projections for the economic opportunity program, housing and community development, agriculture and natural resources, education, health services and research, and public assistance, labor and manpower, and other welfare services, are shown on the same chart.[17]

Through nationwide dedication to a program such as this, we could create in our land by 1977, with sustained maximum employment, production, and purchasing power, conditions under which poverty would be virtually liquidated and great inroads made upon deprivation; the poisoned airs and waters would be purified, and other environmental aspects which now so trouble the ecologists would be taken care of; a decent home would be provided for every American family, and our urban areas carried far along the road to decency and restoration; our farm population would be relieved from the terrible inequities in average incomes and public services which it has so patiently endured for so long; our public schools would become what they ought to be, and everybody, at costs within their means, would be able to carry their educations as far as their abilities and ambitions and the rising needs of the economy call for; modern health services would be available to all American families at costs within their means; and so-called welfare programs would be transformed from their current aspects of bankruptcy and degradation to what they ought to be in a good society.

Most important of all, perhaps, a new awareness by the American people of the feasibility of these goals and of the determination of their

[17] See chart 17 at end of text.

leadership to reach them, would bring one increasing purpose into our national life, replacing the division and disunion which is now our most serious threat as a nation and a people.

Toward Long-Range Budgeting of Our Needs and Capabilities

But there is still a more important point to be made, and I have made it repeatedly. No enduringly sound and rewarding fiscal and monetary policies—and this applies to all basic national economic policies—can be devised, without development of a long-range and integrated set of national economic and social goals, quantitative in nature, under the Employment Act of 1946. I have always insisted that this was the original mandate of the act, but increasingly in recent years this mandate has been honored only in the breach. Such goals, geared to our potentials, are the only adequate guidelines to national policies and programs, as the Employment Act recognizes explicitly.

Concluding Comments

I have endeavored in this statement to highlight our nationwide economic and related social problems, and what changes in policy and programs we need to deal with these problems as well as we can and must. If I have come through with clarity in this effort, it would be superfluous for me to deal with the manifold details of the President's Economic Report and the Annual Report of the Council of Economic Advisers for this year 1970. It must appear, from what I have said—if I am at all right—that these reports move basically in the wrong direction. They misappraise and gloss over the difficulties confronting us. They underwrite the wrong remedies, and do not recognize the correct remedies. I do not comment on them in detail because they just do not relate to what I am saying.

Lest I be regarded as partisan in making these remarks, it should be noted—and it must be known to many—that I have taken the positions contained in this statement consistently for a long time, and that I have directed both my criticisms and my pleas to both Democratic and Republican administrations, and to my usual allies as well as to my usual adversaries.

The times are too dangerous for partisanship of self-seeking. I do belive that the current national administration has its mind and its ears open to those changes in policies which bear the stamp of experience, logic, and common sense. If I did not believe this, I would not be making this effort.

CHART 1

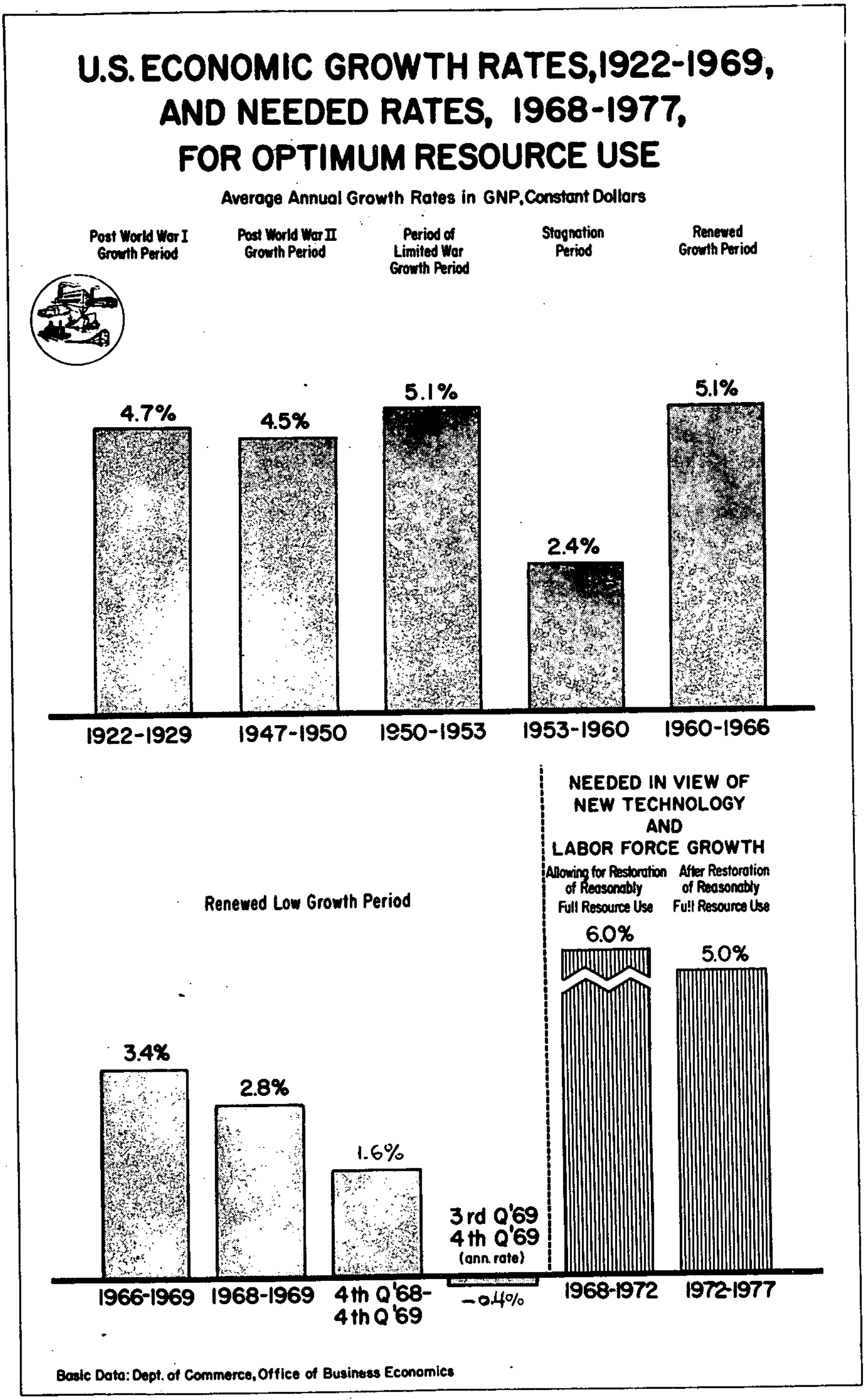
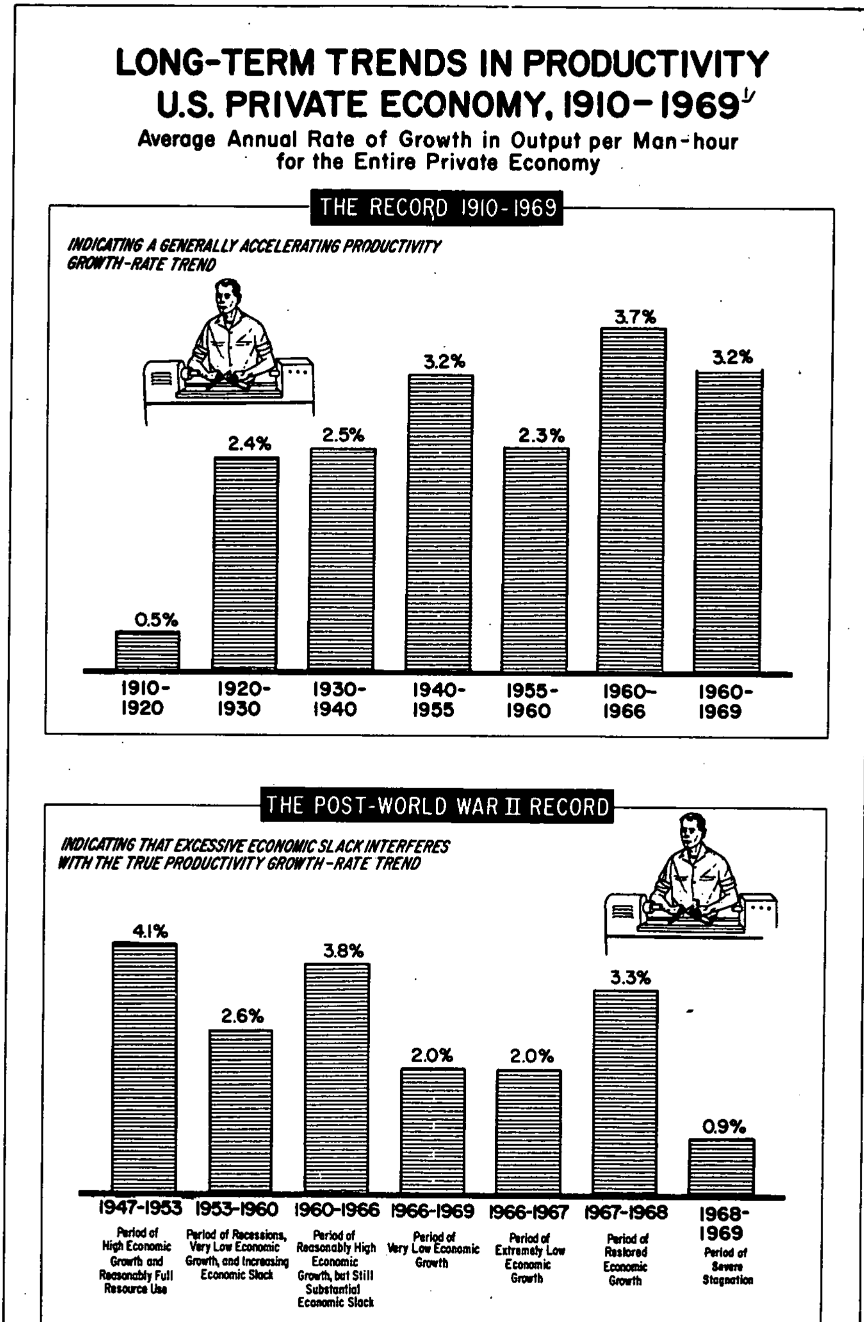
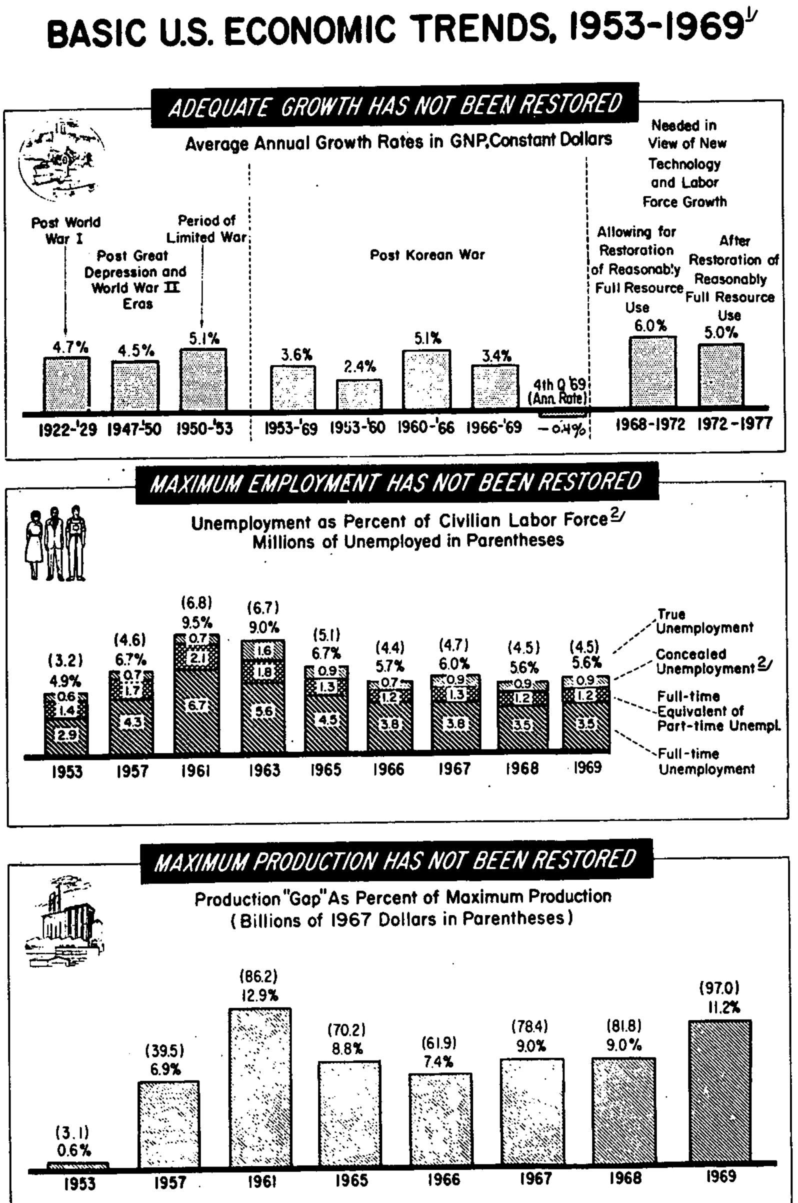

U.S. ECONOMIC GROWTH RATES, 1922-1969, AND NEEDED RATES, 1968-1977, FOR OPTIMUM RESOURCE USE
Average Annual Growth Rates in GNP, Constant Dollars
Post World War I Growth Period
Post World War II Growth Period
Period of Limited War Growth Period
Stagnation Period
Renewed Growth Period
4.7%
4.5%
5.1%
2.4%
5.1%
1922-1929
1947-1950
1950-1953
1953-1960
1960-1966
NEEDED IN VIEW OF NEW TECHNOLOGY AND LABOR FORCE GROWTH
Allowing for Restoration of Reasonably Full Resource Use
After Restoration of Reasonably Full Resource Use
Renewed Low Growth Period
6.0%
5.0%
3.4%
2.8%
1.6%
3rd Q'69
4th Q'69
(ann. rate)
1966-1969
1968-1969
4th Q'68-4th Q'69
-0.4%
1968-1972
1972-1977
Basic Data: Dept. of Commerce, Office of Business Economics

CHART 2



[1] Preliminary 1969 data.
Source: Dept. of Labor estimates relating to man-hours worked (Establishment basis)

CHART 3

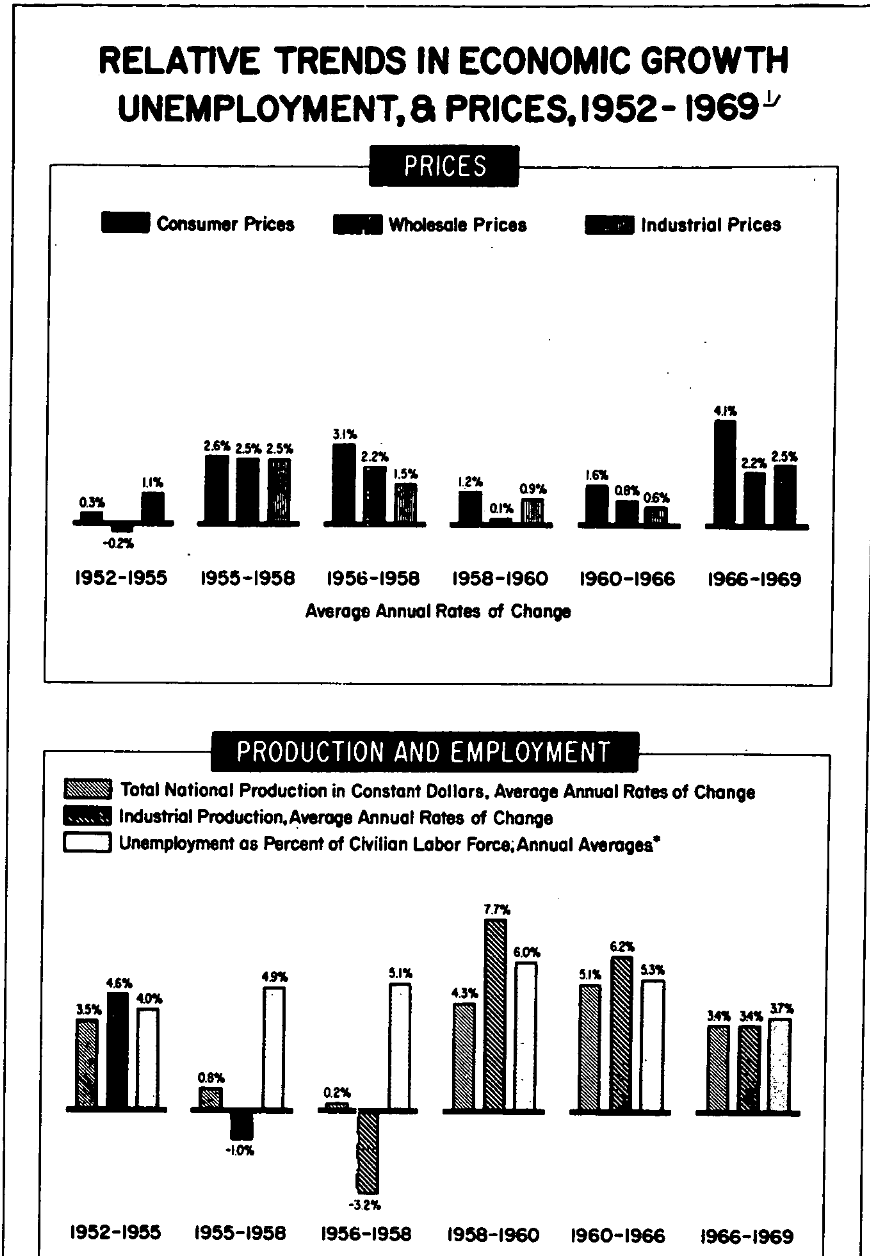


1/ All 1969 data preliminary.

2/ In deriving these percentages, the Civilian Labor Force is estimated as the officially reported Civilian Labor Force plus concealed unemployment. Full-time unemployment of 2.9% and true unemployment of 4.1 % would be consistent with maximum employment. Data for 1953-1966 relate to persons 14 years of age and older; 1967 – 1969 relate to persons 16 years and older.

Basic Data: Dept. of Commerce; Dept. of Labor

CHART 4

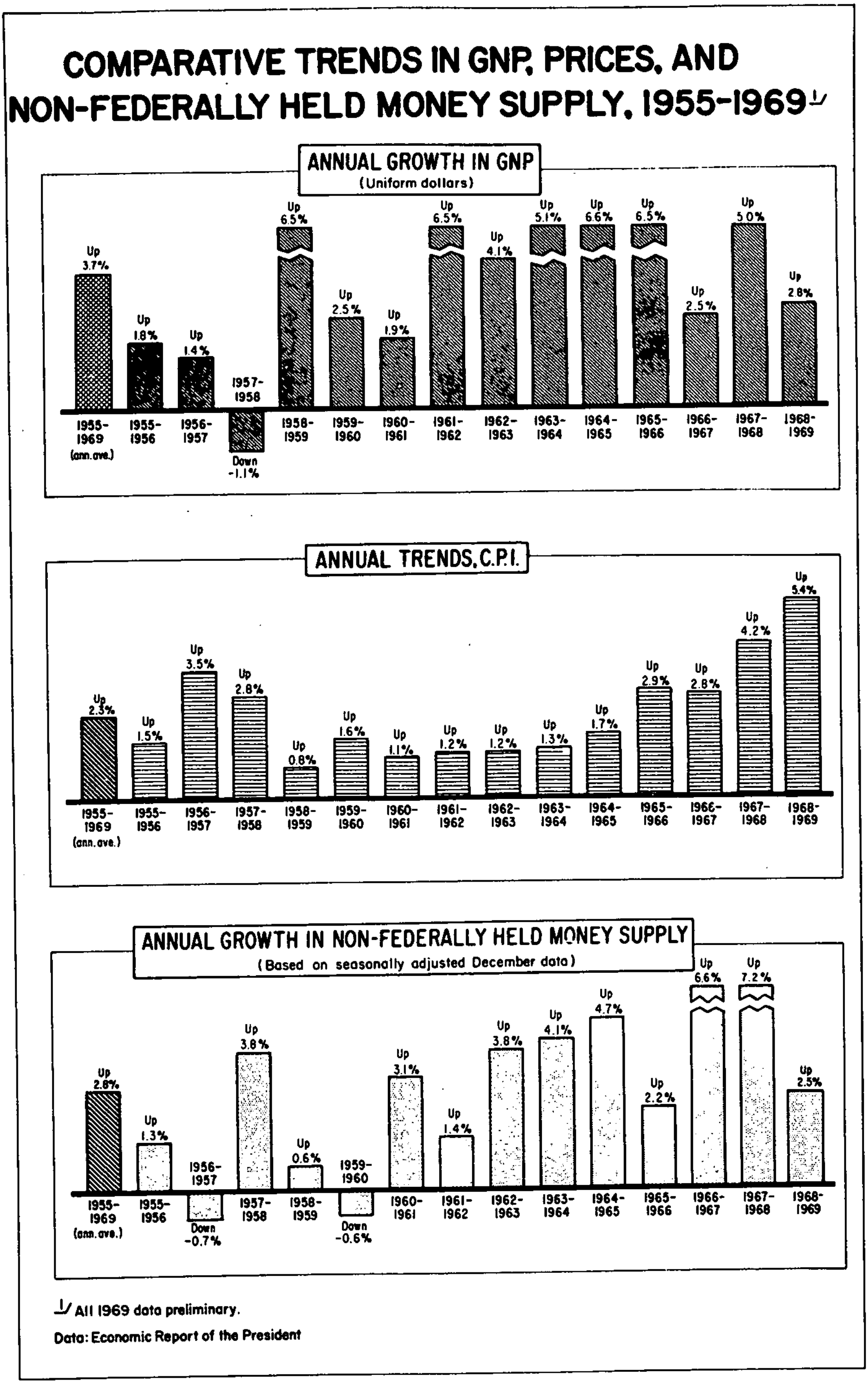


1/ Preliminary 1969 data.

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

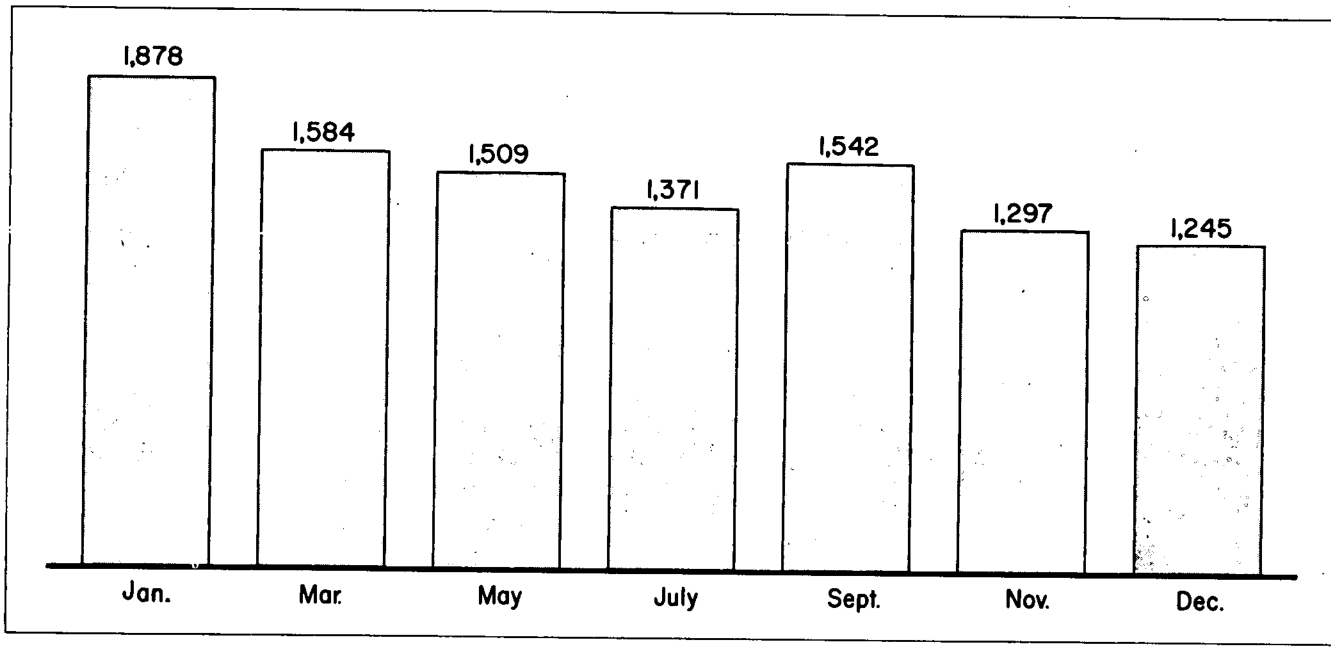
Source: Dept. of Labor, Dept. of Commerce, & Federal Reserve System

CHART 5


COMPARATIVE TRENDS IN GNP, PRICES, AND NON-FEDERALLY HELD MONEY SUPPLY, 1955-1969 1/
ANNUAL GROWTH IN GNP
(Uniform dollars)
1955-1969 (ann. ave.) Up 3.7%
1955-1956 Up 1.8%
1956-1957 Up 1.4%
1957-1958 Down -1.1%
1958-1959 Up 6.5%
1959-1960 Up 2.5%
1960-1961 Up 1.9%
1961-1962 Up 6.5%
1962-1963 Up 4.1%
1963-1964 Up 5.1%
1964-1965 Up 6.6%
1965-1966 Up 6.5%
1966-1967 Up 2.5%
1967-1968 Up 5.0%
1968-1969 Up 2.8%
ANNUAL TRENDS, C.P.I.
1955-1969 (ann. ave.) Up 2.3%
1955-1956 Up 1.5%
1956-1957 Up 3.5%
1957-1958 Up 2.8%
1958-1959 Up 0.8%
1959-1960 Up 1.6%
1960-1961 Up 1.1%
1961-1962 Up 1.2%
1962-1963 Up 1.2%
1963-1964 Up 1.3%
1964-1965 Up 1.7%
1965-1966 Up 2.9%
1966-1967 Up 2.8%
1967-1968 Up 4.2%
1968-1969 Up 5.4%
ANNUAL GROWTH IN NON-FEDERALLY HELD MONEY SUPPLY
(Based on seasonally adjusted December data)
1955-1969 (ann. ave.) Up 2.8%
1955-1956 Up 1.3%
1956-1957 Down -0.7%
1957-1958 Up 3.8%
1958-1959 Up 0.6%
1959-1960 Down -0.6%
1960-1961 Up 3.1%
1961-1962 Up 1.4%
1962-1963 Up 3.8%
1963-1964 Up 4.1%
1964-1965 Up 4.7%
1965-1966 Up 2.2%
1966-1967 Up 6.6%
1967-1968 Up 7.2%
1968-1969 Up 2.5%
1/ All 1969 data preliminary.
Data: Economic Report of the President

PRIVATE NON-FARM HOUSING STARTS, 1969

(Thousands of units, seasonally adjusted at annual rates)

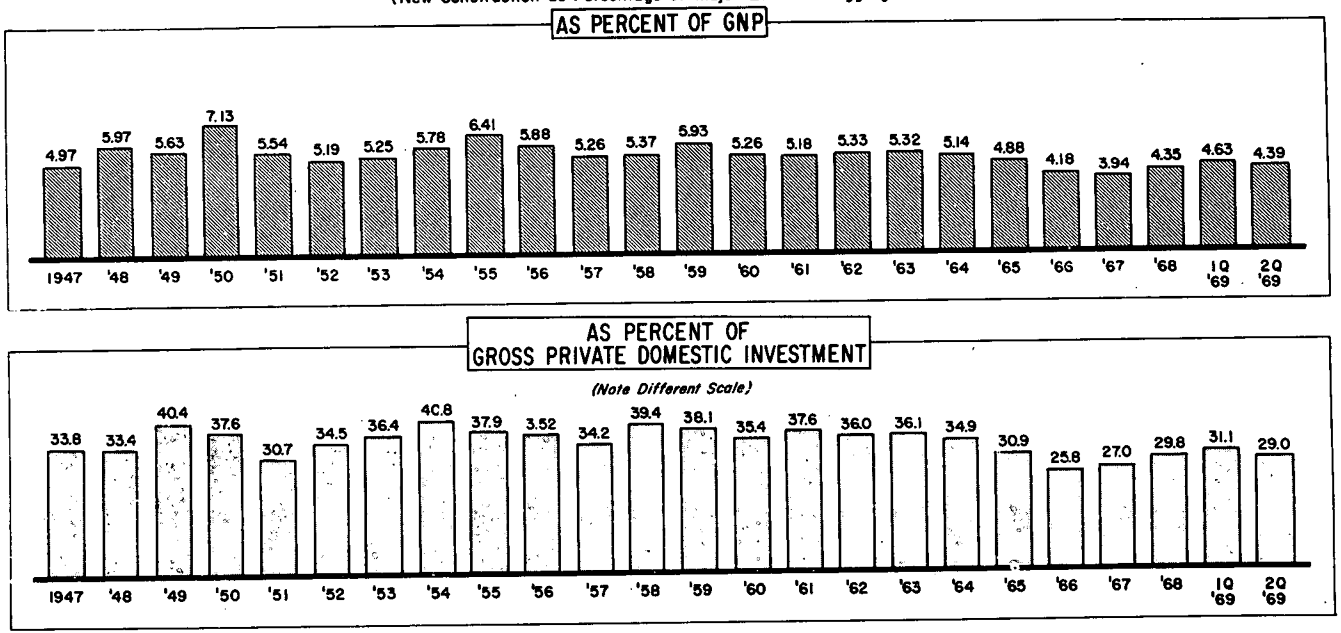


Source: Council of Economic Advisers, Economic Indicators, November and December preliminary

CHART 6

ROLE OF HOUSING AND COMMERCIAL CONSTRUCTION IN THE NATIONAL ECONOMY, 1947-1969

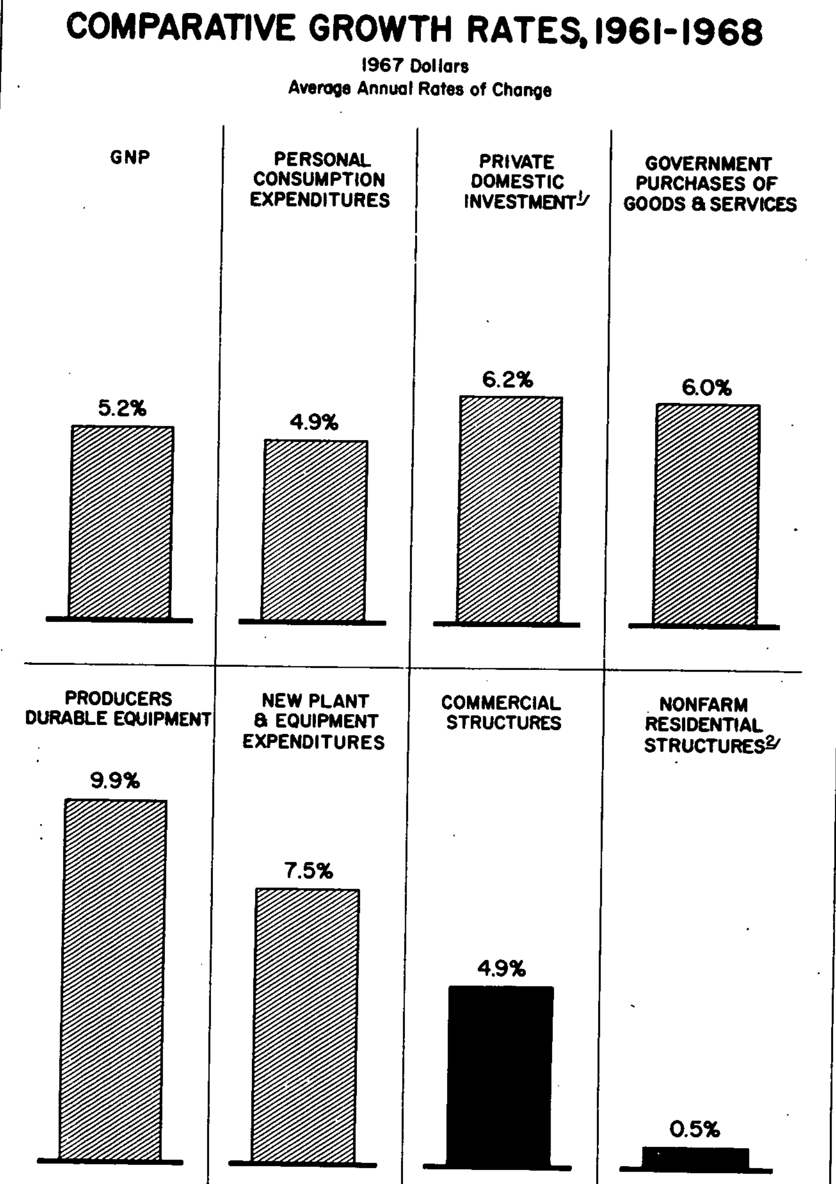
(New Construction as Percentage of Major Economic Aggregates)



Source: Dept. of Commerce, Office of Business Economics, Survey of Current Business

CHART 7

CHART 8



1/ Gross private investment, including net foreign 5.0%.

2/ Total residential structures, 0.4%.

Basic Data: Dept. of Commerce, Office of Business Economics

CHART 9

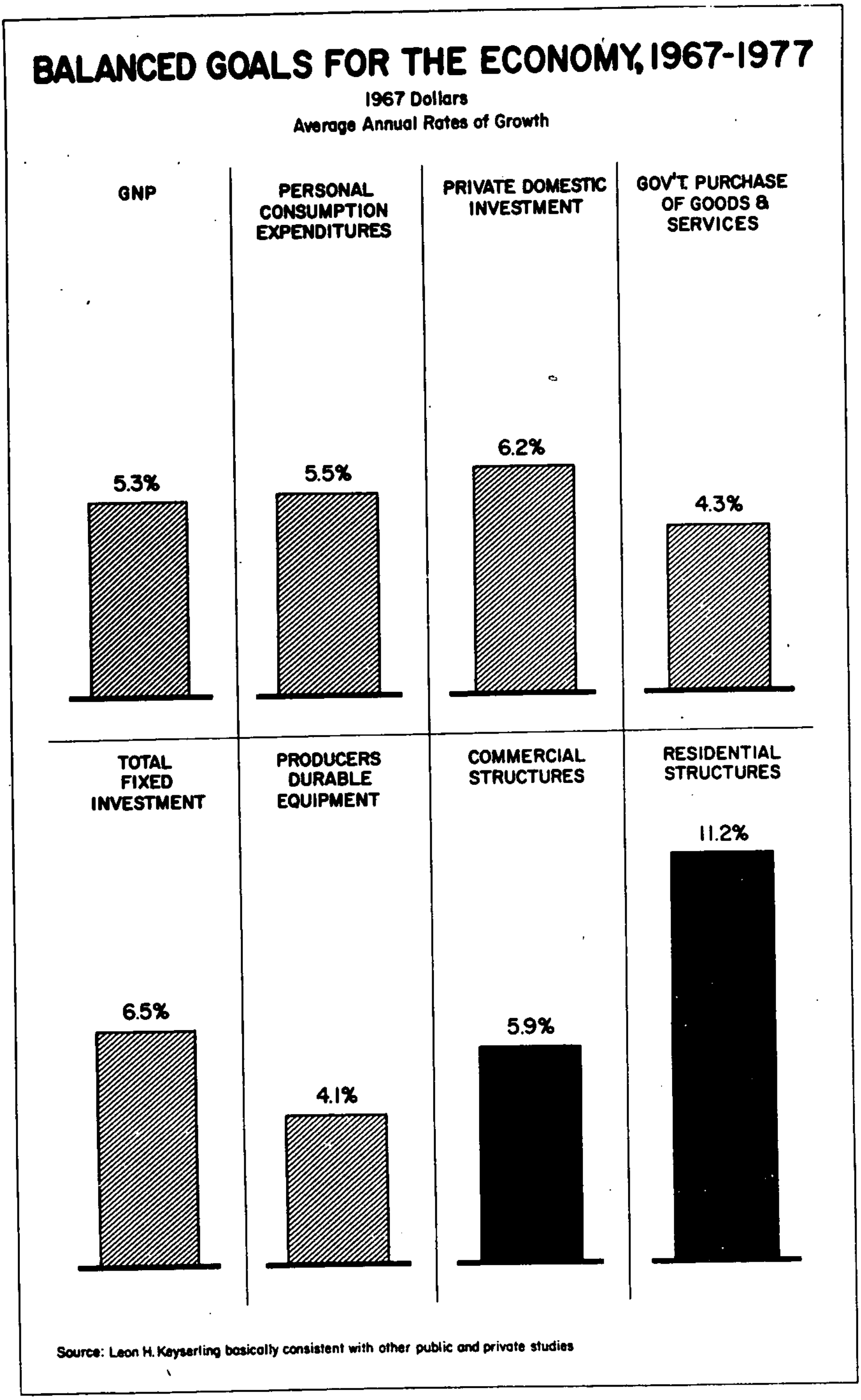
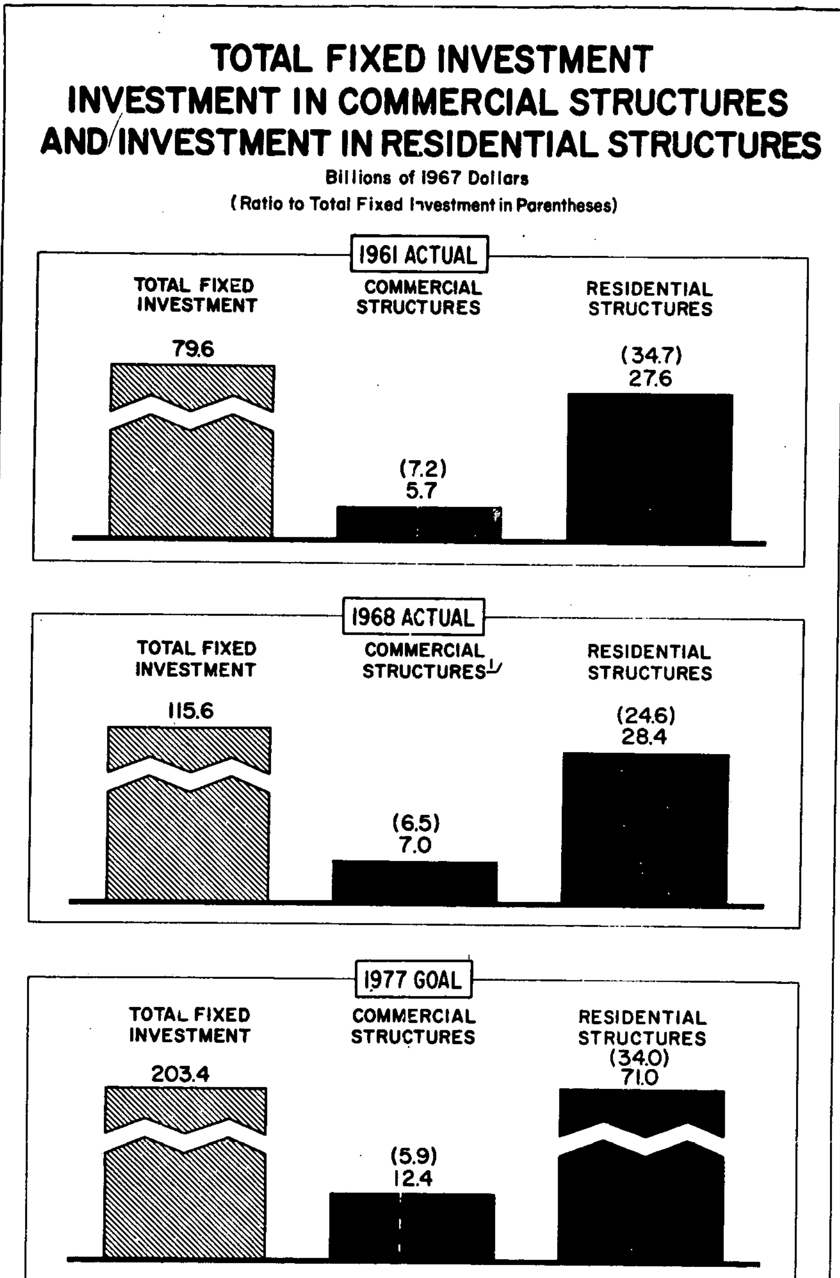

BALANCED GOALS FOR THE ECONOMY, 1967-1977
1967 Dollars
Average Annual Rates of Growth
GNP
5.3%
PERSONAL CONSUMPTION EXPENDITURES
5.5%
PRIVATE DOMESTIC INVESTMENT
6.2%
GOV'T PURCHASE OF GOODS & SERVICES
4.3%
TOTAL FIXED INVESTMENT
6.5%
PRODUCERS DURABLE EQUIPMENT
4.1%
COMMERCIAL STRUCTURES
5.9%
RESIDENTIAL STRUCTURES
11.2%
Source: Leon H. Keyserling basically consistent with other public and private studies

CHART 10



[1] 1967; 1968 not available.

Basic Data: Dept. of Commerce, Office of Business Economics

CHART 11

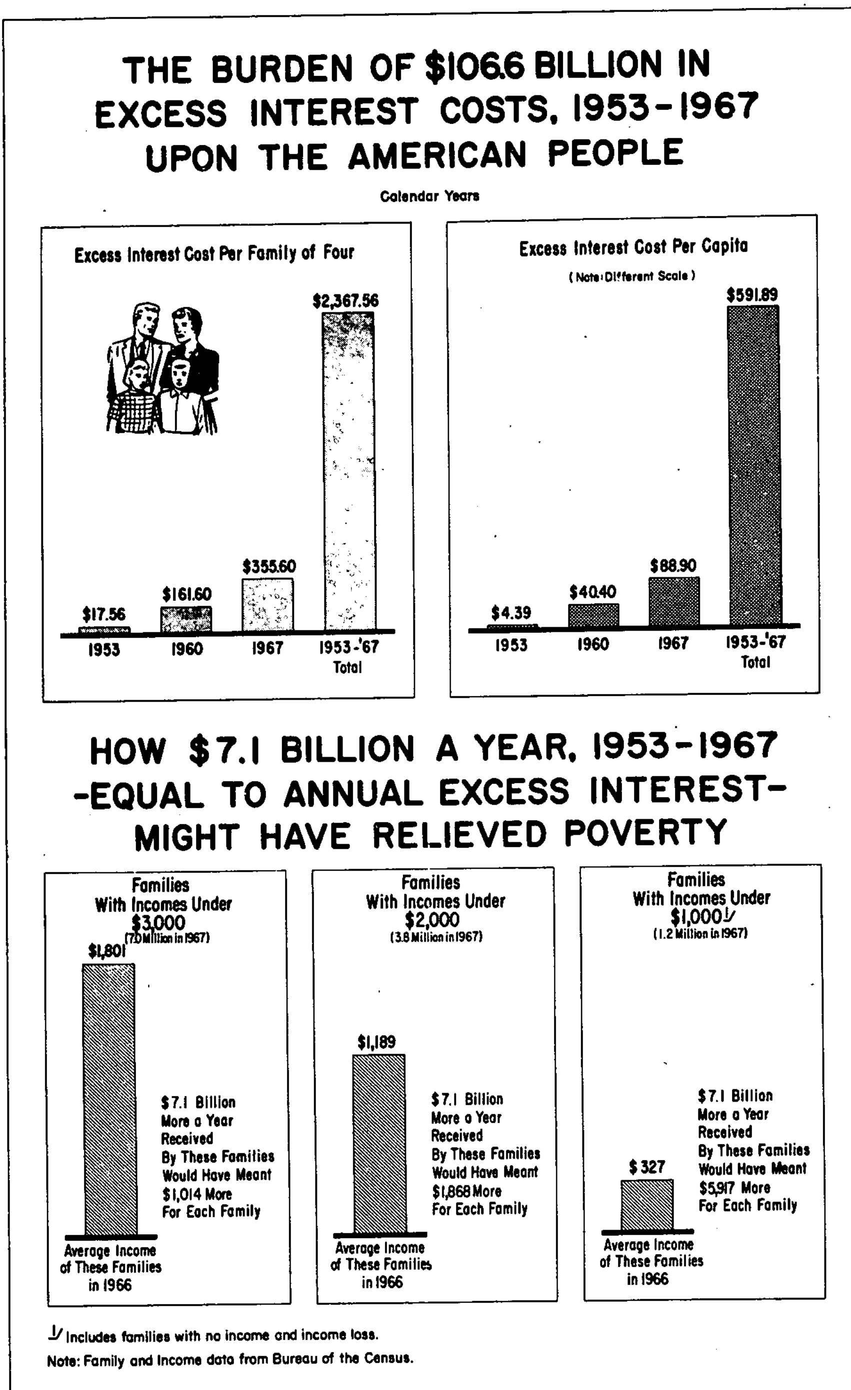

THE BURDEN OF $106.6 BILLION IN EXCESS INTEREST COSTS, 1953-1967 UPON THE AMERICAN PEOPLE
Calendar Years
Excess Interest Cost Per Family of Four
$17.56
$161.60
$355.60
$2,367.56
1953
1960
1967
1953-'67 Total
Excess Interest Cost Per Capita
(Note: Different Scale)
$4.39
$40.40
$88.90
$591.89
1953
1960
1967
1953-'67 Total
HOW $7.1 BILLION A YEAR, 1953-1967 -EQUAL TO ANNUAL EXCESS INTEREST- MIGHT HAVE RELIEVED POVERTY
Families With Incomes Under $3,000
(7.0 Million in 1967)
$1,801
$7.1 Billion More a Year Received By These Families Would Have Meant $1,014 More For Each Family
Average Income of These Families in 1966
Families With Incomes Under $2,000
(3.6 Million in 1967)
$1,189
$7.1 Billion More a Year Received By These Families Would Have Meant $1,868 More For Each Family
Average Income of These Families in 1966
Families With Incomes Under $1,000 1/
(1.2 Million in 1967)
$327
$7.1 Billion More a Year Received By These Families Would Have Meant $5,917 More For Each Family
Average Income of These Families in 1966
1/ Includes families with no income and income loss.
Note: Family and Income data from Bureau of the Census.

CHART 12

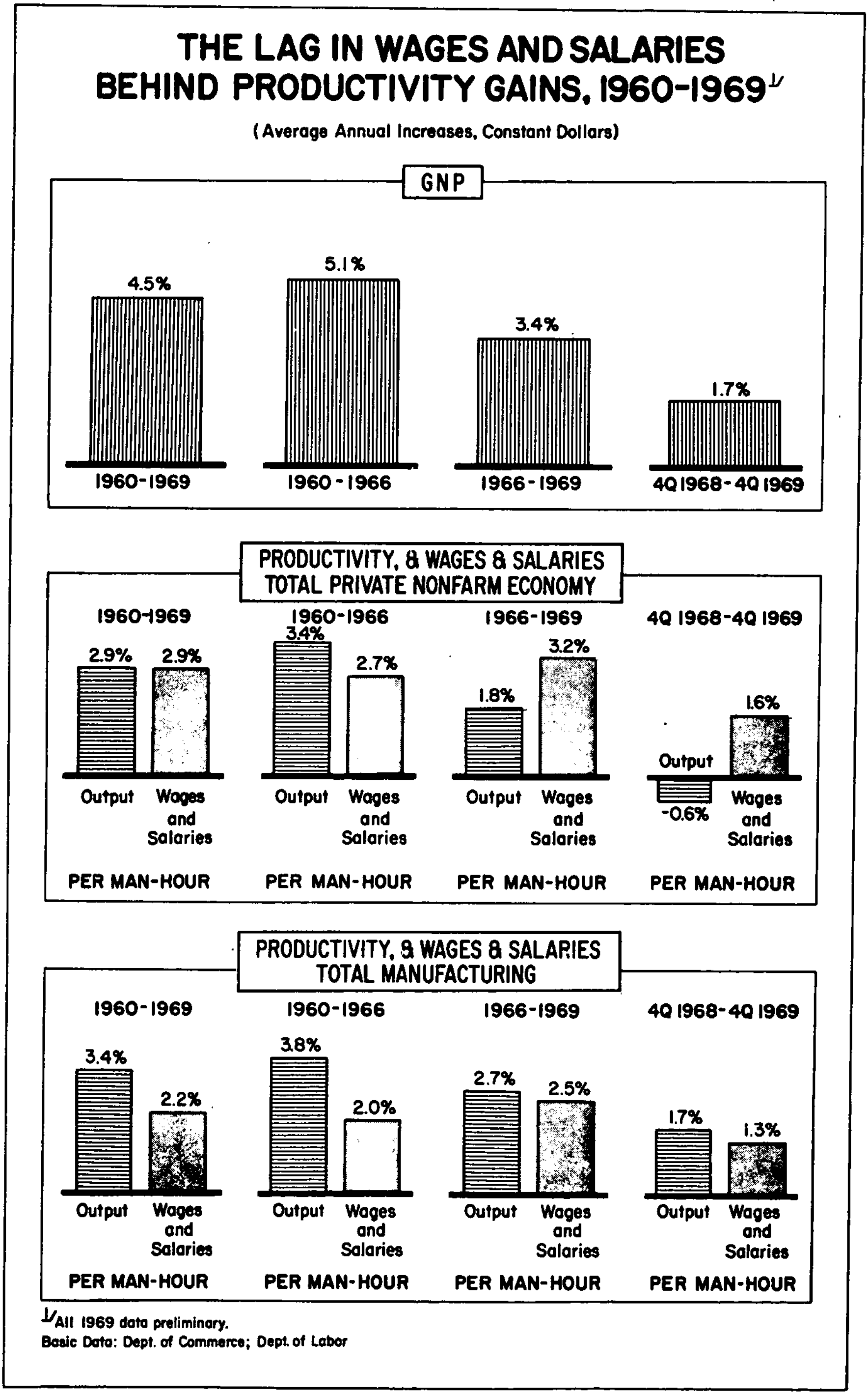

THE LAG IN WAGES AND SALARIES BEHIND PRODUCTIVITY GAINS, 1960-1969 1/
(Average Annual Increases, Constant Dollars)
GNP
4.5%
5.1%
3.4%
1.7%
1960-1969
1960-1966
1966-1969
4Q 1968-4Q 1969
PRODUCTIVITY, & WAGES & SALARIES
TOTAL PRIVATE NONFARM ECONOMY
1960-1969
2.9%
2.9%
Output
Wages and Salaries
PER MAN-HOUR
1960-1966
3.4%
2.7%
Output
Wages and Salaries
PER MAN-HOUR
1966-1969
1.8%
3.2%
Output
Wages and Salaries
PER MAN-HOUR
4Q 1968-4Q 1969
1.6%
Output
-0.6%
Wages and Salaries
PER MAN-HOUR
PRODUCTIVITY, & WAGES & SALARIES
TOTAL MANUFACTURING
1960-1969
3.4%
2.2%
Output
Wages and Salaries
PER MAN-HOUR
1960-1966
3.8%
2.0%
Output
Wages and Salaries
PER MAN-HOUR
1966-1969
2.7%
2.5%
Output
Wages and Salaries
PER MAN-HOUR
4Q 1968-4Q 1969
1.7%
1.3%
Output
Wages and Salaries
PER MAN-HOUR
1/ All 1969 data preliminary.
Basic Data: Dept. of Commerce; Dept. of Labor

CHART 13

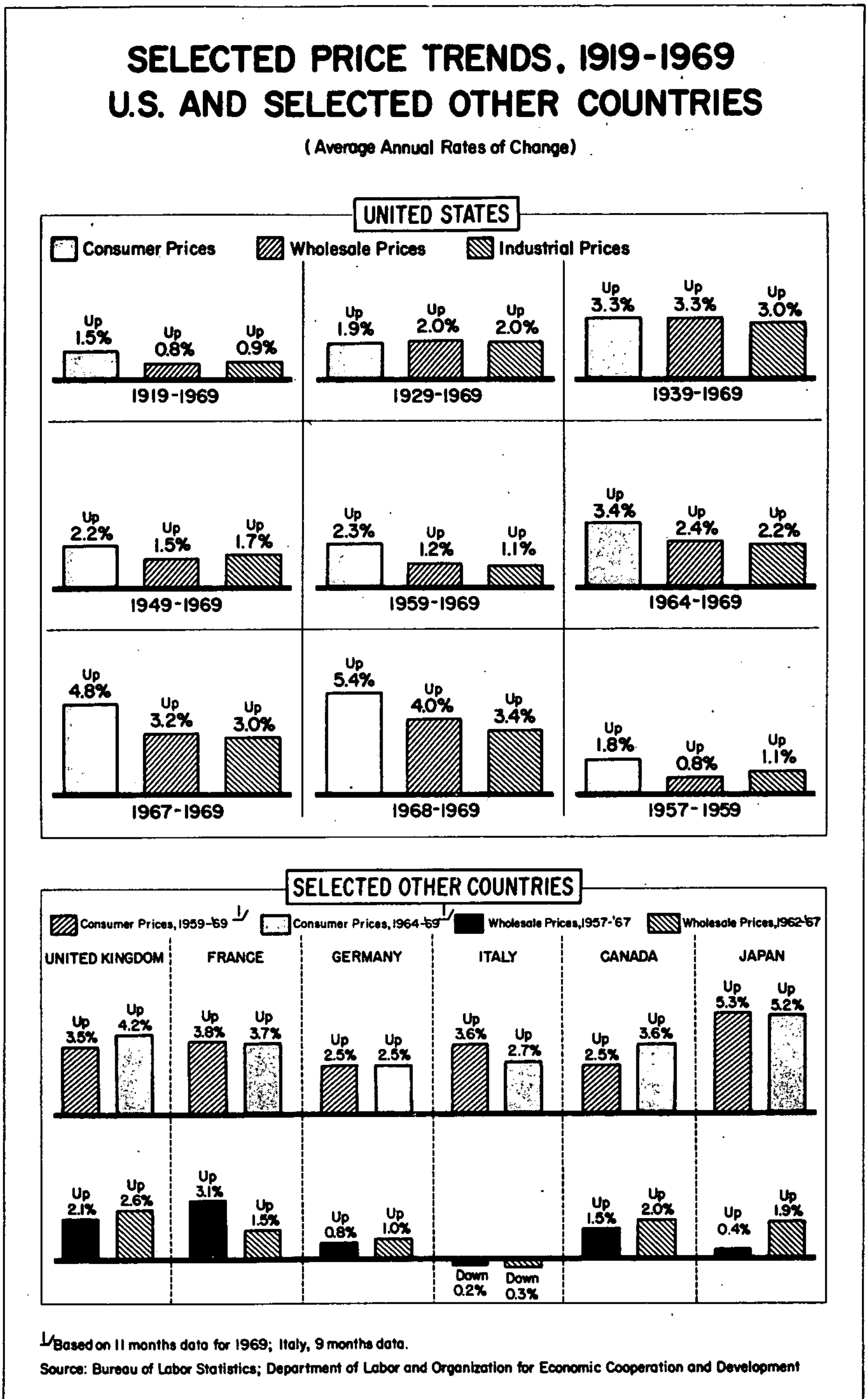

SELECTED PRICE TRENDS, 1919-1969
U.S. AND SELECTED OTHER COUNTRIES
(Average Annual Rates of Change)
UNITED STATES
Consumer Prices
Wholesale Prices
Industrial Prices
Up 1.5%
Up 0.8%
Up 0.9%
1919-1969
Up 1.9%
Up 2.0%
Up 2.0%
1929-1969
Up 3.3%
Up 3.3%
Up 3.0%
1939-1969
Up 2.2%
Up 1.5%
Up 1.7%
1949-1969
Up 2.3%
Up 1.2%
Up 1.1%
1959-1969
Up 3.4%
Up 2.4%
Up 2.2%
1964-1969
Up 4.8%
Up 3.2%
Up 3.0%
1967-1969
Up 5.4%
Up 4.0%
Up 3.4%
1968-1969
Up 1.8%
Up 0.8%
Up 1.1%
1957-1959
SELECTED OTHER COUNTRIES
Consumer Prices, 1959-'69 1/
Consumer Prices, 1964-'69 1/
Wholesale Prices, 1957-'67
Wholesale Prices, 1962-'67
UNITED KINGDOM
FRANCE
GERMANY
ITALY
CANADA
JAPAN
Up 3.5%
Up 4.2%
Up 3.8%
Up 3.7%
Up 2.5%
Up 2.5%
Up 3.6%
Up 2.7%
Up 2.5%
Up 3.6%
Up 5.3%
Up 5.2%
Up 2.1%
Up 2.6%
Up 3.1%
Up 1.5%
Up 0.8%
Up 1.0%
Down 0.2%
Down 0.3%
Up 1.5%
Up 2.0%
Up 0.4%
Up 1.9%
1/ Based on 11 months data for 1969; Italy, 9 months data.
Source: Bureau of Labor Statistics; Department of Labor and Organization for Economic Cooperation and Development

CHART 14

COSTS OF DEFICIENT ECONOMIC GROWTH U.S. ECONOMY, 1953-1968 AND 1969-1977

(dollar items in billions of 1967 dollars)

1953-1968

Total National Production (GNP)	Man-years of Employment[1]	Personal Consumption Expenditures	Gov't Outlay for Goods and Services
1953-1968: $ 917.8 1968: 81.8	1953-1968: 38.6 Million 1968: 2.1 Million	1953-1968: $692.8 1968: 73.1	1953-1968: $32.9 1968: -11.7
Private Business Investment (Incl. Net Foreign)	**Average Family Income**	**Wages and Salaries**	**Unincorporated Business and Professional Income**
1953-1968: $192.1 1968: 20.4	1953-1968: $11,459 1968: 1,208	1953-1968: $637.2 1968: 67.3	1953-1968: $79.4 1968: 8.4

1969-1977

Total National Production (GNP)	Man-years of Employment[1]	Personal Consumption Expenditures	Gov't Outlay for Goods and Services
1969-1977: $1,173.7 1977: 215.4	1969-1977: 31.4 Million 1977: 5.0 Million	1969-1977: $ 764.0 1977: 144.4	1969-1977: $146.1 1977: 27.2
Private Business Investment (Incl. Net Foreign)	**Average Family Income**	**Wages and Salaries**	**Unincorporated Business and Professional Income**
1969-1977: $263.6 1977: 43.8	1969-1977: $ 11,958 1977: 2,349	1969-1977: $ 702.7 1977: 132.8	1969-1977: $ 87.6 1977: 16.6

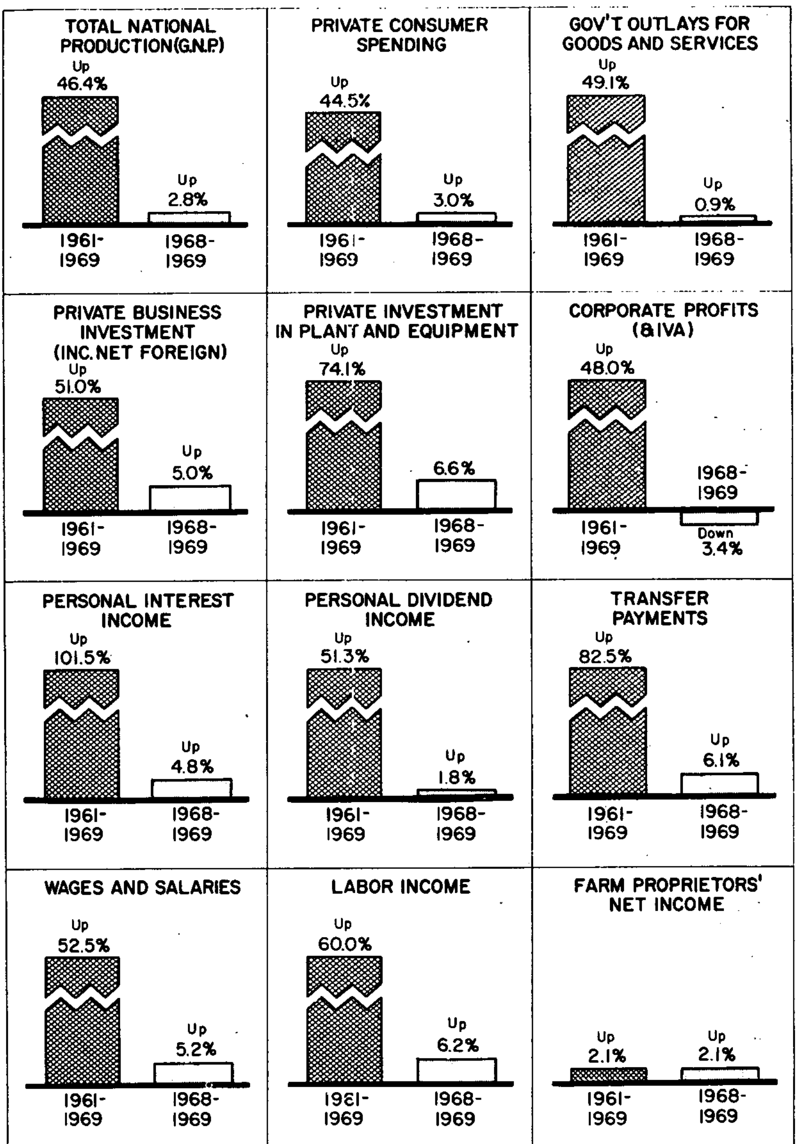
[1] Based upon true level of unemployment concept, including full-time unemployment, full-time equivalent of part-time unemployment, and concealed unemployment (nonparticipation in civilian labor force) due to scarcity of job opportunity.

Basic Data: Dept. of Commerce; Dept. of Labor

CHART 15

COMPARATIVE GROWTH IN VARIOUS ASPECTS OF U.S. ECONOMY 1961-1969[1]

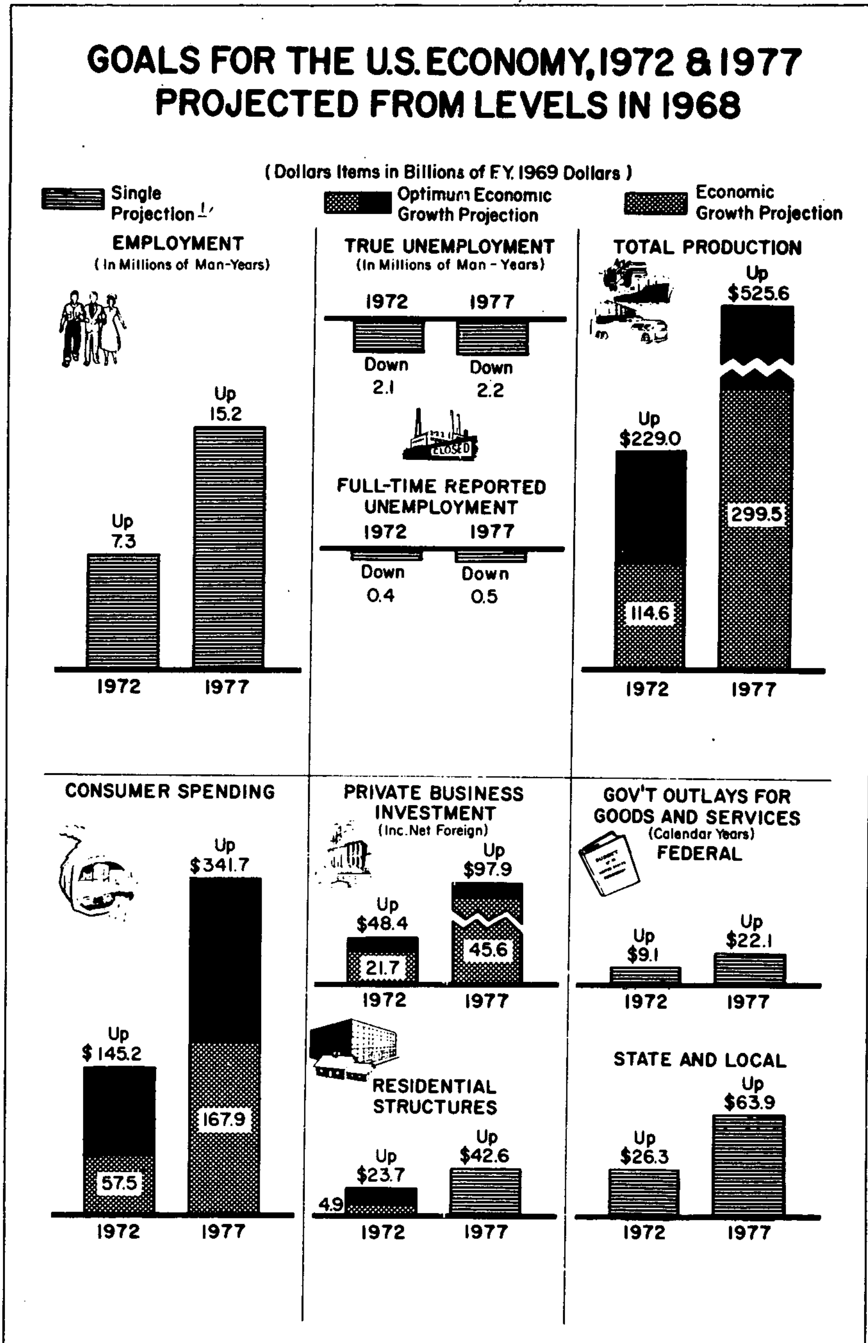
(Constant Dollars)



[1] All 1969 data preliminary

Source: Dept. of Commerce, Office of Business Economics and CEP

CHART 16



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

CHART 17

GOALS FOR A FEDERAL BUDGET, 1972 AND 1977, GEARED TO ECONOMIC GROWTH & PRIORITY NEEDS

1969, fiscal year; goals for 1972 and 1977, calendar years

All figures in fiscal 1969 dollars 1/

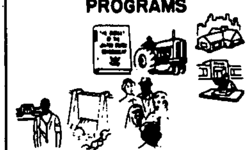
ALL FEDERAL OUTLAYS

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	186.062	917.01	21.02
1972	226.500	1,068.90	20.61
1977	280.000	1,223.77	20.06

NATIONAL DEFENSE, SPACE TECHNOLOGY, & ALL INTERNATIONAL

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	89.515	441.18	10.11
1972	90.000	424.73	8.19
1977	94.000	410.84	6.73

ALL DOMESTIC PROGRAMS



Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	96.547	475.84	10.91
1972	136.500	644.17	12.42
1977	186.000	812.93	13.32

ECONOMIC OPPORTUNITY PROGRAM

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	2.000	9.86	0.23
1972	3.800	17.93	0.35
1977	5.500	24.04	0.39

HOUSING AND COMMUNITY DEVELOPMENT

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	2.784	13.72	0.31
1972	5.500	25.96	0.50
1977	9.000	39.34	0.64

AGRICULTURE; AND NATURAL RESOURCES

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	8.099	39.91	0.91
1972	12.000	56.63	1.09
1977	15.500	67.75	1.11

EDUCATION

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	4.699	23.16	0.53
1972	16.200	76.45	1.47
1977	32.900	143.79	2.36

HEALTH SERVICES AND RESEARCH

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	10.655	52.51	1.21
1972	14.000	66.07	1.27
1977	20.000	87.41	1.43

PUBLIC ASSISTANCE; LABOR, MANPOWER, AND OTHER WELFARE SERVICES

Year	Total Expend. (Bil. $)	Per Capita ($)	% of GNP (%)
1969 2/	6.280	30.95	0.69
1972	9.500	44.83	0.86
1977	15.100	66.00	1.08

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

2/ Administration's Proposed Budget as of Jan. 29, 1968. Beginning with fiscal 1969, the Budget includes the immense trust funds, net lending, and other relatively minor new items. Note: Goals include Federal contributions of one billion in 1970, and more than two billion in 1977, to the OASDHI to help increase benefit payments to the aged.

Projections by Leon H. Keyserling.

CUNA INTERNATIONAL, INC.

By J. ORRIN SHIPE, *Managing Director*

This statement is submitted on behalf of CUNA International, which represents credit unions in all 50 States, the District of Columbia, and Puerto Rico. These groups represent 22 million Americans in the credit union movement. CUNA appreciates this opportunity to express its opinion regarding the President's Economic Report and the Report of the Council of Economic Advisers, submitted to Congress in February 1970.

GENERAL ECONOMIC POSITION

Our major economic problem is inflation. In the last 4 years, real production has lagged behind inflationary growth. Our prime economic objective now is to reduce the rate of inflation.

The expansive governmental fiscal and monetary policies of recent years have led to enormous Government spending. This seemed appropriate from 1961 to 1965, when full use of resources was a necessary goal. Burgeoning costs of the Vietnam war have helped contribute to a rising budget deficit along with accelerating inflation.

There is some argument currently as to the true causes of inflation. One group sees the classic villain—an unbalanced Federal budget. Others blame the current administration procedure of dampening the money supply growth.

Economic expansion has been with us now for 107 months. Our economy is sick with inflationary fever. Prices climb at an annual rate of 6 percent and wage settlements are escalating beyond that. A whole series of policy decisions must be made by the Federal Government; increase taxes; reduce expenditures; produce a budget surplus; turn over the debt. In the process, the Government is paying over 6½ percent for money. This has forced credit unions into an adverse position: we can't borrow in the market to serve our members adequately.

Some people question whether the current monetary policy is too tight; some economists have suggested easing up. Others want controls or at least guidelines. The credit union movement believes that credit controls would cause even greater problems than we have now.

So far, Government policies have not completely stopped the rise of prices, but have caused higher unemployment.

THE CREDIT UNION MEMBER

More than 1.5 million Americans joined credit unions in 1969. These people come from families marked by stable employment, a home mortgage, average of $10,000 a year in family income, education beyond high school, limited liquid assets.

Two-thirds of these families have had to borrow for installment credit in the past decade. Average savings are low. Their basic problem is a rising cost of living aggravated by a desire for a rising standard of living—better home, college for their children, installment credit for durable goods.

What Is a Credit Union?

A credit union is a nonprofit financial institution, operated as a cooperative, to collect savings from members and make loans to members. Credit unions are chartered by State and Federal governments to serve specific groups—employees of a company, church members, community residents (especially in limited-income areas). Operations are regulated by State or Federal legislation.

The principal credit union activity is the accumulation of member savings so that loans can be made to members. Repayment is under 3 years for most loans.

Interest charged for loans is used to cover expenses, including payment of return on savings accounts. Reserves are required.

The key contribution of a credit union to society is its commitment to help members become financially sound. Consequently, whatever hurts the member financially is destructive to all credit unions. This includes runaway inflation, which has already hurt the savings of credit union members and the ability of credit unions to attract such savings. Twenty-two million people—one out of 10—are losing financial solvency and their major source for recovering it—the credit union.

The distortions brought by inflation inevitably hurt people with fixed—or relatively stable—incomes. The present administration has addressed itself to this problem. Credit unions, obviously, want to see inflation controlled.

An important limitation on attempts to control inflation, from the credit union member's view, is the desire to accomplish the control without unduly increasing unemployment.

We feel that continued deescalation of the Vietnam war will reduce inflationary pressure, assuming released funds are not used to build up other defense budgets. Reduced inflation can result if the President has a consistent program to increase budgetary surplus as a means of dampening inflationary psychology. In essence, decreased Federal spending contributes to inflationary control.

On the other hand, most of our members live in urban centers. They pay a large portion of Federal, State, and local taxes. Most nonmilitary spending programs are in the best interests of credit union members. CUNA supports such programs, especially environmental control, job training, education, and public health. The Board of CUNA International has not taken such a position formally, but our position is that reduced spending should be undertaken in such a way as to avoid harm to our urban populations.

Basically, CUNA and the credit union movement are interested in any program that increases the well-being of our members. Inflation has hurt us for several years. The President's program may provide an answer for the fixed-income credit union member and the surety of his savings.

Recent legislation has given Government the power to apply rigid controls. We see no help for credit union members through rigid wage and price controls. The economy that most benefits us—and the Nation—is one marked by free movement of wages and prices. Credit unions have many members who are protected by free collective bargaining. They see no advantage in rigid wage and price controls.

The main concern of our members is maintenance of a rising standard of living. For this reason, they borrow from credit unions. Freezing wages and inflation alike represent a threat to this basic plan. Effective controls would require reversion to the system used during the war years 1941–45.

We actually wish for more competition among financial institutions. In this type of market, the advantages of our rates, methods, and services are most clear. Clearly, Government policies take longer to have effect than many have thought or desired. Prices have not declined as expected; in fact, they are still rising. By the end of 1970, we may have greatly reduced the rate of inflation, perhaps in half; but we see no hope for stable prices in the 1970's.

Present Government policy is directed toward a more stable economy. Causes of the current inflation appear less likely under the current policy. The present administration also places considerable emphasis on monetary policy as a regulator. The expectation is that this will produce more stable and moderate growth. But the transition away from inflation toward stability will be painful. The economy now appears to be in recession. Unemployment will rise above 5 percent this year. Profits will decline due to rising costs, reduced productivity, and increased price resistance.

U.S. Department of Commerce and University of Michigan data show that consumer spending is lethargic. Housing starts are weak and further decline lies ahead. A profit squeeze will result in postponements and stretched-out schedules. Excess inventory must be liquidated. Government outlays are or soon will be declining.

Recession is the customary transition from inflation to stability. Our economic policy faces both formidable opportunity and problems. The stakes are high.

The decade we have just entered can be one of reasonably full employment. For this to happen, however, markets must expand by 50 percent during the decade. This is not a record pace. From 1899 through 1930, for example, decade growth was about 60 percent.

We need to cool an overheated economy. We need to get international trade and finance moving into a more open direction.

Still, we must be realistic about the time required. We hope the administration's current policy can handle the expected labor force. Our first priority is to combat inflation. That the present administration is doing. The second priority is to avoid harsh side effects on the people involved.

FEDERAL STATISTICS USERS' CONFERENCE

This statement is submitted on behalf of the Federal Statistics Users' Conference to express it views on the economic data which provides much of the information upon which the President's Economic Report and the report of his Council of Economic Advisers is based.

FSUC is an association comprising 195 organizations generally classified as business firms, labor unions, nonprofit research organizations, State and local governments and trade associations. These members have a common interest in obtaining adequate, timely and reliable information from Federal statistical programs.

As members of the committee may know, for the past 5 years FSUC has sponsored a 1-day meeting at which the key economic policy documents are considered carefully. This year the meeting included representatives from the Council of Economic Advisers, the Bureau of the Budget and the Treasury Department who discussed the President's Economic Report, the Federal budget and other materials bearing on policy decisions. Throughout these entire discussions it was clear that these policy decisions must be based on adequate, reliable and timely statistics.

Immediately following this special 1-day meeting, the board of trustees of FSUC met for another full day with representatives of the key statistics-producing agencies of the Federal Government. We reviewed with these representatives the current programs of their agencies and their requests for additions to their 1971 budgets. We do not propose in this statement to set priorities or to suggest an allocation of resources for statistics. We shall present our views and comments before the Appropriations Committees when particular programs are being considered. What we wish to present here are our general observations and principles that we believe deserve emphasizing as a result of the broad program review that we have undertaken this year.

We start with the hearty endorsement of the statement of the Joint Economic Committee in its report last year which set forth so clearly the need for improved statistics for economic growth. In our review with individual agencies this year, we directed our attention to the contribution that their particular series of statistics makes both to economic policy and to a better public understanding of economic policy. We also directed our attention to those programs which we feel will have particular significance in terms of assisting Government and private enterprise in working together in mutual respect and understanding toward the goal of sound economic growth. As a result of our review, it was concluded that the proposed 1971 programs represent a minimum that is both necessary and essential in a year of fiscal stringency.

It is highly important to maintain the quality of our basic ongoing statistics while at the same time looking forward to improvements and additions that will help in public and private policy decisions. Although we strongly emphasize the need for improved economic statistics, we also recognize the need for expanding our social and demographic statistics in order to better understand the relationship of these series to our economic statistics generally. For this reason, representatives of agencies producing our social and demographic statistics were invited to discuss their programs with members of our board of trustees. It is quite clear that there is a strong interrelationship and that we need both economic and social statistics in order to make the kind of policy that the problems of the day require.

This year we are especially pleased to note that the 1971 budget for statistical programs has avoided expanding social statistics at the expense of our much neglected economic series. There is, indeed, in this budget a slight increase in appropriations for economic statistics which, in our view, reflects a minimum necessary simply to keep up with the requirements of an increasingly complex and larger economy. We direct your attention to the fact that, if changing costs due to inflation are taken into account, in the past 8 years there have been virtually no increases in the funds available for many of our major economic statistical areas, notably price statistics, construction and housing statistics, national income and business accounts, and labor statistics. The current budget provides a minimum of improvements in economic statistics, many of which were requested but not authorized in budgets in the past several years.

As the Council of Economic Advisers and the Joint Economic Committee move into the full implementation of the Employment Act, through the projection of the economy for 5 years ahead, it is especially important that this be done on an adequate statistical base. The Economic Report indicates the need for seeking patterns of regularity that can be helpful in forming judgements about the future of the economy. Members of the Federal Statistics Users' Conference are finding the same kind of need in their business and economic planning.

In our discussions with representatives of statistical agencies we suggested that they should seek to maximize the use of their statistics and the statistics they proposed to collect by making clear the complete nature and content of their series for a variety of actual and potential uses. The Federal Statistics Users' Conference stands ready as an organization to assist in this effort for the private economy and for State and local governments. In this connection, we believe that it is particularly important that Federal statistical agencies have full control of their individual programs in order to understand and maximize their full potential. Wherever possible, the responsibility for statistics in an agency should lie completely within the statistics producing bureau or bureaus and come under the purview of the Office of Statistical Policy of the Bureau of the Budget.

We commend the administration for its attention and efforts to speed up the release of major economic data. The new schedule of release dates for principal Federal economic indicators is an important step forward and represents a valuable contribution to keeping the public informed. The improvements in timeliness generally will be very helpful in the making of key economic decisions and we will join with the collecting agencies in the next step which is to obtain prompter reporting from the business community.

In conclusion, we wish to thank the chairman and the committee for inviting our comments and views on the economic issues which concern the Nation and our own organization. The committee has played a leading role in urging and defending adequate and proper economic statistics and we pledge our continued support and cooperation to the work of the committee.

MACHINERY & ALLIED PRODUCTS INSTITUTE

By CHARLES STEWART, *President*

We appreciate your invitation of February 10 to submit a statement for the record in connection with hearings of the Joint Economic Committee on the Economic Report of the President.

We are also grateful for the additional time granted us to prepare our presentation so that we might bring to the committee's attention two new MAPI research studies which have just been completed by our research director, George Terborgh. In addition, this extra time enabled us to review the statement of Mr. Nathaniel Goldfinger, director, Department of Research, American Federation of Labor and Congress of Industrial Organizations, dated March 11.

First, our general reaction to the AFL-CIO statement is that it conforms to the traditional economic policy views of the labor movement, including reiteration of several myths which invite an extensive critique. In the interest of brevity, however, we shall confine our reactions to certain points which require at least limited comment in order to give the record minimum balance.

The real cause of inflation.—The AFL-CIO statement is based on the central and fallacious proposition that the inflation which the United States has been experiencing is largely a profit inflation. Further, it is argued that the high level in business investment in plant and equipment is totally unacceptable and is one of the principal contributors to inflation, that investments by U.S. companies in foreign subsidiaries are a major cause of the deterioration of the U.S. position in world trade, and that the Federal Government is making the serious mistake of employing so-called aggregate economic policies and measures as distinguished from selective approaches pinpointed to meet specific problems and to achieve certain social and economic priorities.

With respect to inflation in general, in a MAPI study entitled "The Inflation Dilemma" published last year, the Institute has documented the fact that the principal inflationary dynamic of the past few years has been rising labor costs. It follows that unless national policy can relax the labor market in the major wage-determining category—adult males—the chance of slowing down the advance of hourly compensation, and with it the advance of prices, is slim. "The Inflation Dilemma" is enclosed as a background document for your hearings and for review and consideration by your staff.

Corporate profits.—Turning to the subject of profits, Mr. Goldfinger apparently is unaware of, or chooses to ignore, the fact that the country has already entered a period of profit squeeze for most of American industry, Government data indicate that after-tax corporate profits declined to a seasonally adjusted annual rate of $49.1 billion in the final quarter of 1969 from $49.7 billion in the third quarter, $51.3 billion in the second quarter, and $51.7 billion in the first quarter of last year. This was the lowest level of profits since the first quarter of 1968. Further, the outlook for manufacturing profits continues to deteriorate as the index of labor cost per unit of output moves strongly upward. This index has been rising at an annual rate of over 9 percent since last July, and, as a consequence, the ratio of manufacturing prices to unit labor cost has declined to its lowest level in more than 11½ years.

Finally, the squeeze on profits is aggravated by the effect of inflation. The Institute's new study entitled "Inflation and Corporate Profits" has just come off the press, and we ask that the committee include it in the record as an appendix to this relatively brief letter. Examining the distorting effects of inflation on the accounting procedures by which corporate profits are arrived at, and recomputing them by correcting for these distortions, the study produces startling results. While the overstatement of profits has varied widely over the postwar period, it has averaged 22 percent for after-tax profits, and enough on taxable income to make the average effective tax rate 6 percentage points higher than the nominal rate. Currently, the overstatement ratio is above the average and headed higher.

Business capital investment.—In another research study of the Institute just completed and entitled "New Norms for Business Capital Investment?" it is concluded that there is persuasive evidence that the United States has not been suffering from an artificial boom in plant and equipment expenditures and that new norms have been established for such expenditures. The problem of capital supply in the 1970's to support such levels of capital investment, however, is of vital national concern and deserves intensive study. It is essential that we maintain in this country a high level of investment in plant and equipment in order to produce the goods required by the Nation and in order to compete in international markets. There is another factor which is frequently overlooked—paradoxically, overlooked even by representatives of labor—namely, that with the increase in the growth rate of private employment, there must be an increase in the investment required to equip the added workers with the tools of production. An advance copy of "New Norms for Business Capital Investment?" is attached in mimeographed form. We regret that we cannot furnish copies of the charts in view of the stage of the printing process; however, the narrative copy which is available speaks for itself, and we will send copies of the full document including the charts to the staff of the committee when the pamphlet is off the press. We believe that the material bears so directly on our curreent economic picture and outlook for the economy in the 1970's that it would be a relevant and constructive addition to the record as a part of the MAPI statement.

Private investment abroad.—Mr. Goldfinger's comment with reference to investment abroad deserves at least a limited response. As MAPI has been at pains to point out on so many occasions, private investment abroad by U.S. companies is symptomatic of certain conditions that affect the ability of U.S. industry to compete in foreign trade. U.S. companies go abroad because in a commercial sense they are compelled to. In some instances, nontariff barriers of foreign countries make exports from the United States difficult or absolutely impossible. In other cases, particularly in labor intensive industries such as the capital goods and allied equipment industries, spiraling labor costs in the United States force foreign investment by U.S. companies. We have already referred to the movement of the index of labor cost per unit of output in the United States. This index has skyrocketed from a low of 98.6 in July of 1965 (1957–59 equals 100) to 118.5 in January 1970. The total absence of any recognition of this basic economic fact in Mr. Goldfinger's statement is transparent.

There are other aspects of the economics of foreign investment that are overlooked or misunderstood. Foreign affiliates of U.S. companies in most cases attract from their parent organizations in the United States a large volume of exports of components and subassemblies. Government as well as private studies confirm this fact. In addition, because of the wide range of factors which have compelled American companies to extend their operations abroad and operate under the philosophy of worldwide business, the economic health of such U.S. companies in terms of total profits, employment levels, and research and developemnt commitments has been greatly enhanced. In brief, labor as well as management and government as well as private business have a very important stake in successful foreign operations of U.S. business.

The climate for productive investment.—Finally, we should like to draw to the attention of the joint committee a MAPI presentation to certain tax organizations in the United States entitled "A Favorable Climate for Productive Investment." Although this is a wide-ranging presentation, one proposition which is advanced by the statement deserves to be underlined. The attitude of Government in the United States toward a high level of productive investment and toward Government policies to help support a continuing high level of productive investment seems to have turned adverse and negative. This appears to be true both from the standpoint of broad economic policy and in particular tax policy. As in the case of the pamphlet, "The Inflation Dilemma," we are offering a copy of this presentation as a background document. We trust, however, that the pamphlet "Inflation and Corporate Profits" and the advance copy of "New Norms for Business Capital Investment?" will be included in the record.

It is always a privilege for the Institute to offer its views to your distinguished committee, and we trust that the research studies to which we have referred and our brief commentary contained in this letter will be helpful.

INFLATION
AND
CORPORATE PROFITS

by

GEORGE TERBORGH

MACHINERY AND ALLIED PRODUCTS INSTITUTE
AND
COUNCIL FOR TECHNOLOGICAL ADVANCEMENT

FOREWORD

With reported corporate profits currently declining in the face of continued inflation, it is an appropriate time to examine the distorting effects of inflation on the accounting procedures by which these profits are arrived at, and to recompute them by correcting for these distortions

By all means the largest factor of distortion is the historical costing of physical asset consumption—fixed assets and inventory. MAPI Research Director George Terborgh has dealt with the deficiency of historical-cost depreciation in a recent pamphlet, *Underdepreciation From Inflation—A Ghost Returns.*[1] The present study adds the undercosting of inventory consumption and applies the combined shortfall in the recomputation of corporate profits.

The results are startling. While the overstatement of profits has varied widely over the postwar period, it has *averaged* 22 percent for after-tax profits, and enough on taxable income to make the average effective tax rate 6 percentage points higher than the nominal rate. Currently the overstatement ratio is above the average and headed higher. For 1969, corrected after-tax profits were 18 percent below 1966. The

[1] Mr. Terborgh's current series of studies on inflation also includes: *Accelerated Depreciation as an Offset to Inflation,* MAPI, 1970; "Effects of Inflation on Lenders and Borrowers," *Capital Goods Review* No. 79, September 1969; "Effects of Inflation on Equity Returns," *Capital Goods Review* No. 80, December 1969; and "Gainers and Losers From Inflation," *Capital Goods Review* No. 81, March 1970.

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profit margin on output was down by nearly one-third, to the postwar lows. (The uncorrected profits were up by 1 percent and the margin down by only 19 percent.) Clearly, the distortion from conventional accounting has become a matter of urgent concern, not only for management and the accounting profession, but for public policy.

The study not only documents the need for some kind of accounting adjustment for inflation; it puts to rest the myth that inflation is good for profits. I commend it not only to the business community but to all those interested in a viable free enterprise system.

Charles W. Stewart
President

March 1970

INFLATION AND CORPORATE PROFITS

The effect of inflation on the accounting of corporate profits is not a new subject for the Institute. After World War II it published several studies purporting to estimate this effect, the most recent in 1959.[1] In view of the relative stability of the price level in the early sixties, the subject became increasingly academic, and nothing further was done on it. With the revival of inflation in the second half of the decade, however, it has come back to life, and it is now time to bring the earlier studies down to date.

Fortunately, this operation is greatly facilitated by the results of an extensive investigation of corporate depreciation conducted not long ago by the Department of Commerce.[2] Thanks to computerization, these results provide so many options, both in historical-cost and in current-dollar depreciation, that it is quite unnecessary to repeat the laborious calcu-

[1] *Inflation and Postwar Profits* (pamphlet), 1949; "Inflation and Postwar Profits," *Capital Goods Review* No. 12, 1952; *Realistic Depreciation Policy* (book), 1954; "Postwar vs. Pre-Depression Profits of Manufacturing Corporations," *Review* No. 25, 1956; *Corporate Profits in the Decade 1947-56* (pamphlet), 1957; "Corporate Profits and Rates of Return in the Fifties Adjusted for Comparison With Those of the Twenties," *Review* No. 38, 1959.

[2] See Allan H. Young, "Alternative Estimates of Corporate Depreciation and Profits," *Survey of Current Business,* April and May 1968.

lations that entered into our previous analyses. We can simply borrow.

Notwithstanding this boon, however, the following analysis is rather involved and it may be well to offer a brief preview of the main findings.

Preview of Findings

1. The charging of the historical cost of physical assets consumed in production (fixed assets and inventory), rather than the equivalent of that cost in current dollars (the dollars of realization), has resulted in an enormous *overstatement* of corporate profits in the postwar era, the average relative overstatement of after-tax profits being around 22 percent.

2. The degree of overstatement has varied widely over the period, ranging from almost 100 percent in some early postwar years to virtually none in the early sixties. Since 1964, however, it has risen rapidly. The reported figure of last year was too high by $11 billion, and the excess will almost certainly be larger this year (1970).

3. Because of this history of overstatement, effective tax rates on adjusted corporate income have been substantially *higher* than on reported income, the excess for the postwar period as a whole averaging 6 percentage points.

4. Adjusted corporate saving (retained earnings) has been *lower* than reported by roughly one-third.

5. Corrected for overstatement, profits have been *declining* steadily and substantially since 1966. They will probably drop sharply this year, in view of the prospective runoff in the reported results.

6. When corrected profits are stated, not in absolute amounts, but as percentages of the income produced by the corporate system, the decline since 1966 has been far more drastic. In these terms, the 1969 figure was at the lows reached in postwar recession years—and this in a period of high prosperity.

7. The notion that inflation is good for profits must be put down as a popular myth.

With this preview of findings, we turn to the analysis itself. First, a word on the general principle involved in the adjustment of profits for inflation.

I. THE PRINCIPLE

Our earlier studies described the propensity of conventional accounting procedures to *overstate* profits during and after a period of inflation. Why this overstatement?

> The overstatement arises, of course, from the practice of charging the historical cost of the inventory and fixed assets consumed in production, rather than the equivalent of this cost in current dollars. When the purchasing power of the dollar is shrinking, the charging of historical costs—reflecting earlier, and hence lower price levels—is insufficient for the restoration of the real capital used up in production. This means that the additional amounts required must come from what is accounted as profit. Obviously this much of the so-called profit represents nothing but the uncovered cost of making good capital consumption.
>
> Clearly there is something wrong with an accounting procedure that yields a reckoning of cost insufficient in a period of rising prices to secure the replenishment of the real capital of industry.

We submit that this replenishment is a legitimate cost of production and that there is no true profit until it has been fully provided."[1]

As this implies, a proper reckoning requires the restatement of previously incurred costs *in the dollars of realization,* that is to say, in the revenue dollars against which they are charged. Only when costs and revenue are measured in the *same* dollars can the difference between them (profit) be correctly determined.

The Project

What we propose to do, therefore, is to translate into current-dollar equivalents (equivalents in the dollars of revenue) the costs of physical asset consumption commonly accounted on an historical basis. We can then see what difference the conversion makes in the profit figures. We limit the study to the corporate system because profit as such is not available for the unincorporated sector.

II. THE ADJUSTMENTS

We referred just now to a restatement of the costs of physical asset consumption. This means, of course, the consumption of fixed assets and inventory, and implies two adjustments. Actually the first adjustment consists of two parts. Because the available statistics on historical-cost depreciation are on an income-tax basis, and because tax-allowable methods and practices have changed over the period covered, it is desirable

[1] *Capital Goods Review* No. 25, February 1956, p. 1.

to homogenize the historical-cost series before converting it into current-dollar equivalents.

Adjustment of Historical-Cost Depreciation

The history of tax depreciation since World War II records a number of significant changes. With the outbreak of the Korean War, there was a revival (on a modified basis) of the special 5-year amortization of defense facilities used in World War II.[1] In 1953 the Internal Revenue Service announced a relaxation of depreciation auditing procedures.[2] The Revenue Act of 1954 authorized two new accelerated methods of depreciation, double declining-balance and sum-of-digits. In 1962 the Treasury introduced the guideline-life system, the effect of which was a substantial shortening of tax service lives.[3] This followed a decade during which taxpayers had been reducing tax lives on their own initiative.

The effect of these changes has been to destroy the consistency and comparability of historical-cost tax depreciation, making it generally more liberal in the latter part of the postwar period than earlier.[4] To screen out the variations, it is necessary to assume a *standard* depreciation system, uniform as to writeoff method and service-life assumptions. We propose to use for this purpose double declining-balance depreciation with straight-line switch, with service lives throughout

[1] Revenue Act of 1950.

[2] Revenue Rulings 90 and 91.

[3] Revenue Procedure 62-21.

[4] See *The Fading Boom in Corporate Tax Depreciation*, MAPI, 1965.

equal to 85 percent of Bulletin F lives.[1] This system is applied to amortized, as well as to depreciated, facilities.[2]

Adjustment of Standard Depreciation for Inflation

Having applied standard depreciation on an historical-cost basis, the next step is to restate the accrual in current-dollar equivalents. This yields the underdepreciation from inflation. Here we rely on the Department of Commerce conversion, based, in the case of capital equipment, on commonly available indexes of equipment prices, and in the case of buildings and structures on a specially prepared index of construction costs designed to eliminate the upward bias in the published indexes.

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[1] This service-life assumption is admittedly not too secure. Unfortunately, while we have a good deal of information on lives claimed for tax purposes, we have very little on *actual* lives. It is impossible to say, therefore, whether the downdrift in tax lives that set in in the early fifties indicated a concurrent shortening of actual lives or reflected instead the relaxed audit policy of Treasury Decisions 90 and 91 and the restructuring of depreciation accounts under the 1954 Code. The shortening of tax lives in 1962 by the guideline-life system has even less evidential value. In view of this uncertainty, we assume that actual service lives were constant over the period covered at 85 percent of Bulletin F lives. According to the Department of Commerce Capital Stock Study, this assumption is considered to provide "close approximations to actual service lives." *Survey of Current Business,* May 1968, p. 19.

[2] Special amortization was used in World War II and in the Korean emergency as an incentive to induce private investment in defense production facilities at a time when their post-emergency value was problematical. Since much of the amortized investment was in civilian-type or readily convertible capacity, it had substantial post-emergency value. Lacking any conclusive evidence of what the writeoff should have been, we apply the standard system. Fortunately the amounts involved are relatively minor. For a fuller discussion of the subject, see *Amortization of Defense Facilities,* MAPI, 1952, Chapter V.

Some will prefer the conversion of historical cost into current-dollar equivalents by reference to more general indexes of the purchasing power of the dollar, such, for example, as the GNP deflator. This is an old controversy, which we have discussed elsewhere.[1] Suffice it to say that the alternative procedure would make comparatively little difference in the result, particularly in view of the use here of the Department's more conservative index of construction costs. In any case, the alternative is not available.

Inventory Valuation Adjustment

Here again we rely on the Department of Commerce estimates. These reflect the difference between inventory consumption at replacement cost and at acquisition cost, making due allowance for the existing use of LIFO and similar accounting practices.

While the conversion here is on a specific-replacement-cost basis, the range of inventory covered is so wide that the overall result would not be far different if a general index of commodity prices were employed instead. (If a still more comprehensive index were used, including services, the adjustment would be larger than shown.)

The Adjustments in Graphic Form

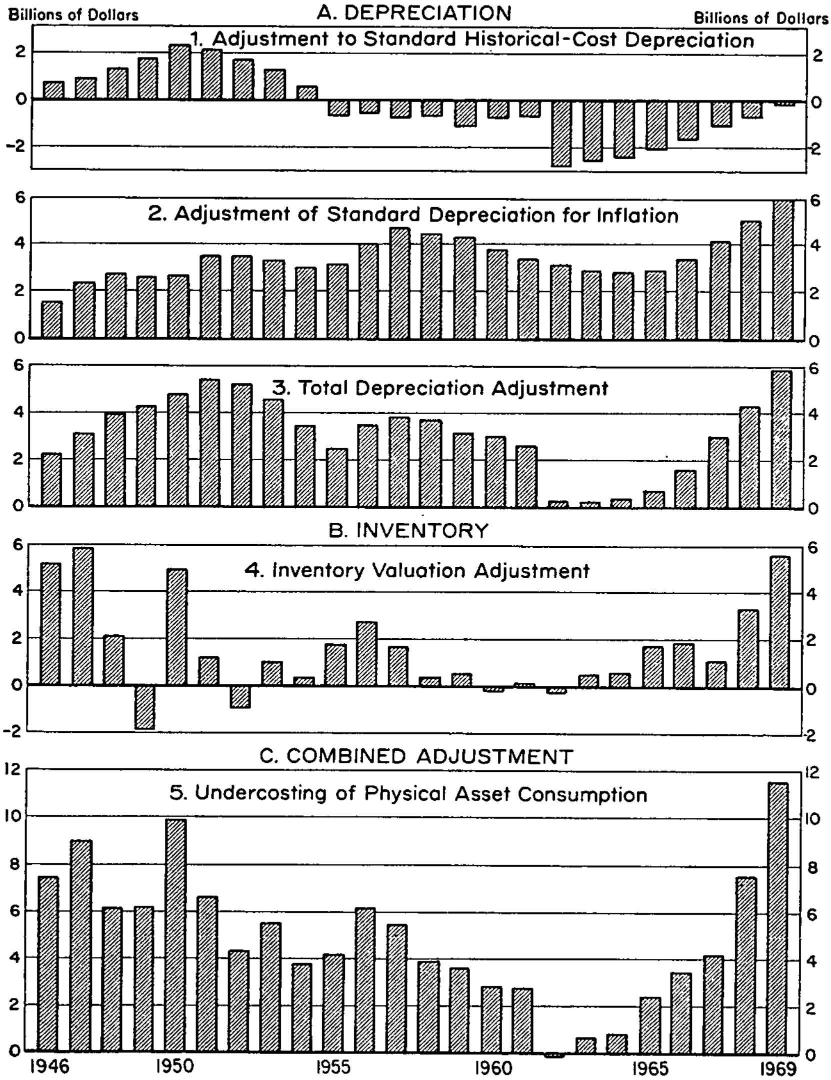
These adjustments are shown in graphic form in the several sections of the chart on page 10.

The first section presents an interesting picture. Standard historical-cost depreciation ran *above* the actual tax accrual for several years after the end of World War II. Thereafter it ran *below* it, especially after the introduction of the guideline-

[1] *Realistic Depreciation Policy,* p. 115.

Chart 1

Adjustments for the Undercosting of Corporate Physical Asset Consumption, and the Combined Adjustment[a]



[a] The depreciation adjustment is exclusive of depreciation on the residential properties of corporations.

life system in 1962. The shortfall has been diminishing since then, however, and by 1969 the standard and actual were approximately the same. The conversion of standard historical-cost depreciation into its current-dollar equivalent (second section) results in adjustments that rose irregularly until 1957. They declined thereafter into the mid-sixties, whereupon the trend was reversed. The combination of these two adjustments yields the pattern shown in the third section. The shortfall of actual depreciation below the *current-dollar* standard accrual was especially heavy in the early fifties, but was substantial through 1961. From 1962-64 it was negligible. Thereafter it soared.

The restatement of inventory consumption costs in current dollars gives the adjustments in the fourth section. Since these are sensitive to short-run price movements, they have been highly erratic, and even at times negative. During inflationary periods, of course, they were strongly positive, as they have been in recent years.

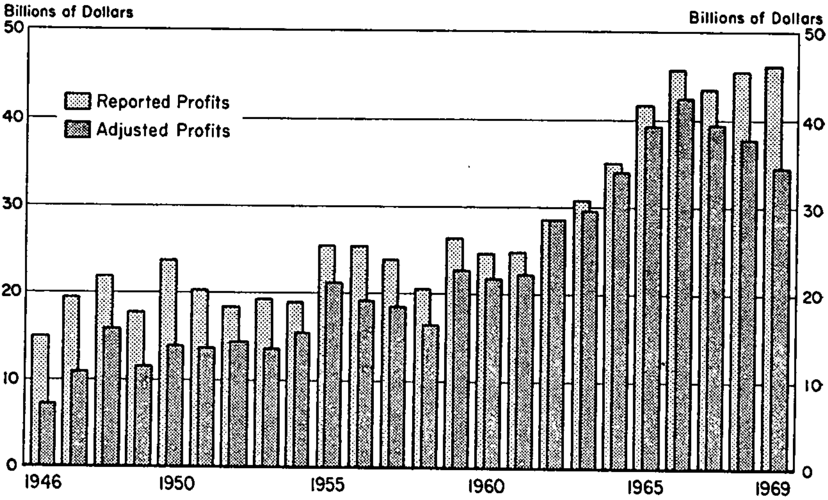
The combination of these depreciation and inventory adjustments appears in the bottom section. This is the payoff. It is obvious that total undercosting has varied widely over the postwar period, being generally high until the late fifties, declining thereafter to zero in 1962, and rising rapidly since then. The total for last year (1969) was nearly $11 billion, and is almost certainly higher this year.

III. REPORTED AND ADJUSTED PROFITS

We are now in a position to adjust postwar corporate profits for the undercosting of physical asset consumption. This is done by *subtracting* the combined adjustment in Section C of the previous chart from the profits reported on an historical-cost basis. This subtraction applies in the first instance, of course, to *pre-tax* profits, but since it is the same in a retrospective calculation for *after-tax* profits, we shall show it only for the latter.[1]

Chart 2

After-Tax Corporate Profits as Reported and as Adjusted [a]



[a] The reported profits are a slightly modified version of the series regularly compiled and published by the Department of Commerce. This is generally on an income-tax basis, but includes depletion allowances. Capital gains and intercorporate dividends are excluded. Since the depreciation adjustments of Chart 1 exclude residential property and assets held abroad, the profit figures shown here are exclusive of earnings from these sources. For this reason they run somewhat below the Department's regular series.

It is obvious at a glance that profits as reported were grossly overstated in the early postwar period, for some years by nearly 100 percent. The overstatement gradually diminished

[1] Since this is a retrospective recomputation of profits, it takes as given the corporate income taxes *actually paid*. If tax liabilities had been figured on the

into the early sixties, being virtually nil for 1962-64. Thereafter it increased rapidly to $11 billion in 1969. Over the entire 24-year period covered by the study, reported profits aggregated $663 billion, against an adjusted $544 billion. The overstatement was thus 22 percent. Conversely, adjusted profits were only 82 percent of reported.

While the relative overstatement for 1969 merely equalled the period average of 22 percent, it is evident that the quality of reported profits has been deteriorating rapidly since 1966, and that the end is not yet in sight. Notwithstanding a sidewise movement of these profits over the interval, the adjusted figures have declined 18 percent, the 1969 level being roughly comparable with that of 1964. (The decline is even more rapid, 27 percent, when the adjusted profits are stated in constant dollars.)

Adjusted Profits Relative to Income Originating in the Corporate System

The *absolute* decline of adjusted profits since 1966 is of course less than the *relative* decline because of the expansion of the dollar volume of business on which they were earned. This becomes evident when we express them as a percentage of income produced.

As a percentage of income produced, adjusted after-tax profits for 1969 were down from 1966 by *almost one-third.* They were down, indeed, to the postwar lows. True, the decline started from a high level, but it is nevertheless an extraor-

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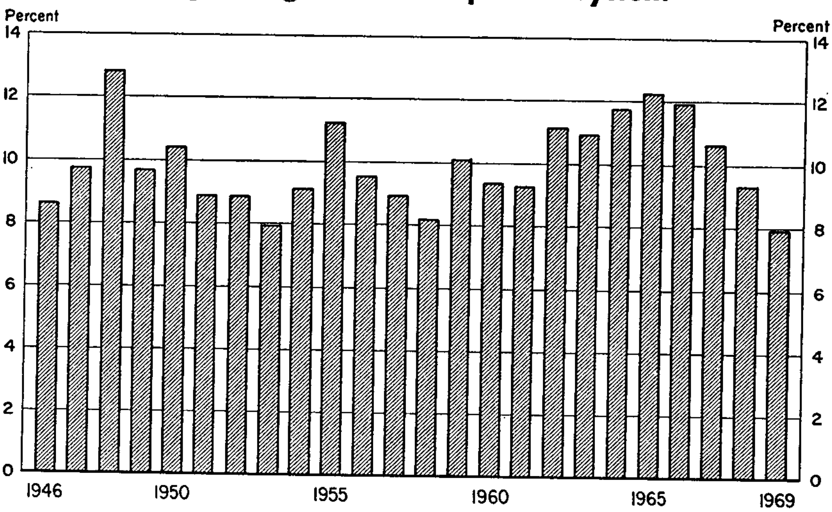
adjusted pre-tax profits, the after-tax effect of the adjustment would of course have been reduced by the tax saving resulting therefrom. But since they were actually figured on the *reported* profits throughout, there were no such tax savings. Adjusted after-tax profits are simply adjusted pre-tax profits minus actual taxes on reported profits.

Chart 3

Adjusted After-Tax Profits as a Percent of Income Originating in the Corporate System [a]



[a] Income originating includes income from residential property and from foreign sources. It is not, therefore, precisely comparable with the adjusted profit figures, but for our present purpose the difference is negligible.

dinary phenomenon to have recession profitability rates at the top of a boom. Here is a dramatic demonstration of the effect of inflation on *real* profit margins.

IV. CONCLUDING COMMENTS

When the cost of physical asset consumption is restated in current dollars, the profit picture for the postwar period is radically transformed. Not only is the average of reported after-tax profits 22 percent above the average of the adjusted figures; the disparities from year to year, and from one sub-period to another, are extremely variable. Clearly, historical-cost profit accounting has been unreliable and illusory.

We may note two corollaries of these findings. (1) Effective tax rates on adjusted taxable income have averaged substantially *higher* than on reported income. For the postwar period as a whole the figures are 51.2 percent and 45.2 percent, respectively. (2) Real corporate saving (retained earnings) has been substantially *lower* than reported. Here the totals for the period are $249 billion vs. $367 billion.

We have commented on the deterioration in the quality of reported profits during the present inflation (since 1964), and on the recent acceleration of the process. The notion that inflation is good for profits is a popular myth based on the illusions of historical-cost accounting. Correctly computed, with costs restated in current dollars, they are almost certain to lose from inflation.[1]

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[1] For a theoretical analysis of this tendency, see "Effects of Inflation on Equity Returns," *Capital Goods Review* No. 80, December 1969.

NEW NORMS
FOR
BUSINESS CAPITAL INVESTMENT?

by
GEORGE TERBORGH

MACHINERY AND ALLIED PRODUCTS INSTITUTE
AND
COUNCIL FOR TECHNOLOGICAL ADVANCEMENT

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FOREWORD

The level of corporate capital expenditures over the period 1965-70 (the last year estimated, of course) has been exceptionally high. In relation to the volume of business done by the corporate system, these expenditures have averaged 20 percent higher than they did in the previous postwar period 1947-64. They have also been high in relation to the internal funds generated by the system, particularly in the last two years. They exceeded these funds by 27 percent in 1969 and on the basis of present forecasts will exceed them by 38 percent in 1970, against an average relation of approximate equality over the pre-1965 period.

The question is raised in this study whether the historical (1947-64) ratio of capital expenditures to business done is valid for the 1965-70 period, and even more important, whether it is valid for the future. The author, MAPI Research Director George Terborgh, examines five factors that may account for the recent high ratio: (1) inflation hedging; (2) accelerated technological change; (3) rapidly rising labor costs; (4) the relation of equipment prices to labor costs; and (5) accelerated employment growth. He concludes that the last named has been the predominant one, accounting for roughly three-quarters of the amount to be explained.

While the future contribution of some of these factors is uncertain, the accelerated employment growth is destined to continue, though less dramatically, and with relatively less impact, than in the recent period. Giving modest weight to the other factors, the study concludes that the old (1947-64) norm is too low for the years ahead. "Corporate investment requirements are going to be substantially higher hereafter in relation to the volume of business done than in the pre-1965 period."

These heavier requirements pose the problem of financing. Since the prospect for a higher ratio of corporate internal funds to business volume is poor, the enlarged requirements imply a relatively heavier reliance on outside financing. This means intensified competition with other capital-market claimants—unincorporated enterprises, housing, consumers, and governments—for the savings of the community, and calls in question the adequacy of these savings to meet the nation's needs.

Since the analysis finds it probable, in view of the prospective demands of these noncorporate claimants, that there will be a capital shortage in the seventies, the essay closes with an admonition that intensive study be given to possible public policies for alleviating it.

I commend the study therefore not only to business executives and economists, but to those responsible for public policy planning.

Charles W. Stewart
President

May 1970

NEW NORMS FOR BUSINESS CAPITAL INVESTMENT?

Those who follow economic affairs are aware that we have had an extraordinarily high level of business capital investment over the past few years, but they do not always realize just how high and how long sustained it has been in relation to previous experience. It represents, in fact, a marked departure from that experience, raising the question whether the historical norms are any longer valid. More to the point, are they valid for the future? It is this question we propose to explore here.

The first step in the inquiry is a look at the historical record itself. Here we are not concerned with the *absolute volume* of business capital investment, which has of course grown enormously, but rather with the *relation* of this investment to other economic series. Specifically, we propose to compare it with two such series: (1) the volume of business done by the investing companies; (2) the volume of funds generated by these companies to finance the investment.

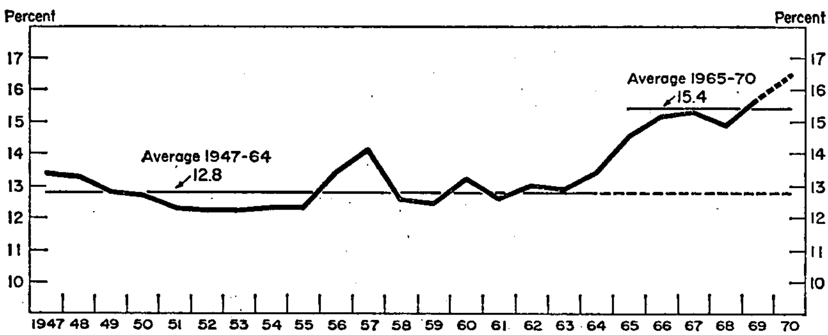
Because of the greater availability of data for corporate business, we shall limit the study to this sector, specifically to *nonfinancial* corporations. These account for the overwhelming bulk of business fixed investment, and their showing is therefore of major significance for the national economy.

I. CAPITAL EXPENDITURES VS. THE VOLUME OF BUSINESS DONE

We begin with the first of the comparisons just mentioned, that between capital expenditures and the volume of business done. As the measure of the latter, we use the gross corporate product.[1]

Chart 1

Capital Expenditures of Nonfinancial Corporations as a Percentage of Their Gross Product[a]



[a] Capital expenditures, Federal Reserve Board (flow-of-funds accounts); gross product, Department of Commerce (GNP accounts). The estimate for 1970 is our own, based on the latest indications available at the time of writing. It is, of course, highly tentative.

[1] The more usual measure is the aggregate sales of the corporate system, but this is a duplicated, or pyramided, figure which includes transfers between corporations, hence is affected by changes in the degree of integration of processes. It is affected also by shifts in the composition of output between companies and industries with different value-added-to-sales ratios, and by changes in the relative cost of purchases from unincorporated suppliers. The gross corporate product calculation avoids these distortions, which can have a significant effect over the long period covered by this study. This product is the sum of (1) compensation of employees, (2) after-tax profits, (3) net interest payments, (4) taxes (direct and indirect), (5) capital consumption allowances, and (6) transfer payments, less subsidies.

An interesting picture, this. From 1947 to 1964, the ratio of capital expenditures to gross product ranged generally in the 12-14 percent zone, the period average being 12.8 percent. Beginning with 1965, however, the ratio broke out on the upside. It made further gains in 1966 and substantially held that year's level for the next two years, following which it went into another climb into new territory. Thus we have *six successive years* with higher ratios than previously attained in any single year of the postwar period, and with an *average* 20 percent above the earlier average. Clearly, investment has been extremely high by historical standards.

II. CAPITAL EXPENDITURES VS. INTERNALLY GENERATED FUNDS

We turn now to the second comparison, that of capital expenditures with internally generated funds (retained earnings and capital consumption allowances).

In comparing internal funds with fixed-asset expenditures, we do not mean to imply that they are exclusively used for this purpose. They are employed, of course, for general corporate purposes, including working capital. It is nevertheless useful to offset them against their principal use to observe changes in relative magnitudes. This is done in the next chart on page 6.

Here is a picture no less interesting than the preceding one. For the pre-1965 period, and further through 1968, we have a similar pattern of moderate oscillations around the average.[1] For the last two years, however, it is quite different.

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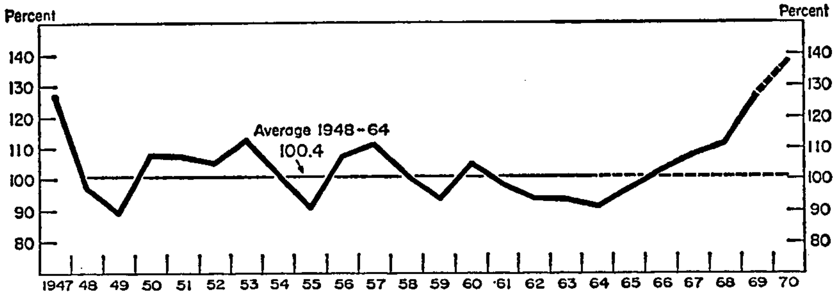
[1] Save for 1947. In that year, the corporate system was still working off its wartime accumulation of liquid assets, a nonsustainable source of internal funds. Because of this we have excluded it from the pre-1965 average, and will exclude it from future references to postwar experience.

Chart 2

Capital Expenditures of Nonfinancial Corporations as a Percentage of Their Internal Funds [a]



[a] Retained earnings are *after* inventory valuation adjustment. Again the estimate for 1970 is our own and is provisional only.

The surge in capital expenditures relative to gross corporate product, which began in 1965, was accompanied for that year, and for 1966 as well, by such a rapid increase in internal funds that the ratio of the expenditures to the latter rose only moderately. The rise was moderate also for 1967 and 1968, though for different reasons: a slowdown in the growth of expenditures in the face of a sidewise movement of internal funds. Only in 1969 did the ratio soar beyond the previous range of variation, here because of soaring expenditures on a continuance of this sidewise movement. It spurted to 127 percent. If the latest forecasts for 1970 are realized, it will advance further to 138 percent. (In dollar terms, the overages are $17 billion and $24 billion, respectively.) Clearly, the record of these two years is extraordinary.

III. INTERPRETATION

A number of factors have been suggested to account for the high level of business capital investment in recent years. We shall comment on five: (1) Inflation hedging; (2) The increased tempo of technological change; (3) Rapidly rising labor costs; (4) A favorable relation of equipment prices to labor costs; (5) The rapid growth of employment.

Inflation Hedging

There is a tendency these days to attribute the recent capital investment level in part to "inflationary expectations." It is said that business has been trying to "beat the gun" on higher equipment prices and construction costs by advancing in time projects that would normally have been undertaken later.

No one can deny that this has been a factor in the situation, but we doubt that it had much impact in the early years of the period under review. We call your attention to the fact that the real surge began in 1965 (Chart 1), reflecting largely decisions made in 1964, before there were any inflationary expectations whatever. The 1966 expenditures, reflecting for the most part 1965 decisions, were only slightly affected, if at all. It seems likely, moreover, that the same can be said of the 1967 and 1968 outlays, responsive in this case largely to 1966 and 1967 decisions. For inflationary expectations among business forecasters at the time these decisions were made were prevailingly modest—generally in the 2-3 percent a year range, hardly sufficient to trigger a major response.[1]

[1] We may cite the average forecast of the annual Business Outlook Forum of the National Industrial Conference Board (held late in the year preceding the forecasted year):

Forecast For	Increase Expected During the Year: Consumer Price Index	Increase Expected During the Year: Wholesale Price Index
	(Percent)	
1966	1.5	2.0
1967	2.4	2.1
1968	3.1	2.5

(*Business Outlook,* 1966, pp. 118-19; 1967, p. 121; 1968, pp. 118-19.)

If inflationary expectations had only a limited impact during the first four years of the period, this is certainly not true of the next two, 1969 and 1970. It was the failure of the credit squeeze of 1966, and later of the fiscal action of 1968, to arrest the accelerating advance of costs and prices that produced the massive skepticism and disillusionment that have since prevailed. For the first time, both the determination and the ability of the government to control inflation have been called widely into question, and business investment decisions have come to be increasingly motivated by hedging considerations. We entertain no doubt that a significant portion of the 1969 and 1970 expenditures have been so motivated. But how much, no one knows.

Tempo of Technological Change

It is widely believed that the tempo of technological progress has been speeding up in the postwar era, affecting both products and processes. In part this belief is an inference from the demonstrably rapid growth of research and development expenditures: it is held that this growth simply *must* have had an accelerative effect. In part it reflects the impressions of observers in close contact with technological developments.

While the belief in technological acceleration is plausible, there is a common tendency to exaggerate the phenomenon. We have commented on this elsewhere:

> One factor contributing to the break-with-history hypothesis is the propensity to discount the technological dynamism of the past. The achievements of today are widely evident; the past is distant and hazy. . . . As the Committee on Recent Economic Changes observed back in 1929, "Each generation believes itself on the verge of a new economic era, an era of fundamental change." We are prone to forget that the world

also appeared in this light to our grandfathers, and that earlier eras may have been almost, if not quite, as dynamic as our own.[1]

Even if the postwar acceleration of technological change has been real and substantial, this does not necessarily provide an explanation of the behavior of capital investment in recent years. For it was under way long before 1965, when the investment surge began. Its continuance thereafter may simply have maintained a support that had been present for years.

If this phenomenon is to serve as an explanatory factor for the recent period, it is necessary to postulate that the rate of acceleration has itself accelerated, with an incremental boost in capital requirements. There is a good deal of informed opinion in favor of this hypothesis, and it is probably valid, but it is impossible to assess the magnitude of the investment effect.

Rapidly Rising Labor Costs

While in theory the stimulus of rapidly rising labor costs to investment in labor-saving mechanization depends on the *relation* between this rise and the accompanying rise in equipment prices, there can be little doubt that in practice the stimulus goes beyond the theoretical effect.

The soaring wage rates and unit labor costs characteristic especially of the later years of the period under review have prompted desperate efforts to reduce labor requirements, and almost certainly have generated an investment demand in excess of that accounted for by a currently favorable equipment-price/labor-cost relation. But again the magnitude of the effect is indeterminate.

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[1] *The Automation Hysteria*, MAPI, 1965, p. 67.

Favorable Relation of Equipment Prices to Labor Costs

Some time ago (1968) we published a study entitled *Equipment Prices and Labor Costs: Current Trends Favorable to Investment.* A word from the concluding section:

> We come now to the main objective of this inquiry, an assessment of the present position of the equipment-price/labor-cost ratio. You will note that there has been a steady improvement in the relation of this ratio to the trend line for a full decade. . . . For the past 5 years it has been below trend, and by a widening margin. At the present time its relation to trend appears more favorable than at any time since the war except for 1946 and 1947 (a period still reflecting the after-effects of price control), or than any time in the pre-war era save 1929-31.[1]

A recomputation of the 1968 figure (preliminary at the time of the study) and the addition of another year confirms this finding. The favorable trend continued through 1969. This has undoubtedly contributed to the high level of investment, though how much no one knows.

Acceleration of Employment Growth

We come now to the last, and in our opinion by far the most important, of the factors under review, the increase in the growth rate of private employment. Here something unique *did* happen around 1965, something, moreover, with major impact on investment requirements. We refer to the arrival on the labor market of youths born in the postwar "baby boom." This produced a sudden and drastic increase in the growth rate of the labor force and a parallel increase in the investment required to equip the added workers with the tools of production.

[1] *Capital Goods Review* No. 75, September 1968.

In the period 1947-64, the private labor force (total labor force minus government employees) grew at an average rate just under 1 percent per annum. For the following 5 years, the rate was nearly 1.6 percent.[1] During this period the average annual increment to the private labor force was larger by 375,000 workers than it would have been if the 1947-64 growth rate had been continued. Since the fixed-asset investment required to equip an additional worker averaged around $15,000 for the period, the added investment required by this factor approached $6 billion a year.

But this is only part of the story. The 1965-69 investment surge did more than equip these additional members of the labor force. Unemployment was reduced sharply during the interval, yielding a further increase of more than 250,000 workers a year over and above the augmented labor-force growth. Applying the $15,000 per-worker investment figure to the sum of the two, 625,000, we get an incremental investment requirement of more than *$9 billion a year.*

It is interesting to note that this estimated contribution to the capital requirements of 1965-69 accounts for three-quarters of the amount to be explained. For the excess of investment for this period over what would have occurred with the continuance of the 1947-64 investment ratio (12.8 percent of corporate gross product) averaged $12 billion a year.

IV. IMPLICATIONS FOR THE FUTURE

This review of five factors contributing to the unprecedented investment level of 1965-70 raises significant questions for the

[1] It is too early in the year to include 1970 in the labor-force and employment calculations, hence in this case we cover only 1965-69.

future. Which of these supports is temporary, or nonrecurrent, and which can be expected to continue? Suppose we take them up in order.

1. As for inflation hedging, the answer obviously depends on the success of anti-inflationary policy. If the current inflation is brought under control, the hedging incentive will disappear. If not, it will remain. Even if it remains, however, it does not follow that the response will continue undiminished. For the borrowing of future investment requirements to avoid price increases cannot be extended indefinitely. It may be economic to anticipate next year's requirements, but not those of the second year hence, much less those of the third. Once next year's have been covered, the pace necessarily slows to the rate at which investment opportunities accrue. Unless we encounter *accelerating* inflation—in which case the borrowing horizon will be extended—this factor can be largely discounted for the future.

2. The case is different for the second factor, accelerating technological progress. Assuming the rate of acceleration increased in the 1965-70 period, thus contributing to higher investment requirements, there appears no clear reason why the process cannot continue, at least for the next few years.

3. The stimulus from soaring wage rates, like that from inflation hedging, depends on the success of anti-inflationary policy. Only if the policy fails will this factor make more than its normal contribution to investment incentives (wage rates rise in a noninflationary economy, of course, but at a slower rate). Even if the recent rate of advance continues, however, it is questionable (barring an *acceleration* of the rate) whether the exceptional stimulus will be long sustained. For here also the anticipation of expenditures that would normally be made later cannot continue to bite farther and farther into the future.

4. As for the recently and currently favorable relation between equipment prices and labor costs, the answer turns on prediction. Will the relation be maintained, improve, or deteriorate? We have no prediction to offer; in any case, this does not seem likely to be a major factor either way.

5. Finally, what of the factor that apparently dominated the picture in the recent period, the accelerated growth of private employment? While the gain to employment over the interval from the reduction of the unemployment rate cannot be sustained in the future (it was made possible by the fact that the period started with a soft labor market), the increased growth rate of the private labor force itself will continue. Current estimates have it averaging 1.7 percent annually, slightly higher than the average rate for 1965-69. If the latter added $6 billion a year to investment requirements, the former should add say $7 to $8 billion a year over the near future. Here, at least, is solid support for higher investment ratios in the future than prevailed before 1965.

Adding this up, we come out with the conclusion that corporate investment requirements are going to be substantially higher hereafter in relation to the volume of business done than in the pre-1965 period. Even if the first four factors we have cited as contributing to the extraordinary investment ratios of recent years are collectively neutral in the future—surely an ultra-conservative assumption—the continuance of the higher rate of labor force growth should create a new normal ratio well above the 12.8 percent average of 1947-64. If we make a more realistic assumption for these other factors, allowing them a net stimulative impact as compared with 1947-64, the case for a new normal becomes even stronger.

The Problem of Financing

If future capital investment requirements do prove to be higher relative to the gross corporate product than in the pre-1965 era, the question presents itself how the extra investment can be financed. One thing is clear. Unless internal funds are also higher relative to this product than in the 1947-64 period, they will fall short of fixed investment, instead of equaling it as they then did (on the average).

The chances that the internal-funds ratio will be higher are not bright. The federal government has recently terminated the investment tax credit. In addition, the shortfall of income tax allowances for capital consumption (consumption of fixed assets and inventory) from adherence to historical costing is already greater relative to the gross corporate product than the 1947-64 average, and is rising.[1] This means a relatively greater taxation of capital consumption as income, to the detriment of retained earnings. It seems likely that the ratio of internal funds to gross product will range below, rather than above, the base-period average.

This raises the question whether the prospectively enlarged corporate requirements for outside funds, in conjunction with what promises to be a greatly expanded aggregate demand by other claimants—unincorporated business, the housing industry, consumers, and governments—will place the capital market under pressure. If it does, as we suspect it will, the American economy will confront the choice either of cutting the investment garment to fit the financial cloth, at the cost of slower progress than it would otherwise make, or of finding some way to augment the supply of capital funds.

[1] See the recent MAPI studies *Underdepreciation From Inflation—A Ghost Returns* (1969) and *Inflation and Corporate Profits* (1970). In dollar terms, the shortfall was over $11 billion in 1969.

If the second alternative is chosen, two principal approaches stand out. (1) Means can be found to increase the internal funds of the corporate system. (2) The federal government can run a sizable budget surplus, thus feeding additional funds into the capital market through the retirement of its own obligations. These approaches are not, of course, mutually exclusive; both can be used.

Unfortunately, as we have just pointed out, recent actions (and inaction) by the federal government have done nothing to augment corporate internal funds. Moreover, the sizable budget surplus is nowhere in sight. We submit that the problem of capital supply in the seventies is of vital national concern, and that it deserves intensive study. It should be high on the agenda of public policy planning.

THE NATIONAL ASSOCIATION OF MANUFACTURERS

The National Association of Manufacturers appreciates the opportunity of presenting to Congress, at this critical time, its views on the economic situation of the Nation and on the recommendations made in the administration's economic reports.

It is clear that the whole basis for the formulation of national economic policy has needed a thorough reappraisal. The assumptions, attitudes, and theories which guided policymaking through much of the 1960's appeared for a while to be highly successful in producing economic growth. But our experience in the last 2 or 3 years of that decade indicates that the growth so produced was neither balanced nor sustainable. We will need to reconsider, not merely the details of the economic policies pursued, but the underlying principles which, explicitly or implicitly, have served as guides to policymaking.

The National Association of Manufacturers believes that the 1970 Economic Reports of the President and of his Council of Economic Advisers provide the basis, at least in embryo, for a new style of economic policymaking. We believe that if the approach outlined in these reports is refined, developed, and implemented, it will lead to an era of more balanced, more sustainable, and generally more satisfactory economic growth in the 1970's.

Among the qualities called for at this juncture are patience and a recognition of the limitations both of our economic wisdom and of the Nation's economic resources. Our present troubles are the result of behaving, in the 1960's, as though both wisdom and resources were limitless. We have suffered from the illusions that we possessed the skill to turn the economy quickly and painlessly whenever desired, and the productive capacity to provide for whatever new Government programs sounded good.

Patience, and a new realization of our limitations, must be combined with a very positive virtue: A strong determination to stick with economic policy decisions despite occasional setbacks and despite the criticism of those who insist that "there must be a better way"—although their notion of what the better way is seems to change from one day to the next. This combination of qualities is what wins long campaigns—and the campaign against inflation will be a long one—by contrast with the spectacular recklessness that occasionally wins a minor skirmish.

Economic Policy for 1970

The report of the Council of Economic Advisers recommends a moderate posture for both fiscal and monetary policies in 1970. In the fiscal area, this is described as implying a modest surplus in the unified budget in fiscal 1971. For monetary policy it is taken to mean a rate of monetary expansion somewhere between the highly expansionary rate of 1967–68, and the highly restrictive rate of the last half of 1969.

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The National Association of Manufacturers endorses this general approach to fiscal and monetary policies for this year. In fact we believe that it would be a good guide to the desirable national fiscal and monetary posture for many years into the future. The notion that economic technicians have become skilled enough to prescribe wide deviations from middle-of-the-road fiscal and monetary policies to meet the particular economic problems of particular years, has been exploded by the experience of the past half decade.

In presenting this recommendation the Council of Economic Advisers comments that: "Not enough is known about the relative influences of fiscal and monetary factors to preclude the possibility that one or the other may be heavily dominant (in 1970)." Hence, their belief that a moderate posture in both fields is called for.

The NAM applauds this salutary recognition of the limits of knowledge. One of the problems of the 1960's was that we knew so many things about economics which turned out not to be so.

Along with its recommendations, the Council of Economic Advisers presents its views on the probable course of economic developments in 1970. It foresees that, during the first half of the year, there will essentially be no growth in real output but that, in the second half, there will be a resumption of growth although at a noninflationary rate.

No one can be certain that this will in fact be the pattern of economic events in 1970, although it is a reasonable expectation. The important point to be made at this time is that the soundness, or unsoundness, of the Council's policy recommendations should not later be appraised in the light of whether its forecast turns out to be correct. The limitation on our ability to forecast is itself an important factor to be taken into account in framing national policy. In itself it is a reason for adhering to moderate middle-of-the-road policies, and avoiding extremes.

The Council's prescription for a modest budget surplus, and moderate monetary restraint, is of course subject to a certain range of interpretation. It leaves room for continuous debate during the year.

We do not, however, believe that the health of the economy necessitates pinning budgetary or monetary objectives down to the last decimal place. We do know, well enough, when fiscal and monetary policies are not moderate, and not restrained. No one would describe the deficits of fiscal 1966, 1967, and 1968 as moderate. And no one would call the expansion of the credit base in 1967 and 1968 a moderate monetary policy. Avoiding a repetition of what happened during those years is more important than reducing present objectives to precise statistical terms.

There has been some criticism of the administration's stance on the ground that moderate restraint hasn't been effective so far, and that therefore we should aim at more extremely restrictive monetary and fiscal policies. Accordingly, some have urged that we should seek, in fiscal 1971, not a "modest" surplus but a very large surplus. And the objective in monetary policy should be, not "moderate" restraint but very severe restraint.

But it is questionable whether such extreme measures would be really effective in leading to a period of economic stability. Neither fiscal nor monetary extremism is a stance which can be maintained indefinitely—presumably no one would argue that they should. Hence they lead to continuous speculation as to when they will be modified or reversed. This speculation is itself a source of economic instability. What is needed is not policies which are extremely restrictive, but policies which are persistently restraining. These must be policies which create public confidence that they can and will be adhered to for a long time, rather than public anticipation that they must be changed shortly.

Economic Policy Beyond 1970

In the text of the Report of the Council it is argued that, after 1970, "* * * at some point it will be necessary that output should rise somewhat more rapidly than potential for an interval. This would be the only way for actual output, starting below potential, to regain the potential."

The difficulty with such a thesis, as a guide to national economic policy, is that there doesn't seem at present to be any solid basis for determining precisely what "economic potential" will be. The concept is a vague one and not well adapted as a basis for policymaking. We regret that this ill-defined and misleading term is used once again in a basic economic document.

Presumably, "potential output" is intended to mean the total output the economy is capable of, without generating inflationary strains. Recent experience should warn us that we do not have any basis for estimating this in precise statistical terms. One of the underlying causes of inflation in the 1960's is that policy was guided by unrealistically high estimates of the economy's possibilities.

In an appendix, the Council does present a statistical chart giving projections of both actual and potential GNP through 1975. In reading this, it is surprising to learn that: "Potential output is considered to be the output the economy would produce when operating at a 3.8 percent unemployment rate." No analysis is presented to support this as a realistic basis for estimating potential. In the light of recent history it seems likely to understate the level of unemployment consistent with stable growth.

It may be that this computation is intended to be merely illusrative, rather than to be a precise guide to future economic policymaking. It would be unfortunate if, in future years, it were felt that fiscal and monetary policy should become stimulative whenever unemployment remained above 3.8 percent for more than a brief period.

The suspicion that this might be the intention of the Council's computation could renew inflationary psychology even at present. We simply do not have any basis for believing that 3.8 percent unemployment represents the dividing line between the overutilization and the underutilization of manpower resources.

If we seem to be making much here of a figure casually introduced in an appendix to the Council's report, it is because it could rise to haunt economic policy discussion in future years. It does not seem to be consistent with the well-balanced and informative discussion of unemployment in appendix A of the Council's report.

Fiscal Policy

The National Association of Manufacturers believes that a balanced budget is one important criterion for sound economic policy, both for 1970 and for the indefinite future. Some reasonable leeway may be allowed, but the belief that the deficit or surplus should be systematically varied from year to year, in response to expected economic changes, ought to be abjured. Although it might seem that in principle such an approach ought to assist in achieving stable growth, in practice it has contributed to instability.

But budget balance is not the only criterion for sound policy. The level of expenditures and receipts at which balance is achieved makes an important difference to the economy. As we learned in 1968 and 1969, balancing the budget by increasing taxes is not the most effective way of suppressing inflation. Temporary tax increases have been discredited as an anti-inflationary device. Taxpayers did not reduce their expenditures in response to such tax increases, to the extent that had been expected.

For this reason we are pleased that the administration was able to present a balanced budget for 1971, without proposing a further extension of the temporary surtax, and without calling for new taxes to take its place.

The preparation of such a budget was a remarkable achievement, but living within it will be an even greater accomplishment. We urge that Congress should regard the task of keeping total expenditures down to the amount estimated in the President's budget a primary objective for this year.

The distribution of the tax burden as between different taxpayers also has important economic consequences. We believe that the shift of tax burdens resulting from the Tax Reform Act of 1969 will create problems that will have to be dealt with in the future.

Whatever the justification may have been for any of the particular provisions of the Tax Reform Act, its end result was to transfer some $6 billion of annual tax burden from individual taxpayers onto business. This massive shift is certain to be an impediment to capital formation and to economic growth in the future. It comes at a time when it is especially important to support capital formation, in order to equip our rapidly growing labor force and to help suppress inflation by supporting gains in productivity.

We urge that for some time Congress will have to be especially conscious of the pressing need for providing a better tax climate for investment. This can be done through reduction in the corporate tax rate, liberalization of depreciation, and other measures. The need for such steps is another reason why strict control will have to be kept on the growth of Federal expenditures.

Monetary Policy

There is much debate at the moment as to whether, and when, the Nation's monetary authorities should modify their highly restrictive stance, to counteract the economic slowdown which is developing. The impression one might get is that a precise sense of timing is all important to the success of monetary policy.

Yet, in retrospect, it is clear that the financial troubles of recent years have not been due to any excessive caution, delay, or hesitation in altering the direction of monetary policy. The reverse seems to have been true—we have seen quite frequent and quite drastic changes in this area. Thus we observe that, in 1968, money supply (including time deposits) increased by 9.4 percent—far greater than any attainable rate of increase in the level of real economic activity. During the next year, 1969, policy went to the opposite extreme—money supply actually fell, by 1.4 percent.

This is merely illustrative of the abrupt changes in monetary policy which have occurred at critical times. And it is perfectly clear that these changes have as often been in the wrong direction as in the right one. The point is hardly debatable, since even the Federal Reserve Board Chairman acknowledged last year that the swing toward expansionary monetary policy after mid-1968 was a grievous mistake.

Our conclusion is that less time and energy should be spent in debating precisely when a swing should be made between restrictive and expansive monetary policy, and more in preaching the virtues of a steady middle course. We believe that this attitude toward monetary policy is implied in the statement, in the President's Economic Report, that "* * * we must achieve a steadier and more even handed management of our economic affairs." The National Association of Manufacturers endorses the application of this principle to the management of the nation's monetary system.

One other point should perhaps be clarified. The present high level of interest rates is sometimes represented as being the result of the Government's stringent efforts to get the inflation under control. This implies that if only those efforts could be relaxed somewhat, the crushing burden of interest rates would be eased.

The very opposite is true. High interest rates are the lingering effects of the inflation itself, rather than of the measures taken to control it. When the expectation is that loans will be repaid in cheaper dollars, lenders require—and borrowers are willing to pay—a premium in the form of higher interest charges. Those who are concerned with the well-being of homebuyers, and others who have to pay interest charges, should support firm adherence to a program for getting inflation under control.

Incomes Policy

Since about the beginning of 1969, both monetary and fiscal policies have been adapted to a position which seems calculated to get the excess demand out of our economy. This has finally produced a slowing down in the pace of economic activity generally. It has not, however, so far resulted in any visible moderation of the rate of price increase.

This leads many observers to argue that "there must be a better way." The better way they usually turn to is some form of what is loosely known as "incomes policy."

Incomes policy is regarded as including not only legislated wage and price controls, but such devices as wage-price guideposts, a temporary "freeze," moral suasion, voluntary restraints, etc. These devices are often advocated but seldom clearly defined.

It is hard to believe that those who advocate a "freeze" of wages and prices can intend the term in any literal sense. It would imply, for example, that, in any industry where a large wage increase had been granted just before the date of the freeze, it would remain in effect. But in an industry where wage negotiations were to be conducted shortly after the date of the freeze, any wage increase whatever would be forbidden. A universal freeze would be a most discriminatory device.

Clearly any such naive approach would be impossible. This means that an administrative body has to be set up to distinguish between increases that are justifiable, equitable, and economically sound, and those that are not. We would be in the nightmarish position of having to establish a huge bureaucracy which would make all wage and price decisions for our economy. Whenever we have tried that in the past it didn't work. The only reason it didn't totally destroy our economy was that the bureaucracy wasn't large enough or efficient enough to cover all the ground it was supposed to.

The National Association of Manufacturers is encouraged to find that the administration has consistently opposed such interventionist devices as a cure for inflation. We urge that Congress support the administration in that approach.

The Price Outlook

The central question on everyone's mind is: When will this inflation come to an end? Some observers have even concluded that all efforts to end it so far have been a failure, since the upward price trend hasn't slowed perceptibly. The advocates of continuing efforts along the present lines are challenged to forecast just when the moderation of price trends will occur.

The National Association of Manufacturers endorses the program of fiscal and monetary restraint outlined in the administration's economic reports as the correct way of dealing with inflation. We do not believe that the validity of the program depends on the ability of its advocates to predict with precision how and when it will affect price trends.

The fund of wisdom available in the economics profession is not of a kind that permits making such forecasts with any confidence in their exactness. The proper answer to the question—when will the annual rate of price increase be reduced to, say, 2 percent—is, simply, that we do not know.

But there are certain things that we do know, from past experience, about inflation. First, we know that it never occurs unless it is initially fueled by Federal deficits and excessive monetary expansion. Second, we know that inflation gathers momentum, and hence continues for a time after the supply of fiscal and monetary fuel is cut off. Finally, we know that this momentum does not last forever—the inflationary flywheel ultimately comes to rest.

These lessons from experience indicate that the administration's program for getting inflation under control will be successful. They also suggest that the process will be a slow one and the time of its completion cannot be exactly predicted.

This is the situation we are in, and it will call for high qualities of economic statesmanship in Government leaders. It will call for perseverance, firmness, courage, patience—and imperturbability while we wait for antiinflation measures to have their effect. It will call for resistance to the tempting panaceas which will be offered with the claim that they can solve the problem overnight.

SUMMARY

To summarize this Association's comments on the recommendations on economic policy contained in the President's Economic Report:

1. We strongly support a "moderate posture for fiscal and monetary policies" in 1970, as described in the administration's economic reports. Furthermore, we believe that such a posture will remain appropriate in future years, and can hardly ever be inappropriate.

2. We question whether 3.8 percent unemployment is a realistic standard for calculating potential output in years after 1970. It is our fear that such a standard could mislead the Nation in the formulation of economic policy, and might result in a premature turn toward stimulative fiscal and monetary measures.

3. Temporary tax increases, as a means of avoiding Federal deficits, have proved an ineffective device for restraining inflation. We urge that Government carefully avoid the necessity for using such measures in the future. They are no substitutes for the control of Government spending.

4. To support long-term economic growth, some relief will have to be granted from the increased load of taxes on business resulting from the Tax Reform Act of 1969. This is a further reason for stressing the importance of restraining the growth in Government spending.

5. In monetary policy, wide swings between expansion and restraint, as occurred in 1968 and 1969, should be avoided.

6. High interest rates should not be blamed on policies adopted to control inflation but on the inflation itself.

7. Wage and price controls, a wage-price "freeze," and similar devices, are not effective in the control of inflation but are seriously disruptive to the functioning of our economy. We most earnestly urge that Congress not turn toward antiinflationary panaceas of this type.

The kind of approach to the problem of dealing with inflation that is outlined in the President's Economic Report cannot offer any promises of spectacular, quick, or painless success. It cannot even make any predictions—expect as very rought guesses—as to when its intended result will finally be achieved. We believe that it is, nevertheless, the only sound program to follow.

NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS

By DR. GROVER W. ENSLEY, *Executive Vice President*

ECONOMIC ISSUES FACING THE NATION AND A PROGRAM FOR MUTUAL SAVINGS BANKING

A decade closes. A decade begins. Massive social and economic problems remain. Indeed, they have become even more pressing, particularly with respect to—

Inflation,
Financial strain and imbalance,
Urban decay and unrest, and
Housing shortages.

These complex, interrelated problems reflect an economy—even one as wealthy as ours—straining to meet vast public and private demands, while engaged in a military conflict of significant dimensions. The resolution of these several problems requires a mix of both short and long run policy measures.

SHORT RUN POLICY OBJECTIVES

There is widespread agreement in both the private and public sectors of the overriding need to dampen inflation and inflationary expectations. This issue need not be labored here. The savings bank industry was among the first to urge vigorous and persistent efforts to restrain an overexuberant economy when signs of increasing stress appeared in mid-1965. The administration merits high marks for its continued resolute anti-inflationary posture.

In particular, savings banks applaud the President for presenting a balanced budget—indeed a modest surplus—for fiscal 1971. This is absolutely essential to the anti-inflationary fight and represents the highest economic statesmanship in view of strong pressures for increased and worthwhile Federal spending programs. The dangers of recession resulting from an overly restraining monetary/fiscal posture cannot be discounted, and there will be a maximum premium on flexibility. But the danger of premature ease is greater, in our judgment, than overly long restraint. Inflation must be stopped!

At the same time, it is clear that vigorous and extended anti-inflation measures, effected especially through a severely stringent monetary posture, have fallen with an uneven hand on the economy. Most cruelly burdened has been the housing sector in which shortages of supply are now severe—particularly for low- and moderate-income families. The Nation is, in fact, facing a housing crisis as reflected in President Nixon's statement of January 21, 1970:

> Housing * * * (is) bearing a disproportionate burden of both current inflationary pressures and the anti-inflation measures instituted to restore price stability * * *. The continuing decline in housing production, the outflow of funds from savings institutions supporting the housing market and the drying up of traditional mortgage sources are contributing to a serious housing shortage * * *.

The immediate dilemma facing Federal policymakers, therefore, is how to continue the anti-inflationary battle without further severely depressing housing or bringing on a general business recession. It is abundantly clear that when monetary policy becomes overly restraining, to compensate for less than adequate fiscal restraints, interest rates are driven up, mortgage-oriented institutions are unable to compete for funds, and housing credit dries up. An overriding requirement of public policy, therefore, must be to place more of the burden of restraint on Federal tax and expenditure policy. This will permit a less restictive monetary posture, lower interest rates, and a more even sharing of the burden of anti-inflation policies among housing and nonhousing sectors of the economy. This and other policy recommendations have been previously urged by the savings bank industry and others, and need only be summarized here:

Maintain the Federal budget in surplus until the current inflation is brought under control. If necessary, extent the 5-percent surcharge beyond midyear to accomplish this crucial objective.

Permit a gradual easing in monetary restraint to lessen financial strain and provide an appropriate environment for expanding mortgage and housing markets.

Reorder national priorities in a conscious effort to reduce Federal expenditures in some low-priority areas and increase them in more critical areas like housing and urban revitalization.

Move as rapidly as possible to continue to issue mortgage-backed securities to attract non-mortgage-oriented inititutions as a supplement to traditional sources of mortgage credit.

Explore new policies to encourage overall saving as the strongest bulwark against persistent inflationary tides.

LONGER-RUN POLICY OBJECTIVES FOR A MORE VIABLE THRIFT INDUSTRY IN THE PUBLIC INTEREST

While pursuing shortrun policies to combat inflation and support sagging housing markets, longer run policies to bring about needed structural change in our economy need also to be pursued. We are pleased that, in his economic message, the President emphasized long-range planning by noting that:

> We have learned that 1-year planning leads to almost as much confusion as no planning at all, and that there is a need to increase public awareness of long-range trends and the consequence for future years of decisions taken now.

In this respect, there is a compelling need to program now for changes in the Nation's financial structure to serve better tomorrow's economy. Within the financial structure, the thrift industry is anxious to expand its role and increase its effectiveness in the broad public interest. In essence, we seek to become "full service family banks" designed to serve individuals and families with the complete package of financial services they require over their entire economic life cycle.

Basic structural changes and the new competitive environment which have emerged and intensified in recent years have made it increasingly difficult for savings banks to function effectively in their traditional thrift and residential financial areas. At least three major developments may be cited:

The emergence of commercial banks as vigorous, no-holds-barred competitors for individuals' savings within a framework of greatly expanded consumer services.

The high and often rapidly rising interest rate structure, which has placed thrift institutions at a competitive disadvantage, because of their locked-in, long-term portfolios and reduced savings flows. The result has been a lagging rate of earnings gains compared with competitors able to turn portfolios over more quickly and acquire higher yielding investments.

The recent enactment of Federal tax legislation, substantially increasing savings bank tax liabilities and internal cost structures, thus further impairing the industry's competitive ability.

These developments have reinforced the need for restructuring the thrift industry to permit a broadened and more flexible package of assets, liabilities, and services to consumers. Otherwise, lagging earnings from limited lending powers and narrow services for individuals and families will keep the thrift industry at a disadvantage.

Some competitive insulation has been provided by a differentiated structure of Federal ceilings on deposit interest rates. Reliance on such controls, however, is hardly a basis for long-range industry growth and effectiveness. It is probable that interest rate ceilings will be put on a standby basis in the not distant future. In any event, it is inconsistent with the savings bank industry's traditional support for free competitive markets to favor controls in other than emergency situations. Moreover, interest rate controls provide no protection from savings shifts to high-flying securities in the capital markets, and disintermediation has become a commonplace word and occurrence in the thrift industry.

At the risk of being repetitive, it bears reemphasis here that the savings bank industry does not like high interest rates. The record is clear that mutual savings banking is seriously hampered in its ability to serve the financial needs of individuals and communities when interest rates are high and rising. During such periods, savings bank earnings lag behind those of other financial competitors, and deposit flows decline sharply as savers seek higher yields available on open-market securities.

Thus, over a decade ago when the Treasury issued the "magic 5's" of 1959 in a climate of high and rising rates, savings bank deposit growth fell by 47 percent from 1958. And in 1966, when the economy was again under severe financial strain and interest rates in the open market were probing new highs beyond the 6 percent level, savings bank deposit gains dropped by almost 30 percent from the preceding year.

These adverse experiences were more than matched last year and in early 1970 when interest rates reached the 8 to 9 percent areas. During 1969, for the first time in decades, savings banks actually experienced net deposit outflows (excluding the crediting of interest) of $753 million. And in January and February 1970, severe adverse deposit experience continued in most savings bank areas.

The savings bank industry has, therefore, long been acutely aware of the seriously harmful impact high interest rates have on its competitive viability, on its deposit structure, and hence on its ability to provide housing credit for American families. Savings banks function most effectively and usefully when interest rates are relatively low and stable. In such a climate, the industry is able to offer competitive rates to depositors, relative to those on open-market securities, and thus generte a substantial flow of funds for housing credit at relatively low rates to borrowers. As mutual institutions, savings banks are not out to maximize earnings for a limited number of stockholders, but rather to maximize the financial welfare of savers, of individual and families who require mortgages and other types of personal credit, and of the local communities in which we function. Savings banks, therefore, impatiently await the return to better balanced financial markets and lower interest rates.

The need for broadened powers.—The case for broadened and more flexible thrift industry powers has been well established over the past decade, not only in detailed NAMSB reports and studies, but also in several independent and objective private and governmental studies. Most recently, the need for basic structural change has been reaffirmed in two important studies by leading academicians, Prof. Leo Grebler of UCLA and Irwin Friend of the University of Pennsylvania. The Friend study was conducted under the official auspices of the Federal Home Loan Bank Board through a congressional authorization.

Both of these studies, independently pursued, concluded that greater diversification of assets and liabilities would be consistent with both public needs and the private interests of the thrift industry. It is important to stress, as did Dr. Grebler, that broadening of industry powers and services can be accomplished—

> within the traditional functions of thrift institutions [in a framework] that would preserve their distinctiveness. The mission of savings associations and savings banks has always focused on the family or consumer unit; the more diversified operations considered in the study would be consistent with this emphasis but adjust them to modern needs.

It is becoming increasingly difficult for the thrift industry to operate with a balance sheet which promises instant liquidity to many depositors from a basically illiquid asset portfolio—the basic problem of institutions which borrow short and lend long. Broadened and more flexible powers are vitally needed to improve the liquidity structure of savings institutions and increase their earning power more rapidly in periods of rising interest rates. Thus, competitive viability will be improved, permitting a larger and more stable flow of residential mortgage credit.

We agree completely with the statement in the annual report of the Council of Economic Advisers that:

> The demands on our flow of national savings * * * will be heavy in the years ahead, and our financial institutions and financial structure must have the flexibility that will permit a sensitive response to changing demands.

The savings bank industry recognizes that the administration and the Congress will want to examine directly ways and means of restructuring the Nation's thrift industry to achieve greater flexibility. We welcome, therefore, the announcement by President Nixon in his recent economic message that he will establish a Commission on Financial Structure and Regulation. We urge that the Commission, building on the foundation already laid in the several exhaustive studies conducted over the past decade, complete its findings expeditiously, so that the administration and the Congress may move ahead in this critical area.

For consideration by the new Commission, and by Federal agencies as well, a condensed outline of an ideal structure of a revitalized thrift industry serving individuals and families is presented below. Its general format has the widespread support of the savings bank industry.

The packing of thrift services.

The widest possible variety of regular and special type deposit accounts.

Savings bank life insurance.

A form of equity participation by depositors.

The package of credit services.

Home mortgage loans, including loans on mobile homes.

Urban revitalization loans.

Consumer loans.

Education loans.

The convenience and service package.

Money transfer accounts, including checking accounts and credit card services.

Trust services.

Financial counseling.

Broadened branching powers.

The package of investment outlets.

Income property mortgage loans.

Equity investment in real estate.

All major types of corporate and governmental securities and investments.

A dual system of chartering and supervising for mutual savings banks.

The broadened concept of savings banking, reflected in this brief outline of powers and services, does not represent a departure from the fundamental purposes and objectives the industry was organized to achieve. On the contrary, it is fully consistent with the origins and traditions of the industry, while being relevant to the needs of the times.

A more viable, more competitive, savings bank industry can be achieved only through new State and Federal legislation. Savings banks have made significant advances on the State legislative front in recent years. While continuing to pursue broadened and more progressive State legislative action, the industry is convinced that a Federal alternative—long available to commercial banks, savings and loan associations and credit unions—is also essential for mutual savings banks. Savings banking remains the only major type of deposit institution without access to dual Federal and State charters.

Industry efforts to achieve dual charter status over the past decade have been supported by all segments of private mortgage, housing, and real estate groups, by the former administration, by a bipartisan majority of the House Banking and Currency Committee in the last Congress, by Congressmen from both parties and by academic study groups. Hopefully, the results of the new Presidential Commission on Financial Structure and Regulation will provide the basis for support by the administration of the savings bank industry's dual charter objective.

Not only will a Federal alternative protect against possible arbitrary, discriminatory, or outmoded State supervisory policies, but also will provide the most expeditious means of establishing strong family-oriented thrift institutions throughout the Nation. The savings bank industry earnestly seeks the guidance and assistance of the administration and the Congress in developing Federal legislation which will assure the viability of the savings bank industry in the interest of contributing more effectively to the resolution of urgent economic issues facing the Nation.

NATIONAL FARMERS ORGANIZATION

By JOHN W. APPLEGATE

I have been invited to submit a statement on the economic issues facing the Nation for members of your committee to consider. Being a farmer, my statement is on agriculture and deals with efficiency and its resulting effect on the economy when applied against our cheap food policy.[1]

The first 20 thousand meals we eat are free but when we get married and must pay for our own food the shock is so great it prevents us from playing fair with its producer. This may be the reason the Government's cheap food policy is so politically popular. However, always an easy mark in any con game the farmer's problem is still more or less of his own making. Even during the first thousand generations of man's existence the farmer as a hunter furnished all of the people's food free. His standing in the community depended on his ability as a hunter and the people took advantage of this by preparing feasts in honor of the best hunters.

This con game is still going on today. Giant corporations hail the farmer as the most efficient man on earth. Food is still prepared in his honor and he is given all expense paid trips until, like the hunters of long ago or the bragged-on 8-year-old boy, he outdoes himself.

The U.S. farmer has been taken in so by efficiency, that for the last 16 years he has paid for the privilege of producing his nation's food. His debts have gone up from $16.2 to $57.1 billion (source—President's Economic Report). Efficiency as it is practiced on the farmer today, is not only destroying him, but it is destroying his nation. Economists now concede that the Government's 16-year-old cheap food policy contains the perfect formula for economic disaster. To sell any product for less than its true value does harm to the economy but, to do so to the Nation's largest industry for 16 years, and the common man pays interest on $1½ trillion. (The borrowed money used to stave off depressions. Also our operating losses.)

We are much in need of a different approach. Efficiency alone in agriculture is not the answer, or in other words, if he has done nothing about pricing his production the pride felt by "The Farmer of the Year" cannot be justified.

For his and for his nation's well-being the U.S. farmer is in need of statesmanlike help and guidance.

[1] CPS—Cost price squeeze.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

By Wilson S. Johnson, *President*

We appreciate your February 10 invitation to comment, on behalf of our 277,000 individual smaller, independent business firm and professional enterprise members who are broadly representative of the small business sector of our economy, on the President's recommendations to Congress in his February 2 Economic Report.

We agree with the stated overall goal, that of achieving a soundly based, balanced growth. We agree that this necessarily involves steps to curb inflation. But we are profoundly disturbed over what seems to us to be the disproportionate share of the burden for combating inflation that is being borne by small business.

Our news media today feature prominently reports of a slowing of the rate of growth, if not actual cutbacks, in the large business sector. Yet according to 3-month moving average numbers drawn from our continuing economic survey of our members, small business has been feeling such pains for almost 1 year.

For instance, upward trends in small business sales volume peaked out in early 1969, and even in face of continued inflation drifted downward. Against this, the cost of goods, even though near the ceiling, maintained a steady climb. While the cost of labor has not been accelerating as rapidly as formerly, during this period small business has been slowing its additional job creation. Though receivables have been declining, they have been doing so during a period when collections have steadily become slower. And throughout this period there has been reported a steady rise in average bank interest rates on borrowings within the past 6 months of each survey reporting period.

In plain language the fact is that small business generally has, during the past year, been subjected to a steadily intensifying financial squeeze. We cite here a representative cross section of comments received from survey respondents:

Eastern manufacturer.—11-plus years old, \$50,000–\$99,000 yearly volume, three employees: "Burden of present tight money seems to be on small manufacturers. We sell primarily to big businesses, businesses who 'raise money' by paying bills slower. Small manufacturers who pay higest borrowing costs are really being squeezed."

Midwest radio-TV retailer.—4–10 years old, \$100,000–\$199,000 yearly volume, four employees: "Due to high interest rates and tight money our business was down 22½ percent during 1969."

Western retailer.—11-plus years old, \$200,000–\$500,000 yearly volume, five employees: "With the cost squeeze as it is, there will be few people left in the farm implement business. After paying wages, social security, insurance, workman's compensation, business inventory tax, there is no reason left to invest money because the return is less than can be had even in Government bonds."

Midwest manufacturer.—11-plus years old, $500,000-plus yearly volume, 145 employees: "We are finding great difficulty in maintaining good sound dollar volume in our operation, which is geared to the building industry. The decline is resulting basically from the tight money market."

Western retailer.—4–10 years old, $100,000–$199,000 yearly volume, 14 employees: "One of the biggest drawbacks I have found in the past year is lack of financing. My business is on the threshold of a boom and I yet haven't been able to come up with necessary financing. The SBA has guaranteed a 90-percent loan of $50,000 and yet they claim no money on their own, and no lending institution will go the route. So I look forward to reducing my inventory, releasing employees, and pulling in my ears."

"Compared with last year," proportion of respondents reporting—	Average—			3-month moving average numbers		
	1968	1969	To date, 1970	January last year	December 1969	January 1970
Employment higher	5.32	53.8	53.7	54.5	53.7	53.7
Sales volume higher	66.4	69.1	68.3	70.6	68.1	68.1
Inventories higher	65.7	(1)	70.6	(1)	(1)	(1)
Receivables higher	63.8	65.3	65.9	65.7	65.7	65.7
Collections faster	37.6	37.7	35.8	38.8	36.4	35.9
Goods cost higher	96.0	97.1	97.3	96.4	97.5	97.4
Labor cost higher	(1)	88.0	89.1	90.3	88.4	88.8
Prices-fees higher	83.0	84.4	88.0	83.1	84.8	84.4
Interest charges (percent) (banks)	(1)	7.7	8.5	7.0	8.4	8.5

[1] Indicates data not comparable.

Explanatory note.—Monthly numbers from which these 3-month moving average numbers are constructed are derived on the following basis: from each pertinent survey question admitting of (compared with last year) answers either "higher," "same," or "lower," the sum of all answers is divided into the sum of all "higher" responses plus one-half all "same" responses.

NATIONAL FEDERATION OF INDEPENDENT UNIONS

By Don Mahon, *Executive Secretary*

My name is Don Mahon. I serve as president of the National Brotherhood of Packinghouse & Dairy Workers and national executive secretary of the National Federation of Independent Unions.

We present herewith our comments with reference to certain issues and recommendations related to the President's Economic Report.

It is our intent to emphasize factors considered to be of concern to all Americans as well as seriously affecting the welfare of members of our organizations.

The President's statement that: "One year planning leads to almost as much confusion as no planning at all" is most appropriate as applied to many of both the social and economic problems facing all of us. The evident alternative is longer range planning plus the necessary incentives that will encourage all concerned citizens to follow through with their endorsement. This must be backed up with their fiscal and moral support, too.

Our experience in this regard, as union representatives, has demonstrated the advantages of greater stability resulting from union contracts of more than 1 year's duration. However, we have found that when bargaining with corporation officers, and ofttimes most members of their boards of directors, whose job security depends almost entirely on the dividends they are able to declare at the end of the current fiscal year, they are reluctant to project beyond that point. Therefore, it is difficult to direct even their attention, much less their planning, much further into the future. As a result, workers have often experienced the sad and disastrous result when their plant closes on or before the end of the fiscal year even though operating profitably at the time. This ruthless action by some company officials is primarily in order to take advantage of a related tax break. These decisions are often made with utter disregard for the welfare of employees and their families. This is especially disastrous to those with long service, who cannot obtain comparable employment and earnings elsewhere due to their age. Many naturally are reluctant to take their children and family to some distant, new plant location. Therefore, the often cited offer of such jobs or relocation of workers is almost meaningless.

The present plight of workers, and especially the senior employees, in the meat packing industry, is a glaring example of this sad picture. These displaced persons have been deserted by the very companies their labor has helped to build and make prosperous. Their dreams can only result in nightmares regardless of the interests of progress philosophy as used by management in connection with their dismissal.

While unions have been most instrumental in establishing some safeguard this unconscionable disregard for the welfare of the individual family and the community becomes a public issue and merits Government surveillance in all cases where interstate commerce is involved.

When assessing our national priorities to provide the desired stability of economic policy, the means to that end should not disregard, but should always be designed to upgrade the importance of family security and the individual human factor. Otherwise, we sacrifice a principle that has made our country the best place in the world for constantly improved living conditions as a way of life for all.

The 1970 Outlook

We support the guidelines indicated in the President's proposal for legislation related to (1) the Manpower Training Act, (2) unemployment compensation legislation, and (3) the family assistance program. (This latter should include a cost-of-living provision for those with limited incomes who are primarily dependent on social security.)

We agree and recommend that these responsible programs be initiated now and activated in the 1970's wherever necessary to solve the many problems carried over from the 1960's.

Strengthening the World Economy

If this is to be the goal, extreme care must be exercised, when attempting to strengthen the world economy. It must not be done by sacrificing their hard earned standard of living for many loyal American workers and citizens. It must not be accomplished by subjecting them to unfair competition from substandard foreign wages. Providing undue profit to greedy industrialists and foreign-flag ship owners, both foreign and domestic, who grasp for our American consumer dollars, is not the proper way to obtain a stronger world economy. Measures to insure equal pay for equal work are necessary from this standpoint too. It will help our foreign friends who actually desire fair trade and are willing to meet this criteria when competing.

The Seven Basic Principles

These principles are certainly commendable as outlined by the President. Carrying them out in a manner that will insure integrity of our purchasing power, as well as expand our economic involvement and still utilize our natural resources, can be in the best interest of all concerned. Government can act as umpire to the advantage of all concerned in this game. That is, providing all concerned are working as a team. This objective must be our goal.

In connection with the free economy of the future, and the genuinely equal opportunity for all, it is necessary that discrimination be eliminated to a much greater extent than in the past.

We would question the allegation of obsolete skills resulting from such examples as exemplified in the once great American watch industry. Our country should make certain that we do not become barren of such skills and thus dependent on a foreign source just because they appear to produce a little cheaper at the moment. As we know from bitter past experience, these needed skills, when neglected, become totally unavailable in an emergency. With proper planning, our country need not be subjected to this peril again.

To be truly free and open, our economic system must be counterbalanced in a manner that will prevent monopoly in any form. By placing human values ahead of, rather than after, economic considerations, we will go far in obtaining this objective.

DANGEROUS CONTROLS

Eliminating pollution; the protection of the environment; and the problems of reasonable financial regulation; as well as regulation of agriculture and the related markets; are all apprently considered by the Council of Economic Advisers to be of an urgent nature.

However, speaking for these we represent and from past experience, we hereby declare our firm opposition to any form of Government regulation or controls that would hamper or restrict the due process of free collective bargaining.

Placing American workers in a straitjacket of this nature would remove and nullify one of the most important incentives for continuing improvement toward a better life for the great majority instead of the favored few. We urge your serious consideration and firm opposition to any such attempted regulation of wages and related prices.

Your consideration of our comments is greatly appreciated.

NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS

NATIONAL ECONOMIC ISSUES OF 1970

The major economic issue facing the Nation is the severely depressed and chaotic condition of our housing market. Accordingly the views expressed by the National League in this statement will be confined to this area of national policy and endeavor since housing and home financing is the League's major concern, and the principal activity of our membership.

Twice in the short span of 4 years the Nation's housing needs have been sacrificed upon the altar of fiscal and monetary policies. In 1966 and in 1969, the massive distortions of savings flows, stemming from the effects of national fiscal and monetary policies drastically reduced available housing credit. In both years, the level of housing starts dropped by almost 50 percent. Moreover, the extremely tight housing credit conditions existing at the commencement of the current year give every indication that housing starts are not only approaching a strikingly deficient level of 1 million units, but that even this prostrate productive output may be lowered further in coming months.

Recognition of the serious plight of housing is becoming more widespread, but unfortunately most of the proposals to alleviate the depressed state of this basic national need have been tediously slow in surfacing to the level of official endorsement. Even then attention to remedies appear to be focused upon short-term solutions or stop-gap measures biding the time until fiscal measures produce surpluses which hopefully might free more funds for the housing sector.

The Congress in the landmark Housing Act of 1968 identified the housing needs of the next decade at 2,600,000 units annually. In its current report at page 87, the Council of Economic Advisers recognizes that this 10-year goal of housing construction reasonably reflects aggregate future needs, and is considered feasible of achievement.

Notwithstanding the unanimous recognition by all sectors and strata of government, Federal, State, and local, of current and future housing requirements, little has been done in a concrete and comprehensive manner towards achieving them. As a matter of fact serious backlogs in housing already exist in almost every region of the country. Faced with inadequate current provision of shelter—all too well marked by the depressed levels of present housing starts—and the recognized future needs, it is patently clear that the only result that might be gained by further lengthy legislative reexamination, or executive department commission studies, of this demanding and undernourished sector of national priorities, is additional lost time and even more serious gaps between needs and fulfillment. The times and the conditions require action, and not rhetoric.

For a number of years the National League has made repeated recommendations to the executive department, as well as the Congress, for statutory amendments which would decidedly augment the flow of funds into savings and loan associations, and instantly increase the credit available for channeling into housing and home financing. All of these proposals, if previously adopted, would have materially ameliorated the diminution of credit available to the housing markets in 1966, 1969, and the present year.

The basic thrust of these recommendations has been twofold: (1) To permit savings and loan associations to have access to funds previously and still available only to discretionary lenders which have shown a consistent bias or disorientation towards housing credit, and (2) enable housing, as an industry, to compete for a fair share of market funds in all periods, especially periods of fiscal and monetary restraint.

All of these recommendations, in addition to new proposals, were vigorously readopted by our legislative conference which met in Washington during the first week of this month.

In the first category—those areas in which legislative prohibitions prevent savings and loan associations from having access to funds now flowing to other financial institutions that are not housing credit oriented—are the following recommendations:

1. *Public unit accounts.*—Broaden the FSLIC insurance coverage for public unit funds in savings accounts in a single association by providing coverage for each "separate use" fund so maintained by a single public official.
2. *Keogh Act funds.*—Permit savings and loan associations to act as custodians or trustees for funds set aside by self-employed persons under the Keogh Act and invest them in savings accounts or other lawful investments, including residential mortgages.
3. *Pension funds.*—Authorize savings and loan associations to act as trustees for pension funds to be invested in savings accounts or other lawful investments, including residential mortgages.
4. *Tax and loan accounts.*—Authorize savings and loan associations to maintain Federal tax and loan accounts.
5. *Checking accounts.*—Authorize savings and loan associations to offer checking account services to account holders, and individuals and groups that engage in activities principally connected with real estate.

It is patently incongruous that the major financial sector of our society devoted to the supply of housing credit is still legislatively prohibited from competing for funds from the above sources. Certainly there is little or no economic or financial logic to the proposition that in continued periods of housing crises, one way to provide a solution is to estop by legislative fiat those financial institutions entirely devoted to housing finance from competing for funds with financial institutions not so oriented.

Current efforts to cajole or jawbone the custodians of these funds into some partial investments of their resources into severely depressed housing market, while maintaining legislative barriers against home financing institutions from even competing for these funds is contradictory on its face. These funds are long term in nature and offer excellent matched maturity durations for residential mortgage investment.

Due to their long term character they also provide insulation against the vagaries of changes in fiscal and monetary policy.

In this regard, an entirely apropos reference might be made to the report of the Council of Economic Advisers, which appears on page 101. At the top of that page the Council states "Throughout our history the Government has been involved in regulation of the financial markets. Such regulation serves these three broad purposes: (1) It provides for an appropriate money supply and efficient operations of the payments system; (2) it protects the public from loss due to financial failures, as well as from misrepresentation and fraud; and (3) *it encourages and subsidizes the allocation of credit to particular sectors.* [Emphasis supplied.] Achievement of the first two objectives increases the efficiency of markets. *The third is aimed at using regulation to accomplish other policy objectives.* [Emphasis supplied.]"

While the restatement enunciated by the Council regarding encouraging the flow of credit via the regulatory process may be temporarily inapplicable housing-wise due to legislative barriers, it nonetheless states a prime and purposeful reason d'etre for the thrust of our proposed legislative enactments and regulatory implementation. It is unfortunate, indeed, that the Council did not take this opportunity, when it saw the need so clearly, to recommend removal of some of the legislative barriers that exist to augmenting the flow of funds into the housing market, especially since such funds are captive to nonhousing investors.

In addition to the previously mentioned sources of funds which the national league has heretofore consistently and vigorously asserted should, at the least, be open to competition by savings and loan associations, the league at its recent legislative conference endorsed the immediate implementation of Federal legislation authorizing deduction by a taxpayer from taxable income of a stated amount of his or its earnings from savings accounts in a savings and loan association or other thrift institution investing a substantial amount of its savings capital in housing mortgage finance.

This recommendation of the league, which is of the highest priority and essential in meeting the housing needs of the Nation, is not at variance with the stated purposes of Federal financial regulation promulgated by the Council of Economic Advisers, nor actions of the Congress in the recent past.

While jawboning and pressure cajolery may be the order of the day with respect to enticing the transmission belt of available financial resources into investment areas of national priority, variances in emphasis via legislative inducements have been a more certain and reliable source in the attainment of desired end results. We need look no further than the investment tax credit allowed business in the sixties for confirmation of the influence of Federal legislation in attaining announced national goals. The sole objective of the investment tax credit was to encourage increased investment by business in new plant and equipment, and modernization, in order to meet the twin goals of increasing domestic employment and improving our international trade posture. While the latter objective remains in the grey area of accomplishment, the former has been eminently successful. In fact, the degree of success in encouraging expansion of domestic business investment probably can no better be measured than by the fact that according to the latest McGraw-Hill survey, industrial capacity usage is now at the 77 percent to 79 percent level, hardly an efficient use of our industrial plant.

Empirical comparisons between the allocation of the Nation's resources, stemming from legislative tax policies, are worthy of note. The following table sets forth the gross private domestic investment in noresidential structures and producers' durable equipment compared to such investment in residential structures for the two decades ending last year:

GROSS PRIVATE DOMESTIC INVESTMENT

[Amounts in billions of dollars]

Year	Total	Non-residential	Residential	Difference	Percent residential to total
1950	$47.3	$27.9	$19.4	$8.5	41.0
1951	49.0	31.8	17.2	14.6	35.1
1952	48.8	31.6	17.2	14.4	35.2
1953	52.1	34.2	18.0	16.0	34.5
1954	53.3	33.6	19.7	13.9	36.5
1955	61.4	38.1	23.3	14.8	37.5
1956	65.3	43.7	21.6	22.1	33.1
1957	66.5	46.4	20.2	26.2	30.3
1958	62.4	41.6	20.8	19.8	33.3
1959	70.5	45.1	25.5	19.6	36.2
1960	71.3	48.4	22.8	25.6	32.0
1961	69.7	47.0	22.6	24.4	32.4
1962	77.0	51.7	25.3	26.4	32.8
1963	81.3	54.3	27.0	27.3	33.2
1964	88.2	61.1	27.1	34.0	30.7
1965	98.5	71.3	27.2	44.1	27.6
1966	106.6	81.6	25.0	56.6	23.4
1967	108.6	83.7	25.0	58.7	23.0
1968	119.0	88.8	30.2	58.6	25.3
1969p	131.5	99.3	32.2	67.1	24.5

Source: Table C-11, p. 190, 1970 report, Council of Economic Advisers.

The above table graphically and pointedly illustrates the effect of tax inducements in energizing capital investment decisions into particular sectors of our economy, and the resultant neutralizing shelter such advantages afford even in periods of fiscal and monetary restraint.

Until, 1963, the vacillations in investments between the residential and nonresidential sectors represented primarily the interplay of supply-demand relationships, effected by war-postponed backlogs and war-induced savings, especially in the housing sector during most of the 1950's, and the usual moderate contractions flowing from the postwar cyclical changes in monetary policies. However, from 1964 to the present time, capital allocations have been very materially influenced by the investment tax credit incorporated in the Revenue Act of 1962.

As an instrument of national resource allocation policy, the investment tax credit accomplished its purpose in more than admirable fashion. Business immediately responded to its inducements, and the record of its response speaks eloquently of the broad and pervasive results that can and do flow from national policies homed in on accomplishing particular and specific remedies for underserved areas of the Nation's economic and social well-being.

It is within this framework of contributing to the long-term solution of a serious deficiency in the Nation's economic and social goals represented by our housing needs that the league vigorously supports the immediate enactment of a tax incentive for channeling savings into those institutions serving the housing and home financing market. The success of the investment tax credit should suffice as an indication of the results that might be expected. Moreover, the justification, logic, and timeliness of legislative inducements of this nature directed to meeting the needs of the housing sector of the economy are already well documented.

Residential mortgage demands of the decade ending in 1968, for new housing units only, have been estimated by Secretary Romney of the Department of Housing and Urban Development, in the following table which was part of his testimony before the Committee on Banking and Currency, House of Representatives, on February 24, 1970:

TABLE III.—CREDIT REQUIREMENTS FOR NEW HOUSING UNITS

[In billions of dollars]

Calendar year	Total requirements all new units	Total mortgages loans	New mobile homes	Public housing units
1965	22.6	21.4	0.7	0.5
1966	21.7	20.6	.7	.4
1967	20.4	19.1	.8	.5
1968	24.1	22.4	1.2	.5
1969	23.1	21.2	1.5	.4
1970	23.7	20.8	1.8	1.1
1971	24.9	21.3	1.9	1.7
1972	30.8	27.1	1.9	1.8
1973	37.2	33.5	1.8	1.9
1974	44.2	40.2	1.8	2.2
1975	49.6	45.2	1.7	2.7
1976	52.1	47.7	1.7	2.7
1977	53.3	49.0	1.6	2.7
1978	53.9	49.6	1.5	2.8

Source: Estimates and projections by Department of HUD. Methodology explained in forthcoming 2d annual report on National Housing Goals.

The mortgage requirements in the preceding table do not include net residential mortgage credit needs required for the net refinancing of existing homes, or credit needed for improvements and modernization expenditures on the existing housing stock. Nonetheless, the Romney estimates for new housing mortgage credit alone would require a doubling of available mortgage housing credit in the short 4 years, from 1970 to 1974, and a total increase of 140 percent by 1978. In view of the almost rigid plateau of $21 billion of annual new housing credit allocations which has prevailed for the 5 years since 1964, and projected for a 7-year period through 1971, it seems unreasonable to expect that our housing needs will be adequately met, let alone reasonably fulfilled, in the immediate years ahead, unless a legislative inducement designed to increase savings flows into residential-oriented savings institutions is given prompt and favorable consideration.

It is interesting to note that the housing credit allocations for 1970 and 1971, contained in the projections, are both at levels below actual outlays in 1968. We are duly concerned that such low projected allocations of new housing credit may tend to confirm the fact that housing, as a national priority, must endure another waiting period of additional years before it will receive the active and long-range support it so desperately requires now. We are well aware of the inherent time-lags in translating increases in credit into housing starts, a situation which unfortunately already exists. The time which will be inevitably lost in closing an ever widening existing lag adds to the urgency for legislation broadening the base of potential savings flows into institutional suppliers of housing credit.

It is the league's judgment that a further period of planned, or unplanned, housing restraint is not in the Nation's best interests. Action is required now to assure that current backlogs, as well as known substantially increased future needs, can be met in a manner consistent with the gravity of the problem. It is our considered judgment that actions implementing the recommendations previously outlined would make a major contribution to successfully meeting the present and emerging national housing needs.

The league is definitely of the opinion that these actions augmenting the supply of housing credit at the source will assure a steadier, as well as a built-in, escalating reservoir of sorely needed funds. Permitting housing-oriented lenders to compete ab initio for trust and pension funds as trustees would eliminate the necessity for consideration of capital credit controls which, by their nature, are basically designed to eliminate or control particular borrowers and simultaneously attempt to compel otherwise unwilling investors to enter investment sectors with which they are not only unfamiliar, but have consistently shown they have no desire to enter in a significant manner.

Complementing the recommendations already outlined relating to increasing savings flows into assured housing outlets, the league strongly endorses other measures designed to provide vehicles for transmitting additional funds into the housing market or insure that funds now so employed are not lost to the housing market. These proposals are outlined, as follows:

1. Create a secondary market for all types of first lien residential estate mortgages within the Federal Home Loan Bank System. Such a secondary market would permit the issuance of marketable securities to investors not now, or in the past, equipped to service mortgage investments. This additional mortgage credit conduit would not only channel substantial additional funds into residential finance, but also would provide an effective additional tool to compete with corporate borrowers in subsequent periods of fiscal and monetary restraint.

2. Authorize savings and loan associations to issue debentures and other debt instruments that need not be subordinated to savings accounts.

3. Remove borrowings from the liquidity base for computing the liquidity requirements of members of the Federal Home Loan Bank System. At the present time the implementation of this requirement would remove about $500 million which is already invested in housing.

4. Enact the proposal for the subsidy of up to $250 million to the Federal Home Loan Bank System. For a very limited outlay, this program will insure that from $2,500 million to $4 billion now invested in residential mortgages will remain so invested.

In summation, we believe that the Nation's prime domestic problem is the current and prospective serious underfulfillment of its housing needs. We firmly believe that these challenges can be met. We know that they will not be successfully attacked without a substantial increase in the volume of the Nation's savings being devoted to the effort. A successful solution does not rest upon short-term serums, but a comprehensive program having as its base materially increased savings flows into those institutions oriented to residential finance. We have proposed such a comprehensive program. In view of the gravity of current conditions and the massive dimensions of prospective needs, we believe the Nation's best interests would be served by immediate implementation of these recommendations.

UNITED MINE WORKERS OF AMERICA

By W. A. Boyle, *President*

My name is W. A. Boyle; I am president of the United Mine Workers of America. I appear here today on behalf of the Nation's active and retired coal miners to present our views on the state of the U.S. economy as it enters the decade of the 1970's.

We appreciate the opportunity to appear here today. We feel that dialogs such as this are essential if the U.S. economy is to provide for an increasing standard of living for the present and future generations of Americans.

We view the current state of the U.S. economy with a great deal of apprehension.

It is obvious to us that economic growth has stagnated. It is apparent that America is now beginning another postwar recession. Whether or not this recession is mild or major depends upon the action taken now by administration and business leaders.

For a number of months economic statistics have pointed to the inevitability of recession. Unfortunately, the decision has been made to continue to apply restrictive monetary and fiscal policies in the hope that inflation will be curtailed. Tragically, recession hits hardest at those who can least afford it. It affects low- and moderate-income Americans who depend mainly upon wages and salaries.

Of special concern to us is the sharp rise in the unemployment rate in the past month. Unemployment now stands at the highest level since the early 1960's. Ominously, for millions of American workers the administration seems content to permit the unemployment rate to rise still further.

This policy is unconscionable. It strikes at the well-being of millions of Americans now on the unemployment rolls. It also affects millions of additional Americans who face the prospect of lay-off over the next several months and perhaps years. Finally, a rise in unemployment strikes a major blow at programs designed to bring the disadvantaged into the mainstream of American life. It will be a cruel paradox indeed if a government supposedly committed to a full employment economy would permit that national priority to be subverted to satisfy classical economic theory.

Disheartening as the statistics on unemployment are, we feel that they understate the case. Indeed, if statistics on underemployment and permanent withdrawals from the labor force were added to the unemployment figures, the picture would be far grimmer. Hopefully, the the administration will undertake efforts to statistically measure this phase of the unemployment picture so that a clearer picture of the extent of the unemployment problem emerges.

The current economic downturn must cause concern for another reason. Millions of Americans born in the immediate post-World War II period are now coming into the labor force. These young men and women will soon marry and begin their families. If our economy is to stagnate, millions of these young men and women will be denied jobs or will be forced to accept jobs at a much lesser income level than they have come to expect.

In our opinion, our Nation owes these young men and women the opportunity to get good jobs at good pay and to raise their families at a standard of living higher than that which we now enjoy. This has been our tradition as a nation. It is one that we cannot lightly cast aside.

It is often said that youth is disenchanted with the American system. We do not believe this. We believe that youth properly motivated and given the opportunity to work within the system will do so to their own advantage, as well as to the long-term well-being of our Nation. But in our opinion, a slackening of economic growth and the denial of opportunities to millions of our young people is a course which can only lead to national disaster.

Perhaps the strongest argument, however, against current regressive economic policies has been that they have not been successful. Inflation continues at a rate which is intolerable. Inflation hits hardest at wage earners and pensioners who rely upon incomes fixed for relatively long periods of time.

Our current inflation is, in our opinion, a business and Government inflation. It has been caused by heavy capital investment on the part of the American industry, by excessively large profit margins from most American corporations, and by a Government policy which is geared to large industry or wealthy individuals. We have a wartime economy which has returned to industry huge profits, without any effort by Government to reduce these profits in the interest of price stability. Much of the cost of living rise is in the service sectors where professional people have enjoyed a tremendous increase in their standard of living, often at the expense of the low- and moderate-income families.

Any anti-inflation policy must strike at the cause of the inflationary spiral. It must somehow attack Government spending and corporate profit and investment policies. Failure to do this can only result in continued inflation. The program that the administration has pursued has hit hardest at low and moderate families, subjecting them to the double burden of unemployment and inflation.

One of the major casualties of restrictive fiscal and economic policy is housing. Millions of Americans have had to settle for inadequate housing because of the unavailability of credit, the high cost of credit, or the prohibitively high level of home prices. America produces approximately 1 million new homes each year, when in fact it should produce 3. The pinch is especially severe for the low- and moderate-income families.

In addition to the monetary and fiscal policies pursued by our Government, its import policies cause us serious concern. Many major American industries are now feeling the burden of unfair import competition. Numbered among the industries affected are steel, coal, oil, textiles, shoes and aluminum. The huge flow of imports threatens the financial stability of these industries.

The coal industry is a good example of what can happen because of excessive imports. The entire east coast of the United States is currently being flooded with low-cost residual fuel oil from Latin America and the Middle East. There is a new threat to the Midwest caused by residual imports. There is at present unrestricted residual fuel oil importation along the east coast. The coal industry supplying this region has been either driven out of business or forced to find markets further inland. Carried to its logical conclusion, the onrush of residual fuel oil can undermine and eventually destroy the economic structure of the major-coal-producing States. Thousands of American workers will be deprived of jobs and income. Eventually, the United States will lose much of its capacity to produce bituminous coal, its largest indigenous fuel resource.

The same story is being repeated in other industries. Spokesmen for those industries have now begun to point to the need for protection. So, too, have major labor unions, long supporters of a free trade policy, begun to call for a more reasonable import program.

Our demand for protection is no more than similar demands made by foreign industries and their workers. We do not ask that a wall be erected to prohibit foreign energy sources from competing. We only ask that national import policy insure that American coal mining can continue to exist as a major energy source.

If our view of the current economic developments is somber, we are optimistic about the future of our Nation. We believe that given proper incentives, the American economy can and will grow to major new heights in the coming decade. We would like to suggest to this committee those economic goals which we feel must guide our economic policies in the years ahead. We would also like to indicate those policies which we feel are necessary to attain these goals. We offer to the committee the full cooperation of the United Mine Workers of America in the formulation and implementation of sound policies geared to economic growth.

1. We believe that economic growth must provide a continuing increase in jobs, incomes and living standards for all Americans. This increase must also be adequate to carry to a successful conclusion the present war on poverty and to insure that the American economic miracle extends to the disadvantaged.

2. We believe that economic growth must maintain and improve the quality of American life. For example, we must:

a. Undertake an extensive program of pollution abatement to insure that industrial activity does not unduly burden the environment.

b. Undertake to clean up that which has been destroyed in prior industrialization.

c. Upgrade our educational system, including provisions for higher education for those who are not able now to afford such education.

d. Provide for removal of solid waste caused in the mineral extraction industry. The UMWA has sponsored and is supporting legislation which would remove such waste from coal mining areas.

e. Provide for recreation facilities for American citizens increasingly able to use leisure time. Such recreation should be readily accessible and within the economic means of the vast majority of our citizens. Americans are increasingly coming to realize the value of leisure for its own sake and its desirability as a part of their American heritage. We would hope that the national economic growth will not only make available sufficient income for Americans, but would also permit the establishment, development, and use of proper recreational facilities.

3. Our Nation must make a definite commitment to improve housing, especially in the low- and moderate-income areas. The UMWA intends to use some of its own resources to provide adequate housing in coal mining areas for coal miners and their families. We would hope that the housing program of the Federal Government would be of assistance to us.

4. We believe that the American worker must continue to increase his living standard and to enjoy more and more of the increasing wealth of our economy. We must turn away from those economic policies which tend to concentrate wealth in the hands of a few individuals or a few large corporations. We must change economic programs which would deprive workers of their proper share in the wealth which they produce. It is all too easy in this era of giant corporations, foundations, and wealthy individuals to forget the fact that the basic strength of the American economy rests in the hands of the wage and salary earner who must support the gigantic industrial machine which turns out such a profusion of economic goods and services.

5. We must, as a nation, somehow continue to reduce poverty in our minority groups and to bring them to a full status in our national life. Denial of the full advantages of citizenship represents a denial of the basic concept upon which our nation was built. It also represents economic waste. We would hope that the Government will recommit itself to the principle of the Employment Act of 1946. The Federal Government should accept, as a moral imperative, the need to bring to every American the opportunity to share in the full advantages of our economic growth.

6. During the decade of the 1970's the United States must also take steps to strengthen our economic base. In our opinion, two programs are vital in this regard.

First, we must adopt a reasonable program on import control. We can no longer permit large sections of our industry to be threatened with economic extinction because of a flood of foreign imports. In our opinion, it is time for the Congress to study this question and to enact legislation which, while not unduly burdening the U.S. consumer, will protect vital American industries from unfair foreign competition.

Second, we must now take steps to upgrade our technologic base. We have special reference to technology concerned with the production, distribution and consumption of anthracite, bituminous, and lignite coal. In our view, the development of the vast coal resources which would be possible through improvements in technology would be of major advantage to the U.S. economy. Not only will technology make possible the more efficient utilization of coal resources, but will also permit the use of coal with less detrimental effects upon the environment.

We have always been amazed that an America which is able to land and astronaut on the moon has not been willing to improve the technology of the generation of electric power. A modern coal-fired plant is capable of only 40 percent efficiency, while a modern nuclear plant is capable of only 30 percent efficiency. To us, an improvement of the efficiency of generation from 40 to 50 percent would justify a major R. & D. effort. We believe also that technology will permit a major reduction in the incidence of death, injury, and disease in coal mines if such technology is developed and properly implemented.

For too long the bulk of our Government research and development has been concentrated in three major fields: Space, atomic energy, and defense. We believe that it is time for a rethinking of our national research priorities. We are hopeful that such a review will point the way toward R. & D. which is aimed at improving the technology upon which our industrial growth is based. Such a change in emphasis will mean a great deal, not only to our economic development, but to a social and political development as well.

The decade of the 1970's poses a major challenge for every American. Our economy is potentially capable of tremendous growth. It is capable of meeting not only the material needs of our citizens, but also, of insuring a solid increase in the quality of their life as measured in nonmaterial terms. The challenge of the 1970's is to provide for economic growth; to provide jobs and incomes for American workers; to provide viable means of insuring the quality of our environment consistent with the need for an increase in our material standard of living. We recognize the challenge. But, we also recognize that the American Nation has grown because it has accepted challenge and overcome problems. We are hopeful that our Nation in this decade will continue in this long and proud tradition.

We of the United Mine Workers of America stand ready to do what we can to cooperate fully in the development and implementation of sound and progressive economic policies which will bring to every American an increase in his material standard of living concurrent with his human dignity and spiritual progress.

JERRY VOORHIS, FORMER MEMBER OF CONGRESS AND PAST PRESIDENT OF THE COOPERATIVE LEAGUE OF U.S.A.

ECONOMIC ISSUES THAT FACE THE NATION

The major emphasis in the 1970 Economic Report of the President is on inflation. Both the report and the policies currently being pursued by the administration raise certain questions:

(1) Is it true that the checking of price inflation will be a master key to the Nation's health?

(2) Once price stability has been achieved, if indeed it is, by the measures now being employed, can we expect such stability to continue if economic growth is again allowed to take place?

(3) Are sharp increases in unemployment, continuance of the present disastrous shortage of homes, maintenance of high interest rates, lack of adequate educational opportunity, inadequacy of measures to save the environment, persistence of slums—are these maladies a necessary price that must be paid for checking the inflationary spiral?

(4) Whatever is done toward depressing economic conditions generally, will administered prices, fixed as they are by deliberate management decision in monopolistic industries, respond at all to a generally lowered price level?

(5) Is it reasonable under any circumstances to regard reduced production of goods and services and the stifling of economic growth as desirable conditions—even temporarily?

I am responding, thankfully, to Chairman Patman's request for comment on the economic issues which concern the Nation. I do so first because I believe the answer to the five questions listed above is generally a negative one. I am responding secondly because I believe our country faces deep, persistent, and dangerous problems which must be dynamically dealt with now, which will certainly not go away, even if inflation is checked, and which will almost certainly be aggravated by the methods currently employed in attempting to deal with inflation.

Price inflation works a hardship on families, particularly those living on small or fixed incomes. Rapid increases in the price level are indeed undesirable. No just criticism can be leveled against sincere efforts to curb such rapid price rises.

But we must, I think, realize that some evils are even greater than inflation. Among them are: progressive destruction of our environment, critical shortage of good homes at costs average families can afford, unemployment of workers, recession, and the escalating crime rate. I believe it nothing less than cruel to force unemployment upon disadvantaged workers and make them pay the price of getting lower prices for all of us.

Fortunately, however, we are not compelled to make a clear-cut choice between enduring continued inflation and risking the very health of our Nation.

I am convinced that price inflation and rising living costs can be curbed and our critically dangerous problems effectively attacked at the same time.

It is first of all necessary to have clearly in mind what are the causes of inordinate increases in price levels. The most basic cause is an excess of active purchasing power over the supply of goods and services to be purchased with that buying power. This cause will operate in all lines of business where competition still prevails. It will operate wherever we still have a free market economy. It therefore follows that, whenever expenditures are made which are not matched by corresponding increase in the production of goods or services available for purchase, inflation of prices is certain to result.

The overwhelmingly important example of such expenditures are those for military weaponry and war. The project to put a man on Mars has the same effect economically.

Not a single dollar's worth of goods or services which can be bought by the people results from these expenditures. Consequently, into the economy at present is being injected some $80 billion a year of expenditures whose only possible effect is to create a tremendous pressure upon all prices of everything being produced for sale.

Now, if the primary objective of governmental policy is actually the curbing of inflation, the one best and most obvious way to accomplish that purpose is not to save $1 billion or half a billion dollars by depriving education and health research, but by promptly ending the Vietnam war or in any case reducing military expenditures to what we really need for an adequate deterrent and using the money thus saved to bring about, for example, a massive construction of the homes our people so desperately need.

Since price inflation is caused by an excess of effective demand over available supply, it would seem quite elementary that the constructive cure for such a condition is not to prevent economic growth, cause unemployment and reduce supply, but rather, to stimulate production of goods and services until it catches up with demand. Not until this is done will there be any long-term cure for price inflation. From this point of view, it is encouraging to find that the President's budget contemplates certain increases in commitments for the stimulation of housing construction and "Operation Breakthrough" inaugurated by the Department of Housing and Urban Development may, over a period of years, succeed in reducing home construction costs and bringing about more mass production of housing.

But much bolder measures than these are needed if the crisis in our core cities and the substandard housing in many of our rural areas are to be overcome. Primary among such measures is a drastic reduction in interest rates. For many years we have had programs in effect whose aim has been to prevent the supply of agricultural commodities from so far exceeding effective demand as to still further reduce the inadequate incomes of our farmers. We have done this on the theory that by adjusting supply to demand, prices would be increased. Conversely, then, how can it be denied that if we desire to depress prices in the economy generally, the logical course is to increase supply until it actually exceeds demand?

Does anyone doubt, for example, that if the number of doctors were by some miracle to be doubled in the next year, then doctors' charges would cease to escalate as they have been doing?

And what would be the certain result if wise and courageous policies brought about an excess of available housing units over the insistent demand for them? If free market competition means anything at all, such a situation would cause the price of homes to begin at once to decline.

So with other services and commodities in the competitive segment of our economy.

Whatever else is done, the road to economic equilibrium and a reasonably stable price level is not to stifle the production of real wealth—goods and services—in the productive industries of the Nation. Quite the contrary, they should be stimulated in every sound way and inflation prevented by quite different means than those now being employed.

For classic economics is not so obsolete that it is not still true that the best, and only long-run cure for rising prices is a supply of goods and services somewhat in excess of the demand for them.

Moreover, the present theory of preventing inflation by stifling economic growth and the risking a recession is a doctrine of despair. For if this theory were correct, we would never dare allow full employment and virile business conditions again unless, indeed, we were ready to bring on another period of severe inflation.

But I do not believe that theory is correct.

There is a second major cause of price inflation—again one lightly mentioned in the report—and certainly seriously neglected so far as present policy is concerned.

That cause is monopolistic control of certain major industries and consequent administered pricing therein. An outstanding example of this is the manner in which all the banks slavishly follow the leader in raising interest rates. Why this practice does not bring about vigorous antitrust action by the Justice Department I am unable to understand.

But the banks are by no means alone.

Price competition has substantially ceased to exist in such industries as automobiles, steel, farm machinery, containers, chemicals—(except in areas where farmers' cooperatives are strong)—electrical appliances, soap and detergents, and dozens of others. Competent economists have estimated that 85 percent of all prices in the United States are either fixed by administrative decision or secondarily affected thereby.

And if proof is needed, we certainly have had it in recent days. In the very same column on the front page of the Washington Post for January 17 appeared an article headed "Economy Reported Declining." It indicated satisfaction among administration circles over the fact that no economic growth in output of goods and services had taken place during the fourth quarter of 1969 and that business activity might actually be declining.

Right beneath this article, however, appeared a brief paragraph stating that Bethlehem Steel Corp. had announced an increase in its prices for steel plate, structural steel, and piling. And, true to the "fraternity," United States Steel responded with like increases barely a week later. Newspaper accounts pointed out that this higher cost of steel would bring about increased cost of construction and of countless other commodities all along the line.

Furthermore, at the present time all across the country public utilities are demanding rate increases despite the fact that their recent earnings have been among the highest in their history.

Movements of the price level in general and overall economic conditions have little effect upon the prices in monopolistic industries. Administered prices will continue at a high level and may even be increased to preserve profit levels in the face of a developing recession. This is why many people fear that further pursuit of existing policies could very well bring down everything—employment, economic growth, housing starts, business activities, tax receipts—everything indeed except prices.

Until effective measures are taken to bring administered prices into line with prices determined in the competitive market, the foregoing danger will remain a menacing one.

WHAT SHOULD BE DONE

When one criticizes existing policy, it becomes incumbent upon him to tell constructively what he believes should be done instead.

First and foremost, the rate of interest should be drastically reduced.

The usurious interest rates that have been in effect, and constantly rising, during the past several years have had the following effect:

(1) They have reduced housing starts to less than half our national needs as officially adopted by the Congress and they have siphoned nearly all such housing construction as has taken place to the luxury market;

(2) They have imposed unbearable burdens upon small business while increasing the advantage, already too great, of large-scale and monopolistic business which is able to obtain most of its financing from internal financing and the plowing back of profit margins into the business;

(3) They have swollen banks' profits to unprecedented and indefensible heights;

(4) They have imposed so great a burden upon farmers that it is now almost impossible for young men to enter agriculture and our countryside continues to lose population;

(5) They have added severely to the burden of debt of State and local governments rendering it in many cases impossible for them to finance the construction of schools to carry on pollution control or to discharge other necessary functions;

(6) They have increased the rate of bankruptcy and virtually doubled the burden of consumer debt; and

(7) They have nearly doubled the interest on the Federal debt and made it the second largest item in the Federal budget, second only to military expenditures.

Indeed, on January 29, the Wall Street Journal reported that the Treasury was borrowing $6.66 billion at 8.25 percent interest—the highest rate ever paid by our Government since 1859! And to the extent that this borrowing is done from banks, the Government is, in effect, paying 8.25 percent interest on its own national credit, since the banks will create the money in the form of demand deposits with which to purchase the Government securities.

But this is not all. The fact is that during the first half of the decade of the sixties our country was achieving the greatest rate of economic growth in its history and with no serious price inflation taking place. The further fact is that the serious and rapid inflation began almost immediately after the Federal Reserve Board, by a 4 to 3 vote, raised its rediscount rate by some 12½ percent in December of 1965. And the higher the interest rate has been pushed since that time, the more severe the inflation has become. And for good and sufficient reason.

For in our present economy the cost of money and credit enters as a major factor into practically every transaction and into the cost of production and distribution of practically every kind of goods or service. At present interest rates and with a 25- or 30-year mortgage, a home buyer pays far more in interest alone than he does for all the brick, mortar, labor, management, and everything else that goes into his house. Indeed he pays almost twice as much.

Just why it should be assumed that the way to make money lending less desirable is by increasing the already swollen profits of the money lenders, I am utterly unable to see in any case.

And it is altogether evident that, far from dampening inflation, the extortionate interest rate has fed its fires.

The Federal Reserve System and the Treasury of the United States have ample powers to bring down interest rates just as they have so recently proved that they have ample power to increase them. And Congress has wisely and specifically given the President and the Federal Reserve carte blanche powers to control interest rates.

Those powers should be used for the benefit of the American people.

A low interest rate would do more, in all probability, than any other single factor to stimulate production and enable supply to overtake demand in the markets of the Nation.

There are two specific measures that should be enacted by the Congress as soon as possible. One of these is Chairman Patman's bill H.R. 11 which would make the Federal Reserve System responsible to the Government of the United States, a most logical move since the Federal Reserve exercises the power of the sovereign government when it creates, as it does, the money of our Nation. The second such measure now needed is the bill of Representative Sullivan which would provide direct Government loans at reasonable rates of interest for home construction for middle and lower income people.

A lower interest rate will do far more to reduce the cost of home construction and to overcome the housing shortage than will all the subsidy programs and the Operation Breakthrough put together. Those programs are indeed excellent ones. Indeed the Housing Act of 1968 is a Magna Carta of homeownership for the American people, but at current interest rates, its provisions are either going to benefit very few families or be so costly to the Government that Congress is unlikely to make adequate appropriations for carrying them out.

A lowering of interest rates will reduce all costs of production and distribution and make possible therefore reductions in prices. Where competition is effective such price reductions should certainly take place.

Because most of the perilous problems that afflict our cities and lead to misery, crime, and disorder, are related to the lack of good homes in good neighborhoods, there should take place a massive program of housing construction, including a great expansion of cooperative housing, since it can bring homeownership within the reach of millions of families which cannot enjoy such ownership otherwise.

We have the resources to accomplish this if we want to. It is all a question of what our priorities are to be.

As I have already suggested, sections 235 and 236 of the Federal Housing Act make it possible for the Government to subsidize interest costs for low income families so as to reduce their payments to what they would be at as low a rate as 1 percent, if that is necessary in order to get their payments down to 25 percent of their annual income.

The problem is implementation. Again Congress has provided that the Government National Mortgage Association can provide a market for below market interest rate mortgages. If this so-called special assistance program were expanded in the extent of many billions of dollars, the rate of interest for home construction and homeownership would be reduced to a reasonable figure and much construction stimulated.

Where could the money come for these programs? Some $3 billion could come from the space program if we decided it was more important to house the American people than to get one man on Mars.

Several hundred million dollars could be available if our Government would stop subsidizing production of the supersonic airplane to break the glass in our homes and buildings, further pollute the air, and according to some scientists, cause the birth of deformed infants.

Even a 20-percent cut in the Pentagon's huge budget could provide enough billions of dollars to build a million homes outright or to subsidize the cost of low income families of many times that number.

Under section 202 of the Housing Act, the Government has made direct 3 percent loans for the housing of senior citizens. It has, I believe, lost no money on this program. If this can be done for senior citizens, why not for all citizens in the need of homes?

We could be building the 2.6 million homes a year which Congress has officially determined to be our national need if we really wanted to badly enough.

Several times in this paper I have urged substantial reductions in military appropriations. I believe there are two compelling reasons for this. The first has already been indicated early in this paper. Such expenditures constitute pure economic waste, produce no goods or services to be bought with the purchasing power they pour into the economic stream, and are therefore a major, continuing, underlying cause of price inflation.

The second reason is that, while the United States cannot of course unilaterally disarm, it should not spend any more than is actually necessary to provide an adequate deterrent. Why, for example, do we need the C5-A military transport airplane if the Nixon doctrine of noninvolvement in the wars of Asia and other parts of the world means anything? The only use of the C5-A is to transport large numbers of troops and weapons to far-away places. A conservative policy on the part of the United States might yield tremendous benefits for mankind. Military weaponry has now "progressed" to the point where it is no longer conceivable that this or any other nation can defend the lives of its people by military means. Only a firm and enforceable peace in the world can do that. If the United States would take bold leadership toward that goal, so necessary for human survival, we might obtain general enforceable disarmament on all nations and the beginnings of a structure of world law.

Such objectives cannot of course be achieved overnight, and even if substantial reductions in military expenditures such as can certainly be made with prudence are made, we will continue to face a very considerable volume of economically wasteful expenditures in the Federal budget. So long as this is the case, it will be necessary to take measures to dampen demand even as we seek to increase supply. At the present time consumer indebtedness amounts to $120 billion in this country. This is an increase from only $18 billion as short a time ago as 1950. Much of this mountain of debt has been contracted for quite unnecessary expenditures on pure luxury items, some of which at least families would actually be better off without. And it would be hard to estimate how much of this indebtedness has resulted from the extravagant use of credit cards which now pollute the mails in ever increasing numbers whether or not requested by the recipients.

Wiser people than I have proposed that the Congress declare a moratorium on the distribution of credit cards. And I imagine if this were done, it would have a substantial influence on checking price inflation. At the very least there should be severe penalties imposed on any agency which sends out unsolicited credit cards and it should be provided, as I believe Senator Proxmire's bill would do, that the credit card issuer in such cases bear the total liability if unsolicited credit cards are lost or stolen and charges made against them.

In a broader sense, it certainly would be far better than risking a general economic recession to reinstitute the type of selective credit controls which worked reasonably well during the years of World War II.

Overspending is undoubtedly a national disease. We are a Nation almost madly seeking material comforts, pleasures, and satisfactions. The excesses of youth which sometimes concern us so much are likely to be a reflection of the materialism of their elders. But much of the overspending would not take place except for the blandishments of high powered advertising and salesmanship. This brings me to the suggestion that Congress might well follow the example of such States as Texas and Pennsylvania and pass a Federal law prohibiting all garnishment of wages or salaries for payment of debts. Were this done, it is not difficult to see that considerably less pressure would be put forth by unscrupulous salesmen to induce people to spend beyond their means.

Whatever else is done, however, about supply and demand, it is highly improbable if we judge from history that prices in monopolistic industries will come down even if the general market is falling.

Those who control such industries have demonstrated repeatedly that they prefer to cut production as much as necessary in order to maintain a sufficient scarcity of their goods to sustain a high level of prices.

Nothing probably short of direct Government controls can bring such prices down. If we are in earnest about controlling the price spiral and if we wish to be fair to competitive business, some such controls are indeed called for. In some cases such as the power industry, competition can be injected in the teeth of monopoly through development of cooperatives or through public power projects and public ownership. But where such opportunity is not present, the antitrust laws should be broadened in effect and much more vigorously enforced and even that is not likely to be enough. Even more direct measures are almost certainly necessary if we really mean business about inflation. Why should not those industries in which a handful of comanies are in position quite effectively to fix prices be treated as public utilities which, for all practical purposes, indeed they are? Why should not their prices be regulated by well staffed commissions with enough power to gather all the necessary facts and to make wise and considered judgments?

If any long-run cure for spiraling inflation is to be hoped for, some such measures as these are necessary.

Finally, it is of course obvious that in periods of inflation the Federal budget should be at least balanced and preferably should run a surplus, paying off thereby a portion of our monumental national debt.

But there are right and wrong ways to balance a budget. It would seem questionable to do so by selling off Government owned property, particularly property like the Alaska Railroad which has consistently produced net revenue for the Federal budget. Proceeds from such sales are not properly current income and should be accounted for as sales of capital assets.

Neither should the budget be balanced or a surplus created by failing to combat hunger in the land effectively or denying full educational opportunity to young people or failing to take giant steps now to clean our air and water.

If we really want to check inflation and have a healthy nation at the same time, we will not appropriate another dime for ABM, Congress will stop development of of the ultimate MIRV weapon, we will not build the C5A, and we will permanently abandon the supersonic airplane. If to these proposals were added a virtual suspension of the space program, budgetary economies of many billions of dollars could be brought about.

And there are some tax revenues that could well be increased. The tax reform bill of last year was, on the whole, a good piece of legislation. The increase of personal exemptions was certainly a sound and just provision.

But excise taxes on luxuries and waste are certainly a logical source of revenue and a sound measure to combat spiraling inflation. I believe the Ways and Means Committee proposed at one time to raise an additional $3 billion by increasing the tax on gasoline and cigarettes, a proposal which the administration unfortunately opposed. I own one automobile and smoke my share of cigarettes, but both these taxes seem to me altogether logical subjects for increase. Automobile exhaust is causing well over half the pollution of the only air mankind will ever have to breathe. This generation is using up the fossil fuels of the earth at a profligate rate. Why not make those who are responsible for those wrongs pay well for their privilege? And as for cigarettes, I am afraid with all the medical evidence in, that we ought to be induced by even heavier taxes to switch to pipe smoking or to cease altogether.

Anyway, I hope enough has been said to make the point that a balanced or even a surplus budget to check spiraling inflation is altogether possible without curtailing essential and, in some cases, desperately needed social programs.

Perhaps the most fundamental need of our Nation and the one which if fulfilled would lead to solution of many of our problems is a steadfast return to moral values. A distinguished Senator once offered this advice to a young colleague. He said: "Son, when in doubt, do right!"

Certainly we are often in doubt, so why not just "do right" by the people of this great Nation.

That is really all I tried to suggest.

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